



Scottish Water

Audit strategy

Year ending 31 March 2017

22 November 2016

For audit committee consideration on 6 December 2016

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About 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 Water and is made available to Audit Scotland and the Auditor General (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, even though we may have been aware that others might 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.

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.

Complaints

If at any time you would like to discuss with us how our services can be improved or if you have a complaint about them, you are invited to contact Hugh Harvie, who is the engagement leader for our services to Scottish Water, telephone 0131 527 6682 email: hugh.harvie@kpmg.co.uk who will try to resolve your complaint. If your problem is not resolved, you should contact Alex Sanderson, our Head of Audit in Scotland, either by writing to him at Saltire Court, 20 Castle Terrace, Edinburgh, EH1 2EG or by telephoning 0131 527 6720 or email to alex.sanderson@kpmg.co.uk. We will investigate any complaint promptly and do what we can to resolve the difficulties. After this, if you are still dissatisfied with how your complaint has been handled you can refer the matter to Russell Frith, Assistant Auditor General, Audit Scotland, 4th Floor, 102 West Port, Edinburgh, EH3 9DN.

SIGNIFICANT RISKS AND OTHER MATTERS

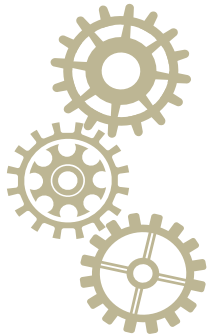


From discussions with management, from our knowledge of the organisation and review of risk registers, we have considered areas of risk and audit focus. We have identified significant risks as:

- fraud risk from management override of controls;
- fraud risk from income recognition (Business Stream);
- Expenditure and capital additions;
- Household bad debt provision; and
- Retirement benefit assumptions.

Other focus areas are receivables and credit note provisions.

WIDER SCOPE REQUIREMENTS



The audit will consider other areas:

- Audit Scotland's Code of Audit Practice ("the Code") and the audit dimensions set out in the 2016 code
- National Fraud Initiative
- Best Value

MATERIALITY

MATERIALITY
£9.1 million
1% EXPENDITURE

REPORTING THRESHOLD
£200,000
2% MATERIALITY

KPMG TEAM



The leadership team for the audit is detailed below

- Hugh Harvie – engagement partner
- Michael Wilkie – engagement senior manager
- Lynsey Patterson – engagement manager

We will harness the expertise of our taxation and pension specialists to support our audit work where necessary.

Scoping and purpose

Our detailed audit plan is set out on the following pages

Scope definition

Audit Scotland has appointed KPMG LLP as auditor of Scottish Water in accordance with the Public Finance and Accountability (Scotland) Act 2000. The period of appointment is 2016-17 to 2020-21, inclusive.

Purpose

This document summarises our responsibilities as external auditor for the year ending 31 March 2017 and our intended approach to issues impacting Scottish Water's activities in the year.

KPMG's planned audit work in 2016-17 will include:

- an audit of the financial statements and provision of an opinion on whether the financial statements:
 - give a true and fair view in accordance with the Water Industry (Scotland) Act 2002 and directions made thereunder by the Scottish Ministers of the affairs of Scottish Water as at 31 March 2017 and of the income and expenditure of the group for the year then ended; and
 - have been prepared in accordance with IFRS as adopted by the European Union, as interpreted and adapted by the 2016/17 FReM and in accordance with the requirements of the Water Industry (Scotland) Act 2002.
- a review and assessment of Scottish Water's governance arrangements, including a review of the adequacy of internal audit and review of the governance statement;
- a review of National Fraud Initiative arrangements; and

Auditors and audited bodies' responsibilities are set out in Audit Scotland's Code of Audit Practice ('the Code'). This Code states the responsibilities in relation to:

- the financial statements;
- corporate governance and systems of internal control;
- prevention and detection of fraud and irregularities;
- standards of conduct and arrangements for the prevention and detection of bribery and corruption;
- arrangements for preparing and publishing statutory performance information;
- financial position; and
- Best Value, uses of resources and performance.

These responsibilities are outlined in appendix six.

Risk assessment

In an environment of public sector reform and continued financial pressures, Public bodies are faced with real term funding decreases combined with increasing demand for services. The Code and Audit Scotland's Audit planning guidance 2016/17 outline a range of focus areas for 2017. These are:

- Focus on financial position;
- Consideration of the four audit dimensions set out in the Code. We will include in our annual audit report findings in respect of the effectiveness and appropriateness of the arrangements Scottish Water has in place regarding the four audit dimensions; and
- Regularity of financial transactions.

