



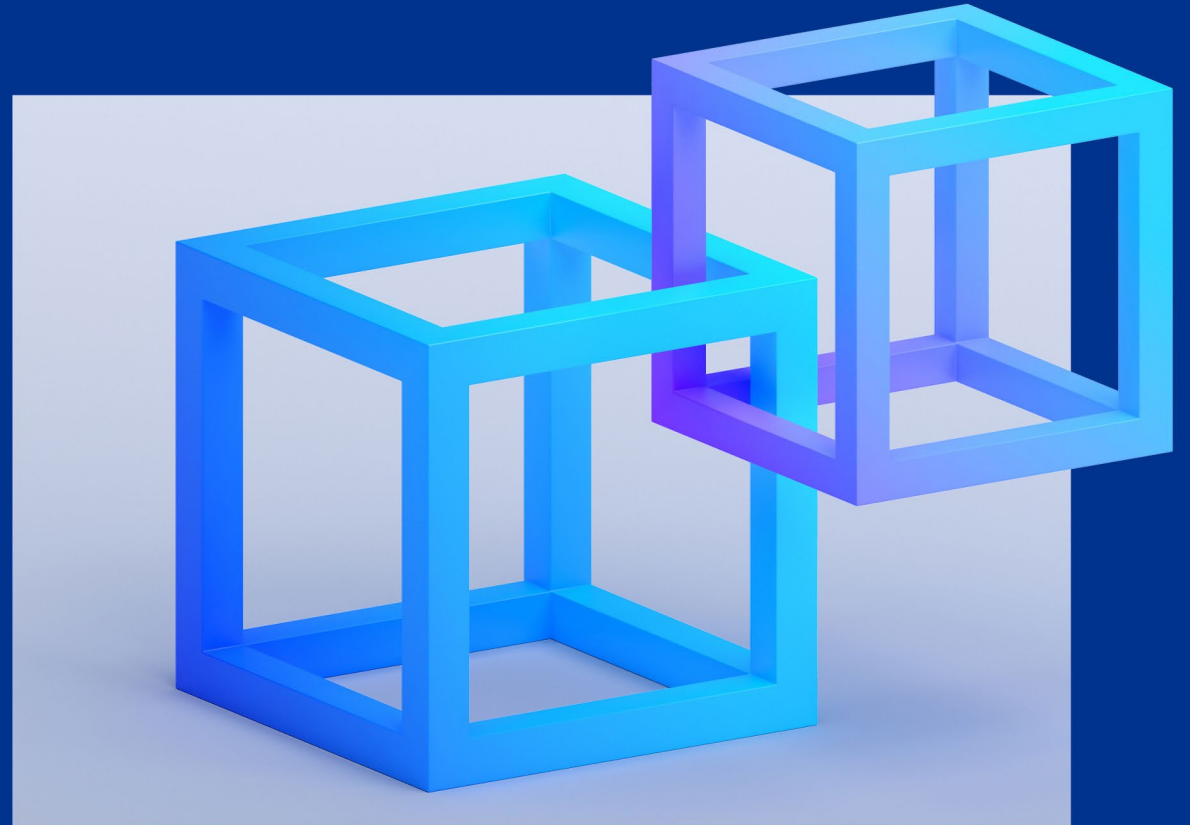
Scottish National Investment Bank plc

Report to the Audit Committee

Audit plan and strategy for the year ending 31 March 2024

Report date: 17 November 2023

Meeting date: 27 November 2023



Introduction

Purpose of this report

This report has been prepared in accordance with the responsibilities set out within the Audit Scotland's Code of Audit Practice ('the Code').

This report is for the benefit of Scottish National Investment Bank plc ('SNIB') and is made available to Audit Scotland, the Auditor General and the Scottish Government, as a body (together 'the Beneficiaries'). This report has not been designed to be of benefit to anyone except the Beneficiaries. In preparing this report we have not taken into account the interests, needs or circumstances of anyone apart from the Beneficiaries, although we are aware that others may read this report. We have prepared this report for the benefit of the Beneficiaries alone.

Nothing in this report constitutes an opinion on a valuation or legal advice.

We have not verified the reliability or accuracy of any information obtained in the course of our work, other than in the limited circumstances set out in the scoping and purpose section of this report.

Restrictions on distribution

This report is not suitable to be relied on by any party wishing to acquire rights against KPMG LLP (other than the Beneficiaries) for any purpose or in any context. Any party other than the Beneficiaries that obtains access to this report or a copy (under the Freedom of Information Act 2000, the Freedom of Information (Scotland) Act 2002, through a Beneficiary's Publication Scheme or otherwise) and chooses to rely on this report (or any part of it) does so at its own risk. To the fullest extent permitted by law, KPMG LLP does not assume any responsibility and will not accept any liability in respect of this report to any party other than the Beneficiaries.

Introduction (cont.)

To the Audit Committee of Scottish National Investment Bank plc

I am pleased to have the opportunity to meet with you on 27 November 2023 to discuss our audit of the consolidated financial statements of Scottish National Investment Bank plc (SNIB), as at and for the year ending 31 March 2024.

This report outlines our risk assessment and planned audit approach. Our risk assessment procedures remain alert to changes in the organisation and environment and we will communicate any significant changes to the planned audit approach subsequently. I provide this report to you in advance of the meeting to allow you sufficient time to consider the key matters and formulate your questions.

Scope definition

Audit Scotland has appointed KPMG LLP as auditor of SNIB in accordance with the Public Finance and Accountability (Scotland) Act 2000.

In addition to responsibilities under our appointment by Audit Scotland, SNIB has appointed us as auditor of its two subsidiaries – Scottish Investments Limited and Scottish Investments Services Limited.

We will also perform work in accordance with the wider responsibilities embodied in the Code of Audit Practice approved by the Commission and the Auditor General (see page 24)

The engagement team

I am the engagement partner on the audit and am responsible for the audit opinion. I have over 24 years of experience with KPMG in the financial services industry and this will be my fourth year signing the audit opinion.

Other key members of the engagement team include Gary Fensom (Director) and Stephen Fisher (Senior Manager) who both have over 16 years of relevant experience.

Yours sincerely



Philip Merchant

17 November 2023

How we deliver audit quality

Audit quality is at the core of everything we do at KPMG and we believe that it is not just about reaching the right opinion, but how we reach that opinion. We consider risks to the quality of our audit in our engagement risk assessment and planning discussions.

We define 'audit quality' as being the outcome when audits are:

- Executed consistently, in line with the requirements and intent of applicable professional standards within a strong system of quality controls and
- All of our related activities are undertaken in an environment of the utmost level of objectivity, independence, ethics and integrity.

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Overview of planned scope including materiality

Our materiality levels

We determined materiality for the consolidated financial statements (“Group Materiality”) at a level which could reasonably be expected to influence the economic decisions of users taken on the basis of the financial statements. We used a benchmark of total assets, which we consider to be appropriate given the sector in which the entity operates, its ownership and financing structure, and the focus of users.

We considered qualitative factors such as the maturity of SNIB’s processes when determining materiality for the financial statements as a whole.

