



## **Zetland Transport Partnership**

Planning report to the Partnership  
on the 2017/18 audit

22 February 2018

**Deloitte Confidential: Public Sector**

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# Planning report



# Director introduction

## The key messages in this report:

Audit quality is our number one priority. We plan our audit to focus on audit quality and have set the following audit quality objectives for this audit:

- A robust challenge of the key judgements taken in the preparation of the financial statements.
- A strong understanding of your internal control environment.
- A well planned and delivered audit that raises findings early with those charged with governance.

We have pleasure in presenting our draft planning report to Zetland Transport Partnership ('ZetTrans', 'the Partnership') for the year ending 31 March 2018 audit. We would like to draw your attention to the key messages of this draft audit plan:

### **Audit Plan**

We have updated our understanding of the Partnership including discussion with management and review of relevant documentation as well as Audit Scotland performance reports published during the year.

Based on these procedures, we have developed this plan in collaboration with the Partnership to ensure that we provide an effective audit service that meets your expectations and focuses on the most significant areas of importance and risk to the Partnership.

### **Key Risks**

We have taken an initial view as to the significant audit risks the Partnership faces. These are presented as a summary dashboard on page 13.

- As with all public sector bodies, the Partnership continues to face significant financial challenges and without sufficient funding the delivery of priorities would be impeded.

- The Partnership approved the budget strategy for 2017/18 on the 21 of February 2017. In agreeing to this, it was determined that the Partnership's main objective is to ensure that it delivers within its approved budget for 17/18.
- ZetTrans is an organisation that is unable to retain reserves or meet unplanned expenditure – in the event that the level of fare income does not meet contractual expectations action would be required by ZetTrans to secure funding or address expenditure levels. The achievement of a breakeven position will be a key focus of our audit.
- In accordance with auditing standards, we have identified a significant risk associated with income. This risk is pinpointed to the completeness and accuracy of the fare based income received from Shetland Islands Council.
- In accordance with auditing standards, management override of controls has also been identified as a potential significant audit risk.

# Director introduction (continued)

## The key messages in this report (continued):

### **Audit Dimensions**

The 2016 Code of Audit Practice sets our four audit dimensions which set a common framework for all public sector audits in Scotland. These are financial sustainability, financial management, governance and transparency and value for money. Due to the relative size and scale of the functions delivered by the Partnership, we have concluded that the full wider scope of audit is not appropriate. In accordance with paragraph 53 of the Code, our work in this area will therefore be restricted to concluding on:

- The appropriateness of the disclosures in the governance statement; and
- The financial sustainability of the Partnership and the services that it delivers over the medium to longer term.

The potential audit risks associated with the wider scope, below, are detailed further on page 16.

- The governance statement is not consistent with the wider disclosure of the accounts or compliant with the CIPFA guidance note.
- A lack of forward financial planning, leading to Partnership's projects being delayed or cancelled.
- Insufficient review of savings plans could impact on achievement of its corporate priorities.

### **Other wider scope work**

In accordance with Audit Scotland guidance, we will be requested to provide information to support national performance audits on Digital.

### **Regulatory Change**

There are limited changes this year affecting the audit, through the Code of practice on local authority accounting or statutory guidance.

We would highlight that new accounting standards on financial instruments will apply from 2018/19 and it is important that the Partnership considers the impact ahead of implementation. See page 23 for more details.

### **Our Commitment to Quality**

We are committed to providing the highest quality audit, with input from our market leading specialists, sophisticated data analytics and our wealth of experience.

### **Adding value**

Our aim is to add value to the Partnership through our external audit work by being constructive and forward looking, by identifying areas of improvement and by recommending and encouraging good practice. In this way, we aim to help the Partnership promote improved standards of governance, better management and decision making and more effective use of resources.