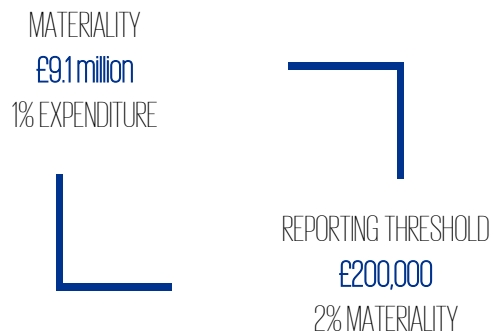
We have considered the appropriate level at which to report audit differences for discussion with the audit committee

We consider quantitative and qualitative factors in setting materiality and in designing our audit procedures.

Audit differences will be presented to the Audit Committee if they are material in size or material in nature. For 2016-17 we consider individual or aggregated financial statement errors of over £9.1 million to be material.

To the extent that we identify misstatements above £200,000 we report them to the Audit Committee and assess whether the misstatement is indicative of a significantly deficient or materially weak control environment.

We recognise that matters can be important because of their nature regardless of their size, for example misstatements to key disclosures such as remuneration and related parties, and we will also report these to Audit Committee.



DETERMINING MATERIALITY

We consider materiality by reference to Scottish Water's total expenditure, which was £912.6 million in 2015-16.

Audit Scotland guidance typically puts this percentage at not higher than 2% of the chosen gross metric (total expenditure).

We consider Scottish Water's total expenditure of 2015-16 along with the expectation for 2016-17 and consider the use of a materiality of £9.1 million, representing 1% of 2015-16 total expenditure to be appropriate.

Significant risks and other focus areas

We have performed our risk assessment based on our review of the predecessor firm audit files, our half year review work and discussions with management

International Standard on Auditing (UK and Ireland) 315: *Identifying and assessing risks of material misstatement through understanding the entity and its environment* requires the auditor to determine whether any of the risks identified as part of risk assessment are significant risks and therefore requiring specific audit consideration.

In determining whether a risk is significant, judgement is applied in respect of the whether, for example, the risk is associated with the complexity of transactions, the degree of subjectivity involved in the measurement of financial information, whether the associated transactions are outside the normal course of business or whether there is an associated risk of fraud. We have set out our assessment of significant risks, along with other audit focus areas below for all operating companies.

Risk	Scottish Water	SW Business Stream	SW Horizons	SW International	SW Solutions 2
Fraud risk from management override of controls	✓	✓	✓	✓	✓
Fraud risk from income recognition		✓			
Expenditure and capital additions	✓				
Bad debt provision	✓	✓			
Retirement benefit assumptions	✓	✓			
Profit recognition			✓		

RISK	WHY	AUDIT APPROACH
Fraud risk from management override of controls	Professional standards require us to communicate the fraud risk from management override of controls as a significant risk; as management is typically in a unique position to perpetrate fraud because of its ability to manipulate accounting records and prepare fraudulent financial statements by overriding controls that otherwise appear to be operating effectively.	<ul style="list-style-type: none"> ■ Our audit methodology incorporates the risk of management override as a default significant risk. We have not identified any specific additional risks of management override relating to the audit of Scottish Water. ■ Strong oversight of finances by management provides additional review of potential material errors caused by management override of controls. ■ In line with our methodology, we will carry out appropriate controls testing and substantive procedures, including over journal entries, accounting estimates and significant transactions that are outside the organisation's normal course of business, or are otherwise unusual.
Fraud risk from income revenue recognition	Professional standards require us to make a rebuttable presumption that the fraud risk from revenue recognition is a significant risk.	<ul style="list-style-type: none"> ■ Our audit methodology incorporates revenue recognition as a default significant risk within Scottish Water Business Stream. ■ In line with our methodology, we will carry out appropriate controls testing and substantive procedures over revenue recognition. Cut-off will be a key revenue recognition test during the course of our audit, along with a review of sales. We will additionally test the deferral of revenue recognised in respect of advanced billing to ensure this is appropriate. We will ensure we understand any unusual revenue contracts to assess the appropriateness of the revenue recognised. We will remain alert to indications of fraud during the course of the audit and respond accordingly. ■ We have considered the fraud risk from revenue recognition for Scottish Water and the other subsidiaries and do not consider there to be a significant risk. This is due to the following factors: <ul style="list-style-type: none"> ■ For Scottish Water, we are able to confirm 100% of household revenue for through external confirmations from each of the Councils. Wholesale revenue is settled monthly and reconciled annually using an income uncertainty provision to prevent over recognition of revenue. This process reduces the risk of fraudulent revenue recognition. ■ For SW Horizons, revenue is recognised based on agreed contract values. ■ For SW International, revenue relates to consultancy services with no complex recognition criteria identified. ■ For SW Solutions 2, management fee income is received for the delivery of the capital management programme for Scottish Water.