To respond to aggregation risk from individually immaterial misstatements, we design our procedures to detect misstatements at a lower level of materiality (“performance materiality”) of £7,250k (2023: £6,430k) driven by our evaluation of the potential for misstatements in the period. Our evaluation considers the history of misstatements, the control environment and other relevant factors. We also adjust this level further downwards for items that may be of specific interest to users for qualitative reasons, such as Directors’ remuneration.

We will report misstatements to the audit committee including:

- Corrected and uncorrected audit misstatements above £427k for the Group and £192k for the Parent.
- Errors and omissions in disclosure (Corrected and uncorrected) and the effect that they, individually in aggregate, may have on our opinion.
- Other misstatements we include due to the nature of the item.

For Directors’ remuneration (audited information within the Directors’ Remuneration Report), we have assessed that a lower materiality is required to be applied as these figures are expected to be immaterial based on the overall materiality we have set for the Financial Statements as a whole, yet in our professional judgement these balances would be of interest to the shareholders of the Group. We have lowered the overall materiality for the Financial Statements as a whole to £1k (2023: £1k) for Directors’ remuneration based on our professional judgement.

Subsidiary materiality

Both subsidiaries are deemed significant components for group reporting and we will perform full scope audit to the materiality levels as disclosed below. The work will be performed by the same audit team.

£'000 (2023 in brackets)	Materiality as % of benchmark	Materiality	Performance materiality	Misstatements reported to the audit committee
Group	2.5% of total assets	£8,540 (£7,560)	£7,250 (£6,430)	£427 (£378)
Scottish National Investment Bank (Parent Company)	1.2% of Company total assets	£3,843 (£3,400)	£3,260 (£2,890)	£192 (£170)
Scottish Investments Limited (Component)	2.5% of Company total assets	£8,280 (£7,330)	£7,030 (£6,230)	£414 (£367)
Scottish Investment Services Limited (Component)	3% of Company total expenses	£425 (£382)	£361 (£324)	£21 (£19)

Overview of planned scope including materiality (cont.)

Control environment

The impact of the group control environment on our audit is reflected in our planned audit procedures. Our planned audit procedures reflect findings raised in the previous year and management's response to those findings. We will continue to assess the impact of the current economic conditions on processes and controls, which may result in subsequent changes in our audit approach.

We will execute a substantive audit approach as the most effective and efficient method of addressing the identified risks of material misstatement. We will test the design and implementation of controls over journal entries and investment valuation processes.

Timing of our audit and communications

- We will maintain communication led by the engagement partner, director and senior manager throughout the audit. We set out below the form, timing and general content of our planned communications:
- Audit committee meeting on 27 November 2023 where we present our initial audit plan;
- Status meetings with management throughout the duration of our audit work where we communicate progress on the audit plan, any misstatements, control deficiencies and significant issues; and
- Audit committee meeting at the completion stage of the audit where we communicate the findings of our work, any audit misstatements and significant control deficiencies.

We plan to perform our audit work as follows:

- Planning and risk assessment will be completed prior to year end;
- As in the prior year, we expect to start our audit work on unlisted investments to allow us to provide an interim update to the Audit Committee in May; and
- Other substantive procedures will be performed from April to June.

The year end timetable, including signing of financial statements has been discussed but is yet to be agreed with management.

Wider scope

The Code of Audit Practice has four areas used to define the wider audit scope. These are financial management, financial sustainability, vision, leadership and governance and use of resources to improve outcomes.

Our audit will take the above areas into account in its execution.

Revenue recognition – rebuttal of fraud risk

Professional standards require us to presume, unless rebutted, that the fraud risk from revenue recognition is a significant risk. We do not believe there is a fraud risk related to revenue recognition because the calculation of revenue is non-judgmental.

Impacts of climate risk and new ESG/climate change disclosures

We will evaluate management's assessment of the potential financial implications of climate risk on the financial statements, including estimates and disclosures.

As part of our procedures on other information, we will obtain and read your ESG/climate change disclosures. We will consider whether there is a material inconsistency between this information include in the annual report and the financial statements, or with our knowledge obtained in the audit; or whether this information appears to be materially misstated.



Overview of planned scope including materiality (cont.)

Our fees

We have included details of our latest fee proposal on page 29 and will be happy to discuss the fees at the meeting.

Using the work of others and areas requiring specialised skill

We outline below where, in our planned audit response to audit risks, we expect to use the work of others such as Internal Audit or require specialised skill/knowledge to perform planned audit procedures and evaluate results.

Others	Extent of planned involvement or use of work
KPMG Tax Manager – Tax specialist	Tax specialists will be engaged to support the audit of current tax computation for SIL.
KPMG IRADAR team – Valuation Specialist	Testing the valuation of a sample of unlisted debt investments by means of reperforming management's calculation/ independently reprojecting the calculations.
Credit Risk Assurance (CRA) – Credit rating specialist	Credit Risk Assurance (CRA) team will inspect a sample of unlisted debt investments to check that the credit ratings assigned by SNIB were awarded in line with the relevant methodologies.
D&A specialist	D&A team will be engaged to perform journal entries analysis, based on high-risk criteria.
Corporate finance	We will consider involving Corporate finance specialist to assist us in the valuation of level 3 investments based on the level of complexity.

Group audit scope

Both subsidiaries are deemed significant components for group reporting and we will perform full scope audit to the level of component materiality. The work will be performed by the same audit team.

The application of the significant risks and other areas of focus to each group entity is summarised in the table below.

	Scottish National Investment Bank plc (Parent)	Scottish Investments Limited (SIL)	Scottish Investments Services Limited (SISL)
Significant Risks			
1. Management override of controls	Y	Y	Y
2. Valuation of unlisted investments		Y	
Other Areas of Audit Focus			
3. Recoverability of debt due from group entities (parent company)	Y		
4. Going concern	Y	Y	Y
5. Expenses			Y
6. Cash	Y	Y	Y

Significant risks and other areas of audit focus

Our risk assessment draws upon our historic knowledge of the business, the industry and the wider economic environment in which SNIB operates.

We also use our regular meetings with senior management to update our understanding.

The risk map shows the identified significant risks and other areas of audit focus, subject to the completion of our risk assessment procedures.

Our long form audit report will include details of our findings in relation to significant financial statement audit risks and key audit matters.

Significant risks

Management override of control is a significant risk that professional standards require us to assess in all cases.

Valuation of unlisted investments is considered to be a significant risk due to a significant estimation uncertainty around the valuations and further complexity in relation to macroeconomic factors. For FY 2024, we consider this risk to be increased based upon continuing economic uncertainty and growth in size and age of the portfolio.

We also recognise a key audit matter for the parent financial statements in relation to the recoverability of debt due from group entities.