**Pat Kenny**  
Audit Director

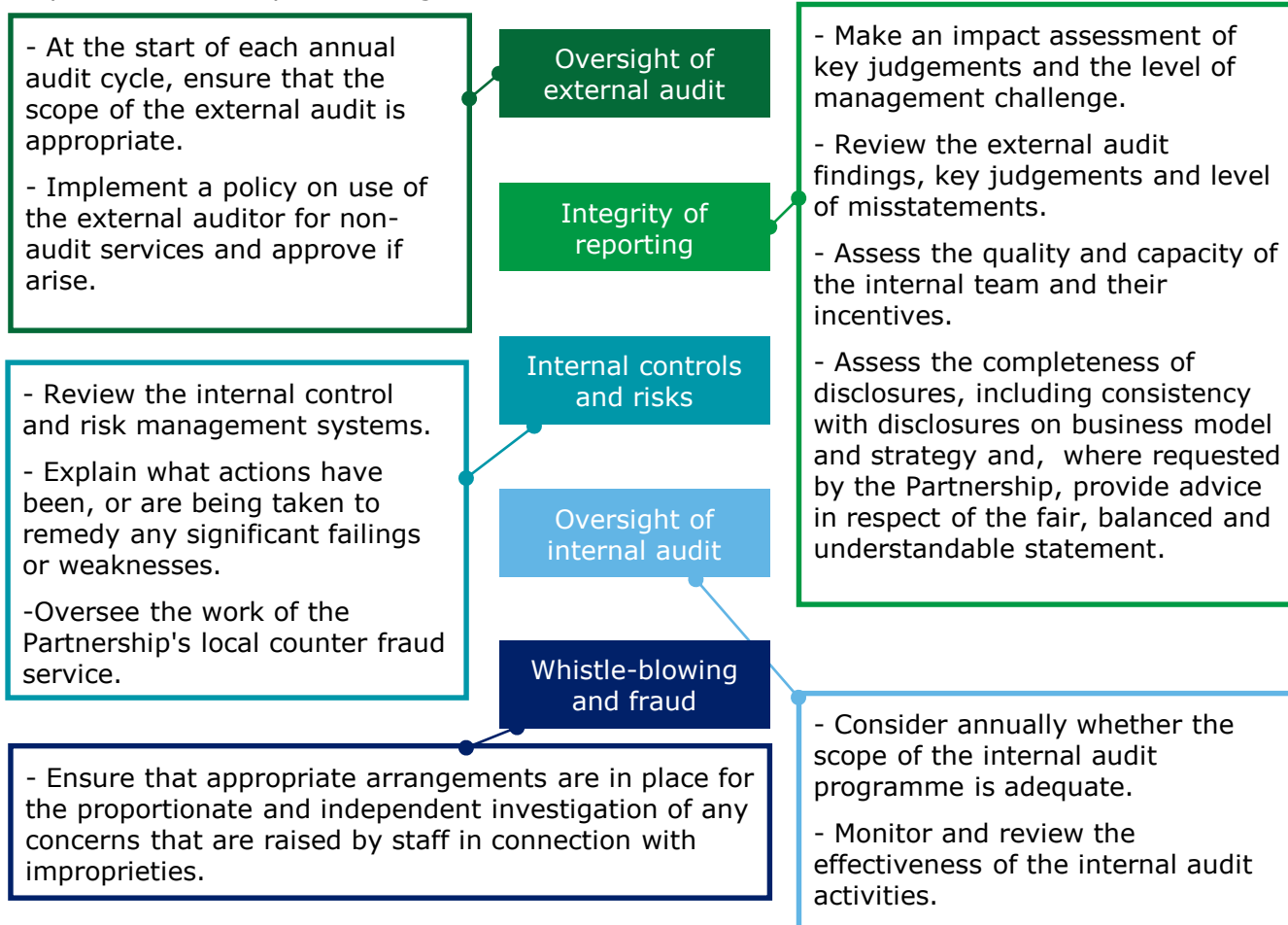
# Responsibilities of the Partnership

## Helping you fulfil your responsibilities

The primary purpose of the Auditor's interaction with the Partnership:

- Clearly communicate the planned scope of the financial statements audit
- Provide timely observations arising from the audit that are significant and relevant to the Partnership's responsibility to oversee the financial reporting process
- In addition, we seek to provide the Partnership with additional information to help fulfil your broader responsibilities