RISK	WHY	AUDIT APPROACH
Expenditure and capital additions	<p>Due to the pressure to deliver the capital investment programmes in line with budget there is a risk of misstatement of the classification of costs between operating and capital expenditure.</p>	<p>Our audit approach will include:</p> <ul style="list-style-type: none"> ■ Testing of key controls and process in place to ensure the appropriate recording of capital and expenses in the financial records and that authorisation by appropriate individuals has occurred; ■ Selecting a sample of capital item additions to agree to invoice to ensure appropriateness of classification of items between expenditure and capital expenditure; ■ Selecting a sample of expense items to agree to invoice to ensure appropriateness of items expense allocation/clarification; ■ Testing of reallocation of assets under the course of construction to fixed asset categories at the period end to ensure appropriate categorisation; and ■ Review of material manual journals posted to both the fixed asset and expense accounts.
Household bad debt provision	<p>The household bad debt provision is highly judgemental, involving estimation of future household collection rates based on historic trends.</p>	<p>Our audit approach includes:</p> <ul style="list-style-type: none"> ■ Comparison of total household billings to actual cash collected by councils for household billings during 2016/17 via confirmations issued directly to councils; ■ Comparison of actual cash collection rates to forecast cash collection rates for previous years; ■ Investigation of any large movements in cash collection rates; and ■ Performing sensitivity analysis to assess what impact a change in assumptions would have on the provision.
Bad debt provision (Business Stream)	<p>The adequacy of the bad debt provision within Scottish Water Business Stream is subjective involving estimates of collection from a large range of commercial suppliers.</p>	<ul style="list-style-type: none"> ■ Our procedures will include testing the design and operating effectiveness of a selection of the controls over the receivables collection processes, including the credit control processes over aged receivables. For a sample of customer balances, we will compare the amount of cash received after the year end to the year-end ledger balances. ■ We will test the adequacy of the provisions against trade receivables by critically assessing the assumptions made in determining the level of provision for each category of aged debt, with reference to the profile of aged debts at the balance sheet date compared with equivalent data observed subsequent to and at prior year ends along with an assessment of the level of post balance sheet cash receipts.

Significant risks

RISK	WHY	AUDIT APPROACH
<p>Retirement benefits</p>	<p>Scottish Water accounts for its participation in 3 pension funds in accordance with IAS 19 Retirement benefits, using information obtained in a valuation report prepared by actuarial consultants.</p> <p>These actuaries use membership data and a number of assumptions in their calculations based on market conditions at the year end, including a discount rate to derive the anticipated future liabilities back to the year end date and assumptions on future salary increases.</p> <p>IAS 19 requires the discount rate to be set by reference to yields on high quality (i.e. AA) corporate bonds of equivalent term to the liabilities. The calculation of the pension liability is inherently judgemental.</p>	<p>Our audit approach to IAS19 includes:</p> <ul style="list-style-type: none"> ■ review by KPMG specialists of the financial assumptions underlying actuarial calculations and comparison to our central benchmarks; ■ testing of scheme assets and rolled-forward liabilities; ■ testing of the level of contributions used by the actuary to those actually paid during the year; ■ testing of membership data used by the actuary to data from the Scottish Water; and ■ agreeing actuarial reports to financial statement disclosures.
<p>Profit recognition</p>	<p>Scottish Water Horizons recognises revenue based on the percentage completion method. As revenue is agreed on entering into the contract, there is a risk that the profit margin is not recognised consistently across the life of the project due to inaccurate budgeting with either too much or too little costs being released.</p>	<p>Our audit approach will include</p> <ul style="list-style-type: none"> ■ Testing of key controls around the project management process including allocation of costs to projects and challenge of project managers on budgeting and costs to complete; and ■ Detailed testing of specific contracts in the year which are significant by nature or value.