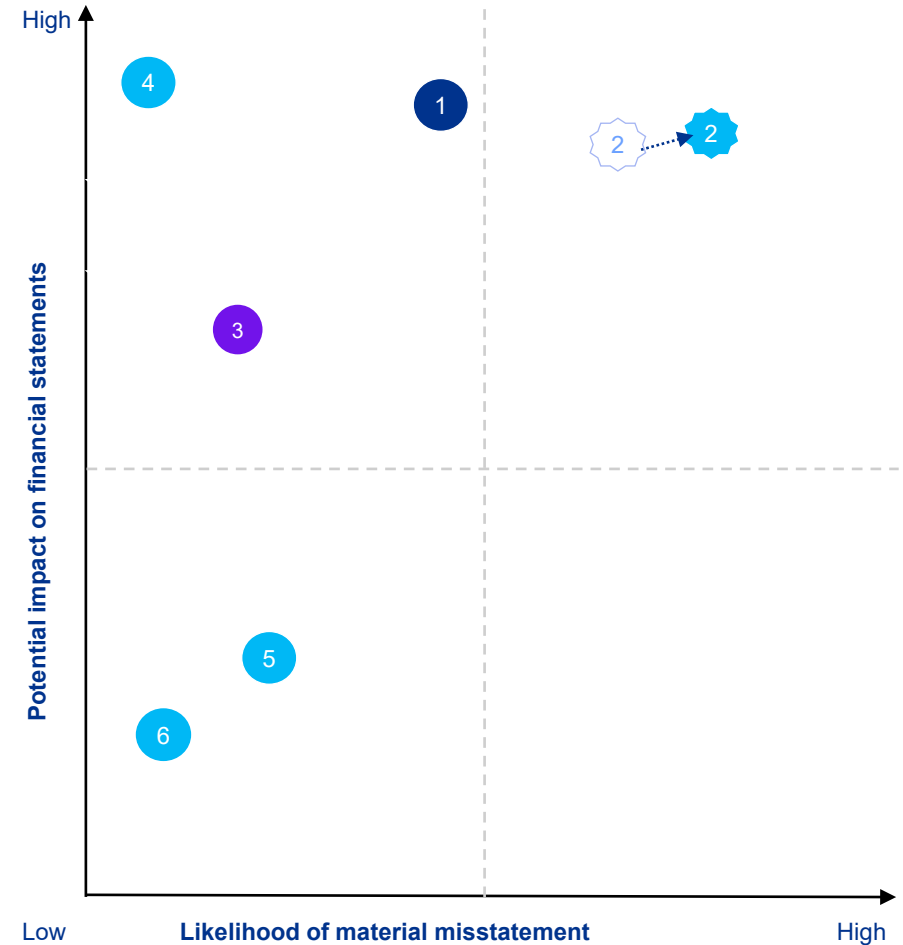
Significant risks

1. Management override of controls
2. Valuation of unlisted investments (Key audit matter)

Other Areas of Audit Focus

3. Recoverability of debt due from group entities (key audit matter for the parent)
4. Going concern
5. Administration expenses
6. Cash


- Key:**
- # Significant financial statement audit risks
 - # Other areas of audit focus
 - # Key audit matter
 - # Key audit matter and significant financial statement audit risk
 - ☁ Change compared to prior year



Significant risks

1 Management Override of Controls(a)

Fraud risk related to unpredictable way management override of controls may occur

Change vs prior year 



Significant audit risk

- Professional standards require us to communicate the fraud risk from management override of controls as significant.
- Management of any company is 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.
- Other than potential for management bias on investment estimates, we have not identified any specific additional risks of management override relating to this audit.



Planned response

- Our audit methodology incorporates the risk of management override as a default significant risk.
- In line with our methodology, we will test the design and implementation of controls over journal entries and post-closing adjustments, as well as the design and implementation of relevant controls within the unlisted valuation process.
- We will set high risk criteria for specific journals to test substantively. If any journals meet this criteria, we will audit each journal individually as part of our year end audit process.
- We will assess the appropriateness of changes to the methods and underlying assumptions used to prepare accounting estimates.
- We will assess the appropriateness of the accounting for significant transactions that are outside the Group's normal course of business, or are otherwise unusual as applicable.

Note: (a) Significant risk that professional standards require us to assess in all cases.

Significant risks (cont.)

2 Valuation of unlisted investments

Risk that the carrying value of unlisted investments is materially misstated

Change vs prior year



Significant audit risk and key audit matter

- The Group's portfolio of unlisted investments makes up 99% (2023: 96%) of the total assets (based on the draft trial balance as at 30 September 2023). Unlisted investments are measured at fair value, which is established in accordance with the International Private Equity and Venture Capital Valuation Guidelines by using measurements of value such as prices of recent orderly transactions, earnings multiples and net assets.
- The effect of these matters is that, as part of our risk assessment, we determined that the valuation of unlisted investments has a high degree of estimation uncertainty, with a potential range of reasonable outcomes greater than our materiality for the financial statements as a whole.



Planned response

- **Methodology choice:** In the context of observed industry best practice and the provisions of the International Private Equity and Venture Capital Valuation Guidelines, we will challenge the appropriateness of the valuation basis selected.
- **Our valuations experience:** We will challenge the directors on key judgements affecting investee company valuations, such as the choice of benchmark for earnings multiples, progress against milestone, credit risk assessments and use of appropriate discount rates. We will compare key underlying financial data inputs to external sources, investee company audited accounts and management information as applicable. We will challenge the assumptions around sustainability of revenue or earnings based on the forecasts of the investee companies and whether these are achievable and we will obtain understanding of milestones completed during the year. We will also challenge the key assumptions of credit ratings and credit spreads used to determine discount rates, used in the discounted cash flow valuations that determine fair values of loans. Our work will include consideration of events which occur subsequent to the period end up until the date our audit report.
- **Comparing valuations:** Where a recent transaction is used to value a holding, we will obtain an understanding of the circumstances surrounding the transaction and vouch the price to supporting documentation. We will also assess whether subsequent changes or events such as market or entity specific factors would imply a change in value.
- **Assessing transparency:** We will consider the appropriateness, in accordance with relevant accounting standards, of the disclosures in respect of unlisted investments and the effect of changing one or more inputs to reasonably possible alternative valuation assumptions.

We will perform risk assessment procedures to determine the level of audit testing required over each asset in the portfolio. This will incorporate the risk assessment prepared by management as well as consideration of the nature and size of each investment in the context of the overall portfolio.

Other areas of audit focus

3 Recoverability of debt due from group entities (key audit matter – parent company)

Risk related to recoverability of intra-group loan from the parent to subsidiary

Change vs prior year 



Key audit matter (parent)

- The carrying amount of the intra-group debtor balance represents 98% (2023: 99%) of the Company's total assets. The recoverability is not at a high risk of significant misstatement or subject to significant judgement. However, due to its materiality in the context of the financial statements, this is considered to be the area that will have the greatest effect on our overall parent company audit. Note: this risk is applicable to the parent only.



Planned response

- **Test of detail:** We will assess whether the debtor company has a positive net asset value and therefore coverage of the debt owed, as well as assessing whether the debtor company has historically been profit-making.
- **Assessing the subsidiary company audit:** We will assess the work performed on the subsidiary company audit, and considering the results of that work, on those net assets, including assessing the liquidity of the assets and therefore the ability of the subsidiary to fund the repayment of the receivable.

Other areas of audit focus (cont.)

4

Going Concern

Ability of the business to continue as a going concern

Change vs prior year 



Other areas of audit focus

- Management's assessment of the Group's ability to continue as a going concern involves consideration of all factors affecting the Group.
- There is a risk that management's assessment of the Group's ability to continue as a going concern does not appropriately consider the impact of all external factors, including plausible but severe downside scenarios on the income and carrying value of assets.
- The risk that disclosures in the financial statement and the annual report are not adequate with regard to the effect of key risks to the financial position, performance, business model and strategy.