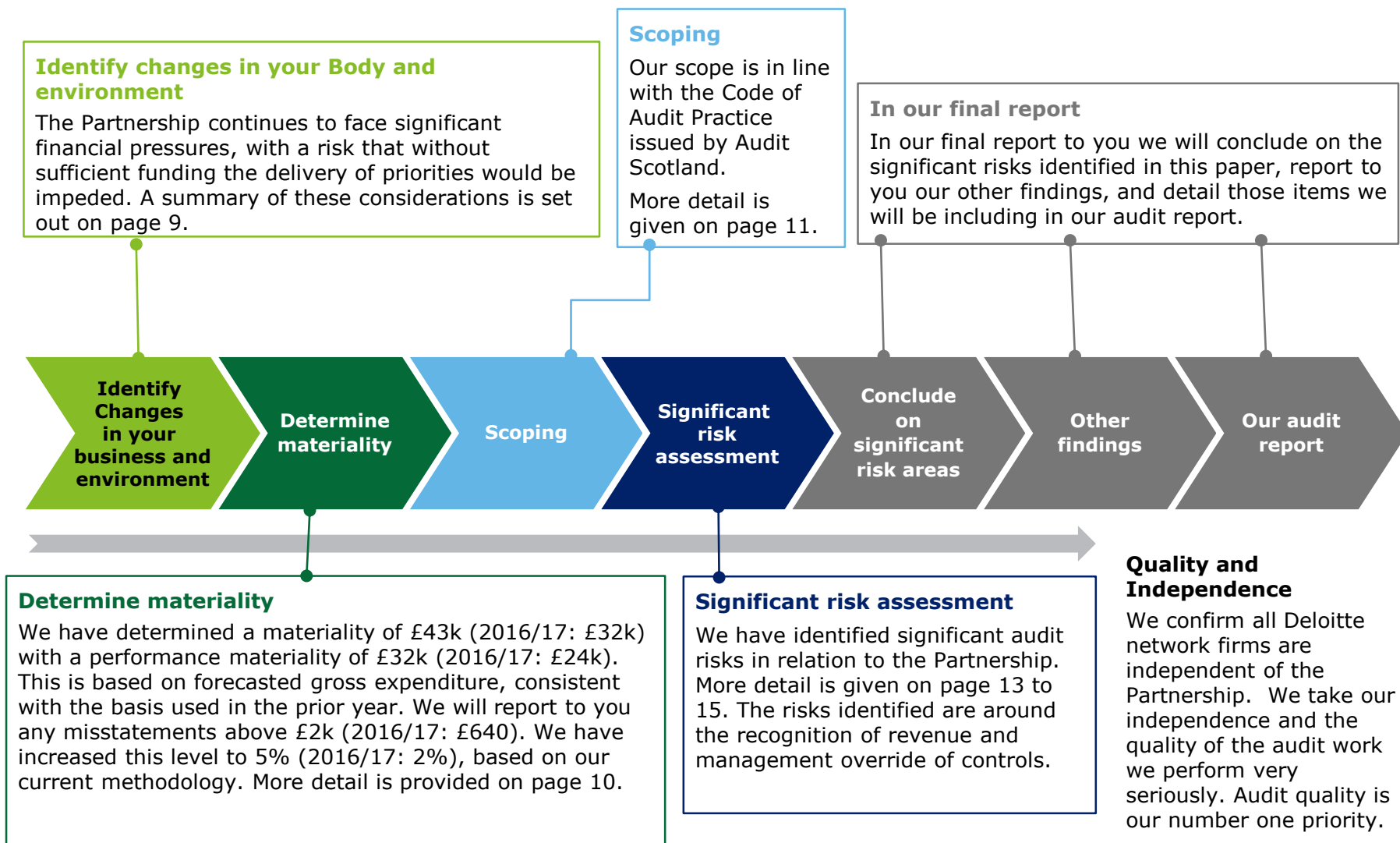
As a result of regulatory change in recent years, the role of the Audit Committee, which is part of the role of the Partnership, has significantly expanded. We set out here a summary of the core areas of Partnership responsibility to provide a reference in respect of these broader responsibilities and highlight throughout the document where there is key information which helps the Partnership in fulfilling its remit.



Target icons throughout the document highlights key information which should be a focus of interest for the Partnership.