RISK	WHY	AUDIT APPROACH
Income uncertainty provision	Due to the timing of the reconciliation process for the wholesale revenue billing between Scottish Water and Licenced Providers (including Business Stream) a provision is held to mitigate the risk of over-recognition of income.	<ul style="list-style-type: none"> ■ Our procedures will include testing the design and operating effectiveness of the controls covering the estimate made in calculating the income uncertainty provision. We will also critically assess the assumptions made in determining the level of provision, with reference to historic data observed.
Credit note provisions	There is a risk that credit notes will have to be issued due to previous billing inaccuracies. This is applicable to both Scottish Water (adjustments to household billings issued by Councils in respect of prior years) and Scottish Water Business Stream (relating to business customers).	<ul style="list-style-type: none"> ■ Our procedures will include testing the design and operating effectiveness of the controls covering the estimate made in calculating the credit note provision. We will also critically assess the assumptions made in determining the level of provision, with reference to data observed subsequent to and at prior year ends.
Going concern	All entities are required to provide appropriate disclosure in the financial statements in regard to the going concern assumption.	<ul style="list-style-type: none"> ■ We will review management's cash flow forecasts which form the basis for the directors' assessment that it is appropriate to prepare the financial statements on a going concern basis. ■ We will also review disclosures in relation to going concern and ensure these are appropriate.

Presentation of financial statements

The 2016-17 financial statements will be prepared in accordance with International Financial Reporting Standards (“IFRS”) as interpreted by the Government Financial Reporting Manual (‘FReM’).

There have been no changes made to the 2016-17 FReM compared with the 2015-16 FReM.

There have been no EU adopted standards or amendments to standards applicable for 2016-17 which need to be included in the FReM at present.

Wider scope requirements

Audit Dimensions

The Code of Audit Practice sets out four audit dimensions which set out a common framework for all the audit work conducted for the Auditor General for Scotland:

- Financial sustainability;
- Financial management;
- Governance and transparency; and
- Value for money

It clarifies that we should make the most of the financial audit work that we carry out and that we express clear conclusions in our reports.

As part of the audit planning process, we prepare an annual audit plan that documents how we intend to meet our responsibilities and communicate them to the Scottish Water Audit Committee.

All annual audit reports should include a summary of each dimension that states any work done in the year by us and the assurances, risks and any good practice that we have identified. Our annual audit report will include:

- A summary of the audit work undertaken in the year in response to identified risks to obtain assurances over the relevant arrangements in place for the audit dimensions;
- A conclusion on the effectiveness and appropriateness of these arrangements;
- Any significant risks that were identified; and
- Recommendations for improvements to mitigate any identified risks.

Governance

Scottish Water is required to prepare and disclose a governance statement to detail the purpose of the framework of internal control, along with an analysis of its effectiveness. We are required to review the governance statement against disclosure requirements and consider its content against our knowledge and understanding of Scottish Water. We will report on findings in the annual audit.