Planned response

- Evaluate how management's risk assessment process identifies business risks relating to events and conditions that may cast significant doubt on the ability to continue as a going concern.
- Evaluate any models management uses in its assessment and evaluate how the information system captures events and conditions that may cast significant doubt on ability to continue as a going concern.
- Evaluate whether management's assessment has failed to identify events or conditions that may cast significant doubt on going concern and whether the method used by management is appropriate.
- Assess management's going concern assessment including the plausible but severe downside scenarios particularly whether those downside scenarios reflect plausible external impacts on the business.
- Evaluate whether sufficient and appropriate audit evidence has been obtained to conclude whether a material uncertainty exists and the appropriateness of management's use (or otherwise) of the going concern basis of accounting.
- Evaluate whether there is adequate support for the assumptions underlying management's assessment, whether they are realistic and achievable and consistent with the external and/or internal environment and other matters identified in the audit.
- Challenge management's plans for future actions, and verify the reliability and relevance of data used. Determine whether the outcome of these plans is likely to improve the situation and whether management's plans are feasible.
- We will inspect letters received by the Directors indicating the Scottish Government's intention to provide ongoing support and will assess the business reasons why the Scottish Government may or may not choose to provide this support. We will also inspect equivalent letters of support received by the Directors of the subsidiaries indicating SNIB plc's intention to provide ongoing support, and will assess the business reasons why SNIB may or may not choose to provide this support.

Other areas of audit focus (cont.)

5 Administrative Expenses

Expenses may be materially misstated

6 Cash

Cash balances may be materially misstated

Change vs prior year



Other areas of audit focus

- Expenses could be recorded in the incorrect year (cut-off), at the incorrect amount (accuracy) or not recorded at all (completeness).



Planned response

- We will trace a sample of administrative expenses back to the supporting documentation and to bank statements.
- We will inspect a sample of payments made post year end to identify expenses that may have been omitted in the year.
- We will recalculate the LTIP expense for the year following direct testing of relevant data elements supporting the calculation. We will agree the LTIP outcome to Remuneration Committee approval.



Other areas of audit focus

- Cash balances, as reported by management, may not be complete or accurate, or the company may not have the rights to ownership of the bank accounts



Planned response

- All year end cash balances recorded in the financial statements will be agreed to third party confirmations received independently. We will investigate any reconciling items above our reporting threshold.
- We will substantively test the period-end bank reconciliation.

Mandatory communications

Type	Statements
Management’s responsibilities (and, where appropriate, those charged with governance)	<p>Prepare financial statements in accordance with the applicable financial reporting framework that are free from material misstatement, whether due to fraud or error.</p> <p>Provide the auditor with access to all information relevant to the preparation of the financial statements, additional information requested and unrestricted access to persons within the entity.</p>
Auditor’s responsibilities	<p>The Audit Scotland letter of appointment and Code of Practice and our subsidiary engagement letters communicate our responsibilities to form and express an opinion on the financial statements that have been prepared by management with the oversight of those charged with governance. The audit of the financial statements does not relieve management or those charged with governance of their responsibilities.</p>
Auditor’s responsibilities – Fraud	<p>This report communicates how we plan to identify, assess and obtain sufficient appropriate evidence regarding the risks of material misstatement of the financial statements due to fraud and to implement appropriate responses to fraud or suspected fraud identified during the audit.</p>
Auditor’s responsibilities – Other information	<p>The Audit Scotland letter of appointment and Code of Practice and our subsidiary engagement letters communicate our responsibilities with respect to other information in documents containing audited financial statements. We will report to you on material inconsistencies and misstatements in other information.</p>
Independence	<p>Our independence confirmation letter on page 16 discloses matters relating to our independence and objectivity including any relationships that may bear on the firm’s independence and the integrity and objectivity of the audit engagement partner and audit staff.</p>

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Confirmation of independence

We confirm that, in our professional judgement, KPMG LLP is independent within the meaning of regulatory and professional requirements and that the objectivity of the Partner and audit staff is not impaired.

To the Audit Committee members

Assessment of our objectivity and independence as auditor of Scottish National Investment Bank Plc and its subsidiaries (“the Group”)

Professional ethical standards require us to provide to you at the planning stage of the audit a written disclosure of relationships (including the provision of non-audit services) that bear on KPMG LLP’s objectivity and independence, the threats to KPMG LLP’s independence that these create, any safeguards that have been put in place and why they address such threats, together with any other information necessary to enable KPMG LLP’s objectivity and independence to be assessed.

This letter is intended to comply with this requirement and facilitate a subsequent discussion with you on audit independence and addresses:

- General procedures to safeguard independence and objectivity;
- Independence and objectivity considerations relating to the provision of non-audit services; and
- Independence and objectivity considerations relating to other matters.

General procedures to safeguard independence and objectivity

KPMG LLP is committed to being and being seen to be independent. As part of our ethics and independence policies, all KPMG LLP partners and staff annually confirm their compliance with our ethics and independence policies and procedures including in particular that they have no prohibited shareholdings. Our ethics and independence policies and procedures are fully consistent with the requirements of the FRC Ethical Standard. As a result we have underlying safeguards in place to maintain independence through:

- Instilling professional values;
- Communications;
- Internal accountability;
- Risk management; and
- Independent reviews.

We are satisfied that our general procedures support our independence and objectivity.

Independence and objectivity considerations relating to the provision of non-audit services

We have not provided any non-audit services to the Group.

Application of the FRC Ethical Standard 2019

We communicated to you previously the effect of the application of the FRC Ethical Standard 2019. That standard became effective for the first period commencing on or after 15 March 2020, except for the restrictions on non-audit and additional services that became effective immediately at that date, subject to grandfathering provisions.

We confirm that as at the date of this document we are not providing any non-audit or additional services that required to be grandfathered.


Confirmation of audit independence

We confirm that as of the date of this letter, in our professional judgment, KPMG LLP is independent within the meaning of regulatory and professional requirements and the objectivity of the partner and audit staff is not impaired.

This report is intended solely for the information of the Audit Committee of the Group and should not be used for any other purposes.

We would be very happy to discuss the matters identified above (or any other matters relating to our objectivity and independence) should you wish to do so.

Yours faithfully



KPMG LLP

KPMG's Audit quality framework

Audit quality is at the core of everything we do at KPMG and we believe that it is not just about reaching the right opinion, but how we reach that opinion.

To ensure that every partner and employee concentrates on the fundamental skills and behaviours required to deliver an appropriate and independent opinion, we have developed our global Audit Quality Framework.

Responsibility for quality starts at the top through our governance structures as the UK Board is supported by the Audit Oversight Committee, and accountability is reinforced through the complete chain of command in all our teams.