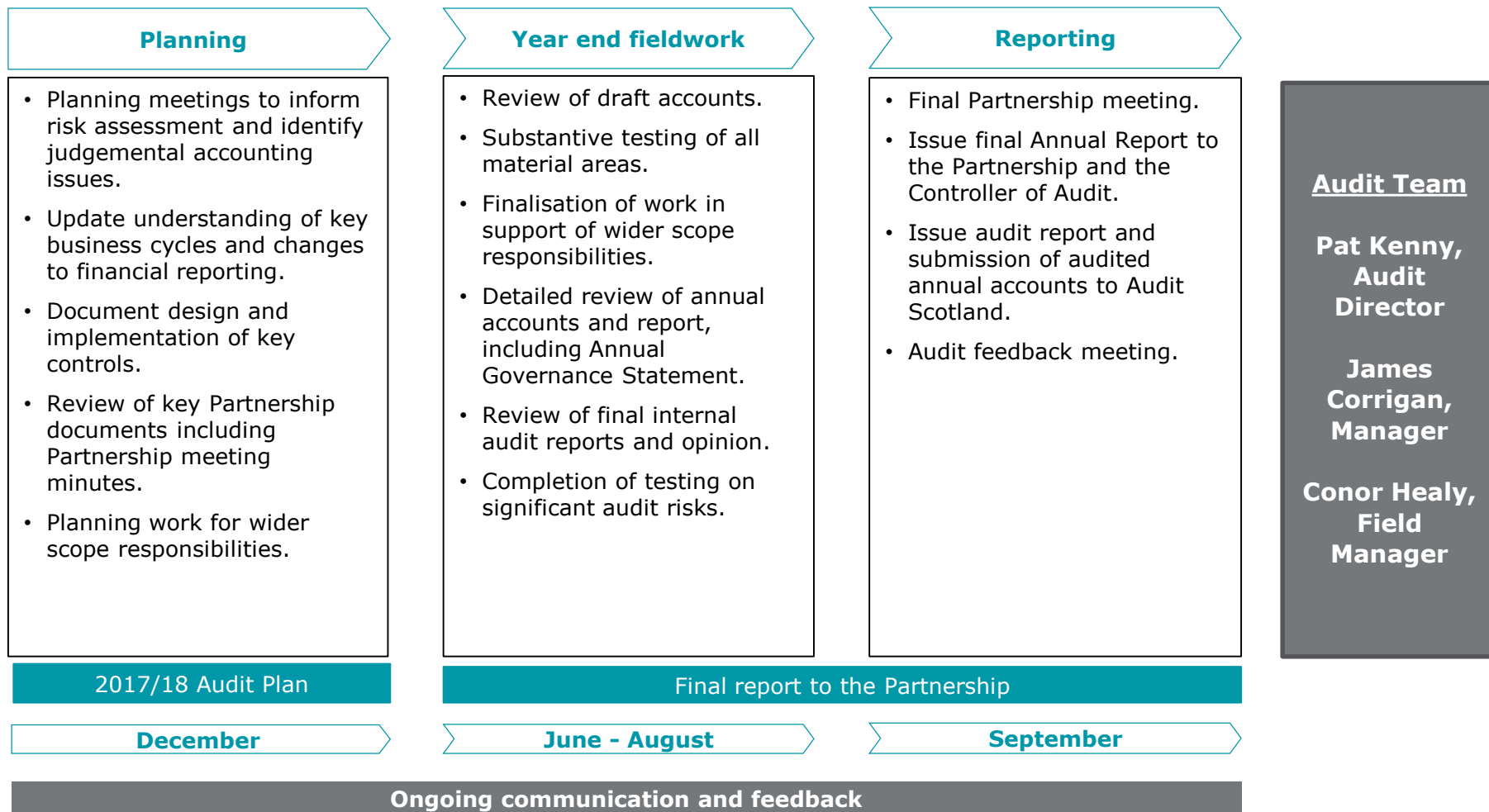
# Our audit explained

## We tailor our audit to your Partnership and your strategy



# Continuous communication and reporting

## Planned timing of the audit





# An audit tailored to you

## Focusing on your business and strategy

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### Description

### Impact on our audit

Future financial sustainability



As with all public sector bodies, the Partnership continues to face significant financial challenges. Deloitte have noted that as at 30 September 2017, the Partnership is forecasting an underspend of £95k and is thus expecting to fall within budget and deliver its responsibilities, although this will be offset by the consequently lower Council funding. The position will be considered again at the year-end.

ZetTrans must continue to look at how it can reduce costs to meet the challenge of making savings per year or secure additional longer term funding. We will consider the Partnership's financial sustainability in the medium to longer term and consider whether it is planning effectively to continue to deliver its services on a sustainable basis. In our prior year report, we recommended that the Partnership looks to the medium to longer term to identify any funding gaps and efficiency savings required and we will review any progress in this regard.

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New significant risk



Continuing significant risk



Considered as part of wider scope audit requirements

# Materiality

## Our approach to materiality

### Basis of our materiality benchmark

- The Audit Director has determined materiality as £43k (2016/17: £32k) and a performance materiality of £32k (2016/17: £24k), based on professional judgement and risk factors specific to the Partnership, the requirement of auditing standards and the financial measures most relevant to users of the annual accounts.
- We have used 1.6% of forecasted gross expenditure as the benchmark for determining materiality.
- This approach is consistent with our prior year materiality calculation.