Audit Intelligence

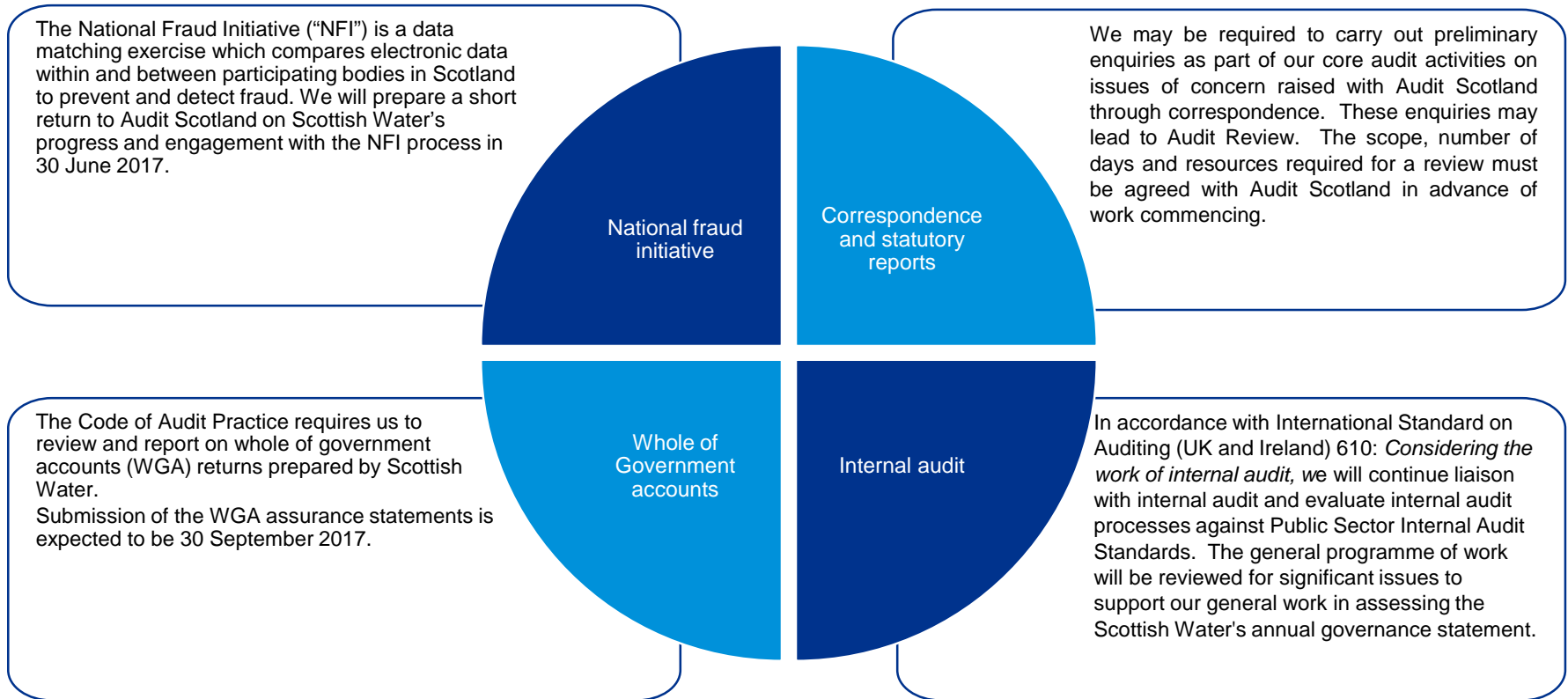
We may be required to carry out preliminary enquiries as part of our core audit activities on issues of concern raised with Audit Scotland through correspondence.

Timely reporting of issues allows Audit Scotland to have a good level of awareness across the public sector and to inform the Auditor General of relevant issues.

We will send current issues returns by the 3 February 2017 and 4 August 2017 considering the strategic audit priorities and using the risk categories below:

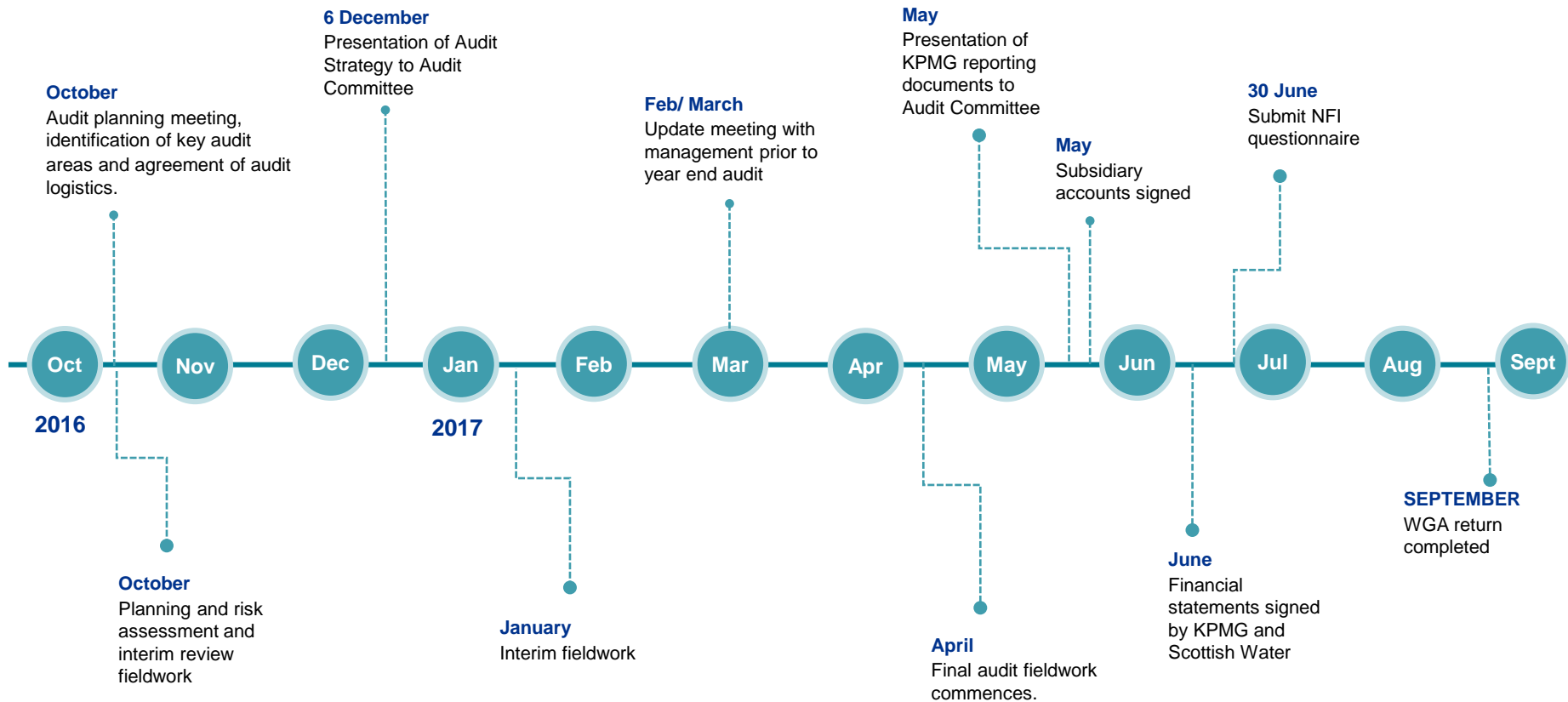
- Parliamentary interest;
- Ministerial interest;
- Financial sustainability;
- Financial management;
- Governance and transparency; and
- Value for money.