■ Commitment to continuous improvement

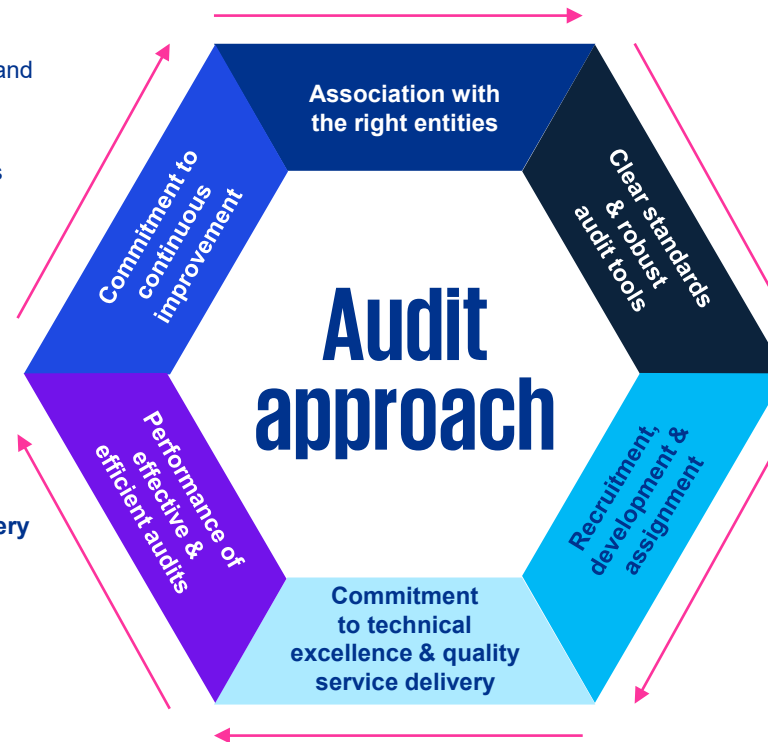
- Comprehensive effective monitoring processes
- Significant investment in technology to achieve consistency and enhance audits
- Obtain feedback from key stakeholders
- Evaluate and appropriately respond to feedback and findings

■ Performance of effective & efficient audits

- Professional judgement and scepticism
- Direction, supervision and review
- Ongoing mentoring and on the job coaching, including the second line of defence model
- Critical assessment of audit evidence
- Appropriately supported and documented conclusions
- Insightful, open and honest two way communications

■ Commitment to technical excellence & quality service delivery

- Technical training and support
- Accreditation and licensing
- Access to specialist networks
- Consultation processes
- Business understanding and industry knowledge
- Capacity to deliver valued insights



■ Association with the right entities

- Select entities within risk tolerance
- Manage audit responses to risk
- Robust client and engagement acceptance and continuance processes
- Client portfolio management

■ Clear standards & robust audit tools

- KPMG Audit and Risk Management Manuals
- Audit technology tools, templates and guidance
- KPMG Clara incorporating monitoring capabilities at engagement level
- Independence policies

■ Recruitment, development & assignment of appropriately qualified personnel

- Recruitment, promotion, retention
- Development of core competencies, skills and personal qualities
- Recognition and reward for quality work
- Capacity and resource management
- Assignment of team members and specialists

ISA (UK) 315 Revised: Overview

Summary

In the prior period, ISA (UK) 315 Revised “Identifying and assessing the risks of material misstatement” was introduced and incorporated significant changes from the previous version of the ISA.

These were introduced to achieve a more rigorous risk identification and assessment process and thereby promote more specificity in the response to the identified risks. The revised ISA was effective for periods commencing on or after **15 December 2021**.

The revised standard expanded on concepts in the existing standards but also introduced new risk assessment process requirements – the changes had a significant impact on our audit methodology and therefore audit approach.

What impact did the revision have on audited entities?

With the changes in the environment, including financial reporting frameworks becoming more complex, technology being used to a greater extent and entities (and their governance structures) becoming more complicated, standard setters recognised that audits need to have a more robust and comprehensive risk identification and assessment mechanism.

The changes result in additional audit awareness and therefore clear and impactful communication to those charged with governance in relation to (i) promoting consistency in effective risk identification and assessment, (ii) modernising the standard by increasing the focus on IT, (iii) enhancing the standard’s scalability through a principle based approach, and (iv) focusing auditor attention on exercising professional scepticism throughout risk assessment procedures.

Implementing year 1 findings into the subsequent audit plan

Entering the second year of the standard, the auditors will have demonstrated, and communicated their enhanced insight into their understanding of your wider control environment, notably within the area of IT.

In year 2 the audit team will apply their enhanced learning and insight into providing a targeted audit approach reflective of the specific scenarios of each entity’s audit.

A key area of focus for the auditor will be understanding how the entity responded to the observations communicated to those charged with governance in the prior period.

Where an entity has responded to those observations a re-evaluation of the control environment will establish if the responses by entity management have been proportionate and successful in their implementation.

Where no response to the observations has been applied by entity, or the auditor deems the remediation has not been effective, the audit team will understand the context and respond with proportionate application of professional scepticism in planning and performance of the subsequent audit procedures.

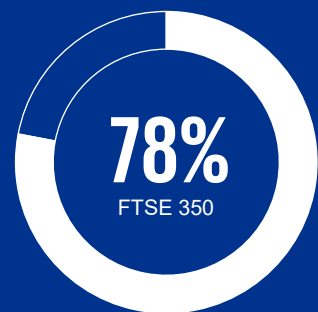
What will this mean for our on-going audits?

To meet the on-going requirements of the standard, auditors will each year continue to focus on risk assessment process, including the detailed consideration of the IT environment.

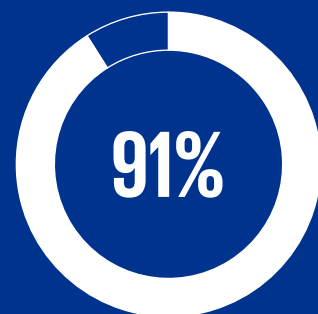
Subsequent year auditor observations on whether entity actions to address any control observations are proportionate and have been successfully implemented will represent an on-going audit deliverable.

Each year the impact of the on-going standard on your audit will be dependent on a combination of prior period observations, changes in the entity control environment and developments during the period. This on-going focus is likely to result in the continuation of enhanced risk assessment procedures and appropriate involvement of technical specialists (particularly IT Audit professionals) in our audits which will, in turn, influence auditor remuneration.

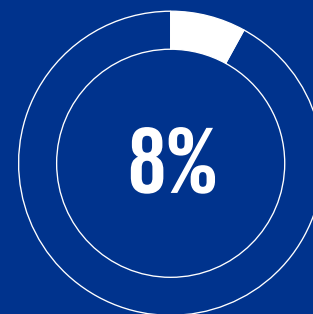
2023 AQR results



Percentage of our audits rated 'good' or 'limited improvements required' by AQR



KPMG audits rated 'good' or 'limited improvements required' by QAD



Proportion of AQR scope audit engagements reviewed by QAD

The FRC published reports on the findings of AQR and QAD 2022/23 inspection of KPMG and the other large firms (which largely covered years ending between 31 December 2020 and 30 June 2022) on 6 July 2023