### Reporting to those charged with governance

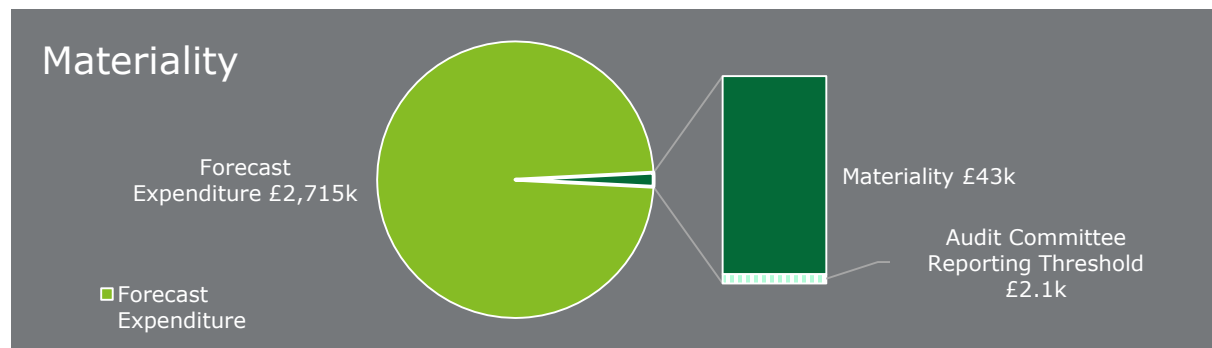
- We will report to you all misstatements found in excess of £2k (2016/17: £640).
- We have increased this level to 5% (2016/17: 2%) of materiality based on our current methodology.
- We will report to you misstatements below this threshold if we consider them to be material by nature.

- Our approach to determining the materiality benchmark is consistent with Audit Scotland guidance which states that the threshold for clearly trivial above which we should accumulate misstatements for reporting and correction to audit committees must not exceed £250k.

### Our annual audit report

We will:

- Report the materiality benchmark applied in the audit of the Partnership;
- Provide comparative data and explain any changes in materiality, compared to prior year, if appropriate; and
- Explain any normalised or adjusted benchmarks we use, if appropriate.



Although materiality is the judgement of the audit director, the Partnership must satisfy themselves that the level of materiality chosen is appropriate for the scope of the audit.



# Scope of work and approach

## Our key areas of responsibility under the Code of Audit Practice

### Core audit

Our core audit work as defined by Audit Scotland comprises:

- Providing the **Independent Auditor's Report** on the annual accounts (and any assurance statement on consolidation packs);
- Providing the **annual report** on the audit addressed to the Partnership and the Controller of Audit ;
- Communicating **audit plans** to those charged with governance;
- Providing **reports to management**, as appropriate, in respect of the auditor's corporate governance responsibilities in the Code;
- Preparing and submitting **fraud returns**, including nil returns, to Audit Scotland where appropriate;
- Identifying significant matters arising from the audit, alert the Controller of Audit and support Audit Scotland in producing statutory reports as required; and
- Undertaking work requested by Audit Scotland or local performance audit work.

### Wider scope requirements

The Code of Audit Practice sets out four audit dimensions which set a common framework for all public sector audits in Scotland:

- **Financial sustainability** – Looking forward to the medium and longer term to consider whether the body is planning effectively to continue to deliver its services or the way in which they should be delivered.
- **Financial management** – Financial capacity, sound budgetary processes and whether the control environment and internal controls are operating effectively.
- **Governance and transparency** – The effectiveness of scrutiny and governance arrangements, leadership and decision making, and transparent reporting of financial and performance information.
- **Value for money** - Using resources effectively and continually improving services.

Due to the relative size and scale of the functions delivered by the Partnership, we have concluded that the full wider scope of audit is not appropriate. In accordance with paragraph 53 of the Code, our work in this area will therefore be restricted to concluding on:

- The appropriateness of the disclosures in the governance statement; and
- The financial sustainability of the Partnership and the services that it delivers over the medium to longer term.

# Scope of work and approach (continued)

## Our approach

### Liaison with internal audit

The Auditing Standards Board's version of ISA (UK) 610 "Using the work of internal auditors" prohibits use of internal audit to provide "direct assistance" to the audit. Our approach to the use of the work of Internal