Wider scope requirements (continued)



Additional wider scope requirements

There are wider scope requirements that relate specifically to local government, local authorities or councils. We have not reported on these.



Timeline and reporting

Audit outputs

Output	Description	Report date
Audit strategy	<ul style="list-style-type: none"> Our strategy for the external audit of Scottish Water, including significant risk and audit focus areas. 	<ul style="list-style-type: none"> By 28 February 2017
Independent auditor's report	<ul style="list-style-type: none"> Our opinion on Scottish Water's financial statements. 	<ul style="list-style-type: none"> By 17 May 2017
Annual audit report	<ul style="list-style-type: none"> We summarise our findings from our work during the year. 	<ul style="list-style-type: none"> By 17 May 2017
NFI report	<ul style="list-style-type: none"> We report on the Scottish Water's actions to investigate and follow-up NFI matches. 	<ul style="list-style-type: none"> By 30 June 2017
Whole of Government Accounts	<ul style="list-style-type: none"> We report on the pack prepared for consolidation and preparation of the Whole of Government Accounts. 	<ul style="list-style-type: none"> By 30 September 2017
Audit reports on other returns	<ul style="list-style-type: none"> We will report on the following returns: <ul style="list-style-type: none"> Current issues return; Progress reports; 	<ul style="list-style-type: none"> To submit by: <ul style="list-style-type: none"> 5 February 2017 and 4 August 2017 6 January 2017, 5 April 2017, 5 July 2017 and 4 October 2017.



Appendices

Mandated communications with the Audit Committee

Matters to be communicated	Link to Audit Committee papers
Independence and our quality procedures ISA 260 (UK and Ireland).	<ul style="list-style-type: none"> ■ See next page
The general approach and overall scope of the audit, including levels of materiality, fraud and engagement letter ISA 260 (UK and Ireland).	<ul style="list-style-type: none"> ■ Main body of this paper
<ul style="list-style-type: none"> ■ Disagreement with management about matters that, individually or in aggregate, could be significant to the entity's financial statements or the auditor's report, and their resolution (AU 380). 	<ul style="list-style-type: none"> ■ In the event of such matters of significance we would expect to communicate with the Audit Committee throughout the year. ■ Formal reporting will be included in our audit highlights memorandum for the March 2017 Audit meeting, which focuses on the financial statements.
<ul style="list-style-type: none"> ■ Significant difficulties we encountered during the audit. ■ Significant matters discussed, or subject to correspondence, with management (ISA 260). 	
<ul style="list-style-type: none"> ■ Our views about the qualitative aspects of the entity's accounting and financial reporting. ■ The potential effect on the financial statements of any material risks and exposures, such as pending litigation, that are required to be disclosed in the financial statements (ISA 260 and ISA 540). 	
<ul style="list-style-type: none"> ■ Audit adjustments, whether or not recorded by the entity, that have, or could have, a material effect on its financial statements. We will request you to correct uncorrected misstatements (including disclosure misstatements) (ISA 450). 	
<ul style="list-style-type: none"> ■ The selection of, or changes in, significant accounting policies and practices that have, or could have, a material effect on the entity's financial statements (ISA 570). 	
<ul style="list-style-type: none"> ■ Material uncertainties related to events and conditions that may cast significant doubt on the entity's ability to continue as a going concern (ISA 570). 	
<ul style="list-style-type: none"> ■ Expected modifications to the auditor's report (ISA 705). 	
<ul style="list-style-type: none"> ■ Related party transactions that are not appropriately disclosed (ISA 550) 	