Key findings	Our response	Good practice identified
<p>Impairment assessments</p> <p>“Improve the quality and consistency of audit procedures performed over impairment assessments for non-current assets and other valuations reliant on cash flow forecasts.”</p>	<p>We have implemented a new impairment triage process to focus central technical and valuation team support at the planning stage of the audit and challenge some of the behavioural biases seen in engagement teams with findings in this area. There is also greater emphasis on going further on some central technical consultations and revisiting the evidence for how Second Line of Defence (2LD) findings have been closed out on file.</p>	<p>At an engagement level areas of good practices were identified including:</p> <ul style="list-style-type: none"> • Risk assessment and planning including climate risk and fraud risk; • Challenge of management; • Audits of banks and similar entities; • Use of specialists; • Other – group audit oversight, revenue data analytic procedures in the audit of revenue and assessment of accounting policies and disclosures on a first year audit.
<p>Audits of banks</p> <p>“Continue to improve the quality and consistency of certain audit procedures for banks and similar entities.”</p>	<p>Our Banking Audit Quality Improvement Programme (BAQIP) continues to drive our focus on banking audits with measures including a focus on planning, resourcing, cultural-change and process improvements to provide both challenge and support to banking audit engagement teams.</p>	<p>Good practices were identified in various areas at the firm level including independence monitoring, staff feedback processes and client and engagement acceptance procedures.</p>
<p>Accounting judgements and disclosures</p> <p>“Exercise greater professional scepticism in the assessment of accounting judgements and disclosures in financial statements.”</p>	<p>We have introduced processes which extend technical specialists’ consultations through to seeing evidence on file which will support teams in evidencing well important decisions.</p> <p>We have also issued clearer guidance to address one specific finding relating to the interpretation of accounting periods.</p>	

The Audit Quality Review (AQR) team of the Financial Reporting Council (FRC) undertakes independent inspections of the overall quality of the audit work of those UK audit firms that audit listed and other major public interest entities. The AQR inspections involve a number of file reviews at each firm visited. The result of these file reviews are summarised into three main categories as follows:

- Good or limited improvements required;
- Improvements required;
- Significant improvements required



ISA (UK) 240 Revised: changes embedded in our practices

Ongoing impact of the revisions to ISA (UK) 240

ISA (UK) 240 (revised May 2021, effective for periods commencing on or after 15 December 2021) The auditor's responsibilities relating to fraud in an audit of financial statements included revisions introduced to clarify the auditor's obligations with respect to fraud and enhance the quality of audit work performed in this area. These changes are embedded into our practices and we will continue to maintain an increased focus on applying professional scepticism in our audit approach and to plan and perform the audit in a manner that is not biased towards obtaining evidence that may be corroborative, or towards excluding evidence that may be contradictory.

We will communicate, unless prohibited by law or regulation, with those charged with governance any matters related to fraud that are, in our judgment, relevant to their responsibilities. In doing so, we will consider the matters, if any, to communicate regarding management's process for identifying and responding to the risks of fraud in the entity and our assessment of the risks of material misstatement due to fraud.

Area	Our approach following the revisions
Risk assessment procedures and related activities	<p>[1] Increased focus on applying professional scepticism – the key areas affected are:</p> <ul style="list-style-type: none">• the need for auditors not to bias their approach towards obtaining evidence that is corroborative in nature or excluding contradictory evidence,• remaining alert for indications of inauthenticity in documents and records, and• investigating inconsistent or implausible responses to inquiries performed. <p>[2] Requirements to perform inquiries with individuals at the entity are expanded to include, amongst others, those who deal with allegations of fraud.</p> <p>[3] We have determined whether to involve technical specialists (including forensics) to aid in identifying and responding to risks of material misstatement due to fraud.</p>
Internal discussions and challenge	<p>We will have internal discussions among the audit team to identify and assess the risk of fraud in the audit, including determining the need for additional meetings to consider the findings from earlier stages of the audit and their impact on our assessment of the risk of fraud.</p>

Newly effective standards

Standards	Expected impact				Effective for years beginning on or after	
	High	Moderate	Low	None	1 Jan 2023	1 Jan 2024
IFRS 17 Insurance Contracts, including amendments Initial Application of IFRS 17 and IFRS 9 – Comparative Information				●	✓	
Definition of Accounting Estimates – Amendments to IAS 8 Accounting Policies, Changes in Accounting Estimates and Errors			●		✓	
Disclosure Initiative: Accounting Policies – Amendments to IAS 1 Presentation of Financial Statements and IFRS Practice Statement 2 Making Materiality Judgements			●		✓	
Deferred Tax Related to Assets and Liabilities Arising from a Single Transaction – Amendments to IAS 12 Income Taxes				●	✓	
Lease Liability in a Sale and Leaseback (Amendments to IFRS 16)				●		✓
Classification of liabilities as Current or Non-Current and Non-current Liabilities with Covenants (Amendments to IAS 1 Presentation of Financial Statements)			●			✓

Controls reporting by companies: this year and into the future

The corporate governance reforms proposed by Department for Business and Trade (DBT) have heightened the focus on reporting on the effectiveness of risk management and internal controls.

The board already has responsibilities to monitor the effectiveness of internal controls and report in relation to these in the annual report however as the demand for high quality, transparent and reliable reporting increases, so does the demand for efficient and reliable internal controls, this message is strengthened in the proposed amendments to the Corporate Governance Code.

What are the current requirements in respect of an entity's internal controls?

The current UK Corporate Governance Code 2018 ('the Code') already requires the board to:

- establish an effective risk management and internal control system;
- monitor and review the effectiveness of the risk management and internal controls system and;
- report on this process and assessment within the annual report including any incremental improvements that a Company is making;

The risk management and internal control system considered by the Board is broader than those risks and controls relating to financial reporting. It should cover operational, financial and compliance controls as well as the board response to its principal risks and mitigations, such as cyber, bribery and corruption compliance.

Why is it important?

Over half of FTSE 350 and Small Cap companies provide a statement of effective internal controls or that no weaknesses or inefficiencies identified* that does not mean that there are no non-performing controls. There is increasing focus on the articulation in the Annual Report as to how the Board has arrived at such an assessment.

Reporting on the steps taken by the board to review its risk management and internal control systems provides shareholders and other stakeholders with assurance that the company has taken active steps to assure the efficiency and resilience of these systems. By doing this, it also increases confidence in the company's capability to identify and manage risks effectively and allows investors to make informed decisions.

What is the future of internal controls reporting?

In May 2023, the Financial Reporting Council (FRC) released their consultation on the updated UK Corporate Governance Code. [It is focused on the Audit and Corporate Governance reforms that Government proposed within their response to the consultation 'Restoring Trust in Audit and Corporate Governance'.]

The updated Code "*strengthens*" the board's accountability and transparency for the effectiveness of the risk management and internal controls framework by reconfirming that the board has put in place and maintains effective systems that deliver the expected outcomes.

It **extends** the expectation that boards should monitor the company's risk management and internal control systems and, at least annually, carry out a review of their effectiveness and report on that review in the annual report, with an explicit provision that the annual report should include:

— a declaration of whether the board can **reasonably conclude** that the company's risk management and internal control systems have been effective throughout the reporting period and up to the date of the annual report;

— an explanation of the basis for such a declaration, including **how** the board has monitored and reviewed the effectiveness of the company's risk management and internal control systems; and

— a description of **any material weaknesses or failures identified** and the **remedial action** being taken, and over what timeframe.

This reiterates the key findings and expectations outlined within FRC [Review of Corporate Governance Reporting \(2022\)](#).

What is the auditor's responsibility in respect of the Board's assessment of internal controls?

The board's assessment of controls is much wider than internal controls relevant to the audit, therefore the auditor's consideration under ISA (UK) 315 (Revised July 2020) will be narrower in scope. The auditor is therefore not expected to assess whether all risks and controls have been addressed by the directors or that risks are satisfactorily addressed by internal controls.

However, given these disclosures are included within the narrative reporting, auditors are required by ISA (UK) 720 to perform such procedures as are necessary in the auditor's professional judgment to identify material inconsistencies or material misstatements within these disclosures and our knowledge obtained during the audit or the disclosures in the financial statements.

* Source: FRC [Review of Corporate Governance Reporting \(2022\)](#)

Establishing best practice for risk management and internal controls: Principle 0 of the UK Code requires the board to establish the company's risk management procedures

Board's responsibilities for risk management and internal control

The board has responsibility for an organisation's overall approach to risk management and internal control by

- ensuring the design and implementation of appropriate risk management and internal control systems that identify the risks facing the company and enable the board to make a robust assessment of the principal risks;
- determining the nature and extent of the principal risks faced and those risks which the organisation is willing to take in achieving its strategic objectives (determining its "risk appetite");
- ensuring that appropriate culture and reward systems have been embedded throughout the organisation;
- agreeing how the principal risks should be managed or mitigated to reduce the likelihood of their incidence or their impact;
- monitoring and reviewing the risk management and internal control systems, and management's process of monitoring and reviewing, and satisfying itself that they are functioning effectively and that corrective action is being taken where necessary; and
- ensuring sound internal and external information and communication processes and taking responsibility for external communication on risk management and internal control.

Establishment of the risk management and internal control systems

The risk management and internal control systems encompass the policies, culture, organisation, behaviours, processes, systems and other aspects of a company that, taken together:

- facilitate its effective and efficient operation by enabling it to assess current and emerging risks, respond appropriately to risks and significant control failures and to safeguard its assets;
- help to reduce the likelihood and impact of poor judgement in decision-making; risk-taking that exceeds the levels agreed by the board; human error; or control processes being deliberately circumvented;
- help ensure the quality of internal and external reporting; and
- help ensure compliance with applicable laws and regulations, and also with internal policies with respect to the conduct of business.

A company's systems of risk management and internal control will include: risk assessment; management or mitigation of risks, including the use of control processes; information and communication systems; and processes for monitoring and reviewing their continuing effectiveness.

Monitoring and review of those systems

The board should define the processes to be adopted for its on-going monitoring and review, including specifying the requirements, scope and frequency for reporting and assurance.

Regular reports to the board should provide a balanced assessment of the risks and the effectiveness of the systems of risk management and internal control in managing those risks.

The board should form its own view on effectiveness, based on the evidence it obtains, exercising the standard of care generally applicable to directors in the exercise of their duties.

Annual review should consider:

- the company's willingness to take on risk (its "**risk appetite**"), the desired culture within the company and whether this culture has been embedded;
- the **operation of the risk management and internal control systems**, covering the design, implementation, monitoring and review and identification of risks and determination of those which are principal to the company;
- the integration of risk management and internal controls with considerations of strategy and business model, and with business planning processes;
- the changes in the nature, likelihood and impact of principal risks, and the company's ability to respond to changes in its business and the external environment;
- the extent, frequency and quality of the communication of the results of management's monitoring to the board with an assessment of the effectiveness of controls.

Board's related financial and business reporting responsibilities

The process of monitoring and review is intended to allow the board to conclude whether the systems are properly aligned with strategic objectives; and satisfy itself that the systems address the company's risks and are being developed, applied and maintained appropriately.

Effective monitoring and reviewing the risk management and internal control systems by the board should be articulated within the annual report. The required disclosures are:

- reporting on the principal risks facing the company and how they are managed or mitigated (as required by the Companies Act 2006 (the "Companies Act") and the UK Corporate Governance Code 2018 ("UK Code"): Provision 28);
- reporting on whether the directors have a reasonable expectation that the company will be able to continue in operation and meet its liabilities as they fall due (as required by the UK Code: Provision 31);
- reporting on the going concern basis of accounting (as required by accounting standards and the UK Code: Provision 30); and
- reporting on the review of the risk management and internal control system (as required by the UK Code: Provision 29), and the main features of the company's risk management and internal control system in relation to the financial reporting process (as required under the UK Listing Authority's Disclosure and Transparency Rules: 7.2.5).

Audit Scotland Code of Audit Practice

The Code of Audit Practice sets the framework for public audit in Scotland. It outlines the responsibilities of external auditors appointed by the Auditor General for Scotland and the Accounts Commission and describes the scope of public audit in Scotland. This is set out on the following pages.

The Code of Audit Practice has four areas used to define the wider audit scope. These are financial management, financial sustainability, vision, leadership and governance and use of resources to improve outcomes.

Our audit will take the above areas into account in its execution.

Responsibilities of management

Financial Statements

Audited bodies must prepare an annual report and accounts containing financial statements and other related reports. They have responsibility for:

- preparing financial statements which give a true and fair view of their financial position and their expenditure and income, in accordance with the applicable financial reporting framework and relevant legislation;
- maintaining accounting records and working papers that have been prepared to an acceptable professional standard and that support their financial statements and related reports disclosures;
- ensuring the regularity of transactions, by putting in place systems of internal control to ensure that they are in accordance with the appropriate Council;
- maintaining proper accounting records; and
- preparing and publishing, along with their financial statements, an annual governance statement, management commentary (or equivalent) and a remuneration report that are consistent with the disclosures made in the financial statements. Management commentary should be fair, balanced and understandable and also clearly address the longer-term financial sustainability of the body.

Further, it is the responsibility of management of an audited body, with the oversight of those charged with governance, to communicate relevant information to users about the entity and its financial performance, including providing adequate disclosures in accordance with the applicable financial reporting framework. The relevant information should be communicated clearly and concisely.

Audited bodies are responsible for developing and implementing effective systems of internal control as well as financial, operational and compliance controls. These systems should support the achievement of their objectives and safeguard and secure value for money from the public funds at their disposal. They are also responsible for establishing effective and appropriate internal audit and risk-management functions.

Audited bodies are responsible for providing the auditor with access to all information relevant to the preparation of the financial statements, additional information requested and unrestricted access to persons within the entity.

Audit Scotland Code of Audit Practice (cont.)

Responsibilities of management
Prevention and detection of fraud and irregularities
Audited bodies are responsible for establishing arrangements for the prevention and detection of fraud, error and irregularities, bribery and corruption and also to ensure that their affairs are managed in accordance with proper standards of conduct by putting proper arrangements in place.
Corporate governance arrangements
Each body, through its chief executive or accountable officer, is responsible for establishing arrangements to ensure the proper conduct of its affairs including the legality of activities and transactions, and for monitoring the adequacy and effectiveness of these arrangements. Audited bodies should involve those charged with governance (including Audit Committees or equivalent) in monitoring these arrangements.
Financial position
Audited bodies are responsible for putting in place proper arrangements to ensure that their financial position is soundly based having regard to: <ul style="list-style-type: none">• such financial monitoring and reporting arrangements as may be specified;• compliance with any statutory financial requirements and achievement of financial targets;• balances and reserves, including strategies about levels and their future use;• how they plan to deal with uncertainty in the medium and longer term; and• the impact of planned future policies and foreseeable developments on their financial position.
Best Value, use of resources and performance
The Scottish Public Finance Manual sets out that accountable officers appointed by the Principal Accountable Officer for the Scottish Administration have a specific responsibility to ensure that arrangements have been made to secure best value.