Auditor Independence

Assessment of our objectivity and independence as auditor of Scottish Water

Professional ethical standards require us to communicate to you, as part of planning, all significant facts and matters, including those related to the provision of non-audit services and the safeguards put in place, that, in our professional judgement, may reasonably be thought to bear on KPMG LLP's independence and the objectivity of Hugh Harvie and the audit team. 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.

We will communicate any significant judgements made about threats to objectivity and independence and the appropriateness of safeguards put in place.

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 APB Ethical Standards. As a result we have underlying safeguards in place to maintain independence through:

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

The conclusion of the audit engagement partner as to our compliance with APB Ethical Standards in relation to this audit engagement and that the safeguards we have applied are appropriate and adequate is subject to review by an engagement quality control reviewer, who is a partner not otherwise involved in your affairs.

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

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

Summary of fees

We have charged no non-audit fees to Scottish Water and its affiliates for professional services during the reporting period to date.

Independence and objectivity considerations relating to other matters

There are no other matters that, in our professional judgment, bear on our independence which need to be disclosed to the Audit Committee.

Auditor Independence (continued)

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 Scottish Water 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

Fees

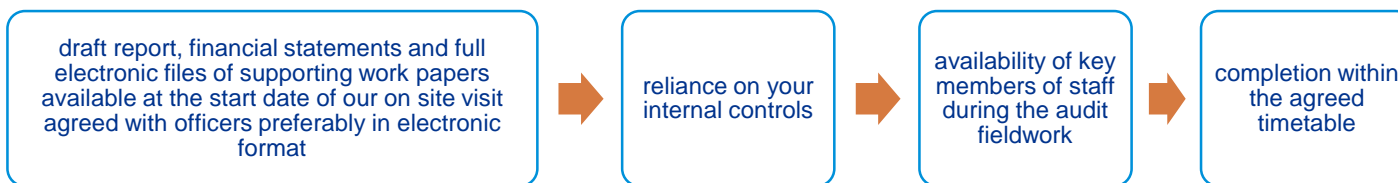
The fee range for 2016-17 for Scottish Water is still to be communicated by Audit Scotland

The proposed fees for the subsidiaries are set out in the table opposite.

Audit Scotland requires that the fee for our work is set within an indicative range, depending on the assessment of risk and other factors facing the Council. The indicative fee range is calculated using a number of inputs:

- A central estimate of the number of days needed to complete the audit;
- The average remuneration rate for the audit team;
- The contribution to travel and expenses within the sector;
- The contribution towards performance audits, where relevant; and
- The contribution towards other central costs not met by the Scottish Consolidated Fund.

The indicative fee ranges are based on the following assumptions to ensure an efficient audit process:



Audit Scotland has still to notify us of the fee range for 2016-17. Should we be required to undertake significant additional audit work in respect of any of the areas of audit focus or other matters arise, we will discuss with management the impact of this on our proposed fee.

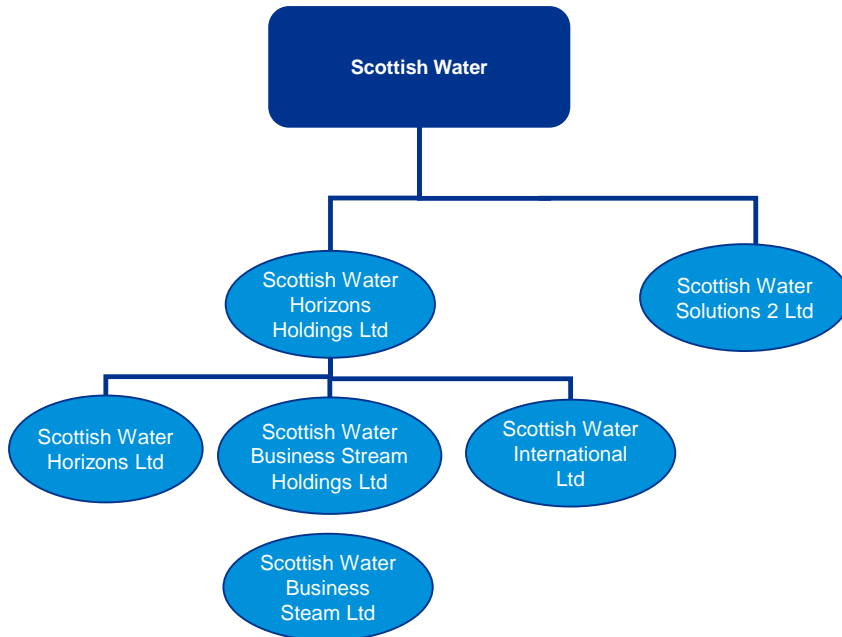
Subsidiary audits and interim review fees