Audit Scotland Code of Audit Practice (cont.)

Responsibilities of auditors

Appointed auditor responsibilities

Auditor responsibilities are derived from statute, this Code, ISAs, professional requirements and best practice and cover their responsibilities when auditing financial statements and when discharging their wider scope responsibilities. These are to:

- undertake statutory duties, and comply with professional engagement and ethical standards;
- provide an opinion on audited bodies' financial statements and, where appropriate, the regularity of transactions;
- review and report on, as appropriate, other information such as annual governance statements, management commentaries, remuneration reports, grant claims and whole of government returns;
- notify the Auditor General when circumstances indicate that a statutory report may be required;
- participate in arrangements to cooperate and coordinate with other scrutiny bodies (local government sector only);
- demonstrate compliance with the wider public audit scope by reviewing and providing judgements and conclusions on the audited bodies:
 - effectiveness of performance management arrangements in driving economy, efficiency and effectiveness in the use of public money and assets;
 - suitability and effectiveness of corporate governance arrangements; and
 - financial position and arrangements for securing financial sustainability.

Weaknesses or risks identified by auditors are only those which have come to their attention during their normal audit work in accordance with the Code, and may not be all that exist. Communication by auditors of matters arising from the audit of the financial statements or of risks or weaknesses does not absolve management from its responsibility to address the issues raised and to maintain an adequate system of control.

This report communicates how we plan to identify, assess and obtain sufficient appropriate evidence regarding the risks of material misstatement of the financial statements due to fraud and to implement appropriate responses to fraud or suspected fraud identified during the audit.

Audit Scotland Code of Audit Practice (cont.)

Responsibilities of auditors
General principles
This Code is designed such that adherence to it will result in an audit that exhibits these principles.
Independent
<p>When undertaking audit work all auditors should be, and should be seen to be, independent. This means auditors should be objective, impartial and comply fully with the FRC ethical standards and any relevant professional or statutory guidance. Auditors will report in public and make recommendations on what they find without being influenced by fear or favour.</p> <p>Our independence confirmation letter (page 16) discloses matters relating to our independence and objectivity including any relationships that may bear on the firm's independence and the integrity and objectivity of the audit engagement partner and audit staff.</p> <p>We confirm that, in our professional judgement, KPMG LLP is independent within the meaning of regulatory and professional requirements and that the objectivity of the Partner and audit staff is not impaired.</p>
Proportionate and risk based
Audit work should be proportionate and risk based. Auditors need to exercise professional scepticism and demonstrate that they understand the environment in which public policy and services operate. Work undertaken should be tailored to the circumstances of the audit and the audit risks identified. Audit findings and judgements made must be supported by appropriate levels of evidence and explanations. Auditors will draw on public bodies' self-assessment and self-evaluation evidence when assessing and identifying audit risk.
Quality focused
Auditors should ensure that audits are conducted in a manner that will demonstrate that the relevant ethical and professional standards are complied with and that there are appropriate quality-control arrangements in place as required by statute and professional standards.

Audit Scotland Code of Audit Practice (cont.)

Responsibilities of auditors
Coordinated and integrated
It is important that auditors coordinate their work with internal audit, Audit Scotland, other external auditors and relevant scrutiny bodies to recognise the increasing integration of service delivery and partnership working within the public sector. This would help secure value for money by removing unnecessary duplication and also provide a clear programme of scrutiny activity for audited bodies.
Public focussed
The work undertaken by external audit is carried out for the public, including their elected representatives, and in its interest. The use of public money means that public audit must be planned and undertaken from a wider perspective than in the private sector and include aspects of public stewardship and best value. It will also recognise that public bodies may operate and deliver services through partnerships, arm's-length external organisations (ALEOs) or other forms of joint working with other public, private or third sector bodies.
Transparent
Auditors, when planning and reporting their work, should be clear about what, why and how they audit. To support transparency the main audit outputs should be of relevance to the public and focus on the significant issues arising from the audit.
Adds value
It is important that auditors recognise the implications of their audit work, including their wider scope responsibilities, and that they clearly demonstrate that they add value or have an impact in the work that they do. This means that public audit should provide clear judgements and conclusions on how well the audited body has discharged its responsibilities and how well they have demonstrated the effectiveness of their arrangements. Auditors should make appropriate and proportionate recommendations for improvement where significant risks are identified.

Audit fees

Fee proposal for year ended 31 March 2024

We recognise the need for competitive fees and we wish to provide value. We believe in being very open in the way we deal with audited entities and our approach to fees is no different.

Audit quality is our number one priority, and we are committed to delivering consistently high-quality audits. We've made good progress supported by our record levels of investment but there is still more to do. We are committed to continuous improvement and investment.

We have estimated the audit fee based on our understanding of the portfolio at 31 March 2023. As noted below and in line with last year, the fee will be revised based on our risk assessment procedures and changes to the portfolio prior to year-end. Our audit is priced based on a detailed budget and by applying our minimum pricing metrics, taking into account inflationary pressures, demands on senior time and current audit market conditions.

Entity	2023	Inflation	Investment portfolio FY24 additional fees	Total
SNIB	80,500	8,855	-	89,355
SIL	107,038	11,774	0 – 36,000	118,812 – 154,812
SISL	28,342	3,118	-	31,459
Total	215,880	23,747	0 – 36,000	239,627 – 275,627

Scope changes from prior year

The following changes in scope are applicable to the year ended 31 March 2024:

- Inflation – inflationary pressures continue to increase the cost of overhead expenses. Our largest expense is our people and in a capacity constrained industry, we are significantly exposed to the increased cost of living. We have had to invest more in our people to retain talent and must continue to do so. We can offset this pressure through efficiency (by collectively working to reduce hours) whilst still ensuring audit quality. On this audit we are budgeting an approximately 20% reduction in hours on last year and have discussed ways to make the audit more efficient with management as part of our debrief.

- Accounting and Reporting changes – There are no significant change to the auditing and accounting standards.
- Investment portfolio – the audit fee for SIL is dependent on the size and complexity of the investment portfolio at year end. The estimate above has been calculated based on the investments in the portfolio at 31 March 2023 along with an approximation of an additional 15 new investments and will be revised once we receive the year end portfolio. We also highlight that we have not yet completed our risk assessment procedures over investment valuations and will revise our fee proposal accordingly. The fee charged per investment reflects the work required to audit unlisted investments and has been benchmarked to fee levels for similar audited entities.

Revision of fee estimate

As in the prior year, we will revise our fee estimate as we approach year end, taking into account:

- The size and composition of the portfolio at year end;
- The results of risk assessment procedures over the portfolio; and
- Discussion with management about how to make the audit as efficient as possible.

We will provide an update at future audit committee meetings.

CASS audit

- The fees above do not include any CASS audit that may be required for SIL depending on the timing of permissions approval by FCA.
- If we are engaged to deliver this work, the fee for it will be agreed separately.



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