	2017 £
Scottish Water Interim Review	TBC
Scottish Water Business Stream Limited	TBC
Scottish Water Horizons Limited	TBC
Scottish Water International Limited	TBC
Scottish Water Solutions 2 Limited	TBC

	2017 £
Scottish Water Horizons Holdings Limited	TBC
Scottish Water Business Stream Holdings Limited	TBC
Scottish Water regulatory accounts	TBC
Whole of Government accounts	TBC

Group financial statements

Group structure



Audit Scope

In addition to our audit appointment for Scottish Water under audit Scotland, we will perform the statutory audits of each of the subsidiaries in the Group.

The financial statements of the subsidiaries will be prepared in line with FRS 101 the reduced disclosure standard.

Approach to fraud

We are required to consider fraud and the impact that this has on our audit approach.

We will update our risk assessment throughout the audit process and adapt our approach accordingly.

In accordance with International Standards on Auditing (UK and Ireland) ISA 240 “The Auditor’s responsibility to consider fraud in an Audit of a Financial Report”, we will undertake specific procedures and report findings to management and the Audit Committee in respect of financial reporting fraud. The following diagram highlights our approach to fraud.

Management responsibilities	KPMG’s identification of fraud risk factors	KPMG’s response to identified fraud risk factors	KPMG’s identified fraud risk factors
<ul style="list-style-type: none"> – Adopt sound accounting policies. – With oversight from those charged with governance, establish and maintain internal control, including controls to prevent, deter and detect fraud. – Establish proper tone/culture/ethics. – Require periodic confirmation by employees of their responsibilities. – Take appropriate action in response to actual, suspected or alleged fraud. – Disclose to Audit Committee and auditors: <ul style="list-style-type: none"> – Any significant deficiencies in internal controls. – Any fraud involving those with a significant role in internal controls. 	<ul style="list-style-type: none"> – Review of accounting policies. – Results of analytical procedures. – Procedures to identify fraud risk factors. – Discussion amongst engagement personnel. – Enquiries of management, Audit Committee, and others. – Evaluate broad programmes and controls that prevent, deter, and detect fraud. 	<ul style="list-style-type: none"> – Accounting policy assessment. – Evaluate design of mitigating controls. – Test effectiveness of controls. – Address management override of controls. – Perform substantive audit procedures. – Evaluate all audit evidence. – Communicate to Audit Committee and management. 	<ul style="list-style-type: none"> – We will monitor the following areas throughout the year and adapt our audit approach accordingly: <ul style="list-style-type: none"> – Revenue recognition. – Management control override. – Manipulation of results to achieve targets and expectations of stakeholders. – Assessment of the impact of the any identified fraud. – We consider the risk of material fraud around the Group to be low.

Audit Scotland code of audit practice - responsibilities of auditors and management

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 authority;
- 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.

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.

Audit Scotland code of audit practice - responsibilities of auditors and management

Responsibilities of management

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:

- 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 – responsibilities of auditors and management

Responsibilities of auditors

Appointed auditor responsibilities

Auditor responsibilities are derived from statute, this Code, International Standards on Auditing (UK and Ireland), 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.

Audit Scotland code of audit practice – responsibilities of auditors and management

Responsibilities of auditors
<p>General principles</p>
<p>This Code is designed such that adherence to it will result in an audit that exhibits these principles.</p>
<p>Independent</p>
<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 Financial Reporting Council's (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>Proportionate and risk based</p>
<p>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.</p>
<p>Quality focused</p>
<p>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.</p>

Audit Scotland code of audit practice – responsibilities of auditors and management

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 focused

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.

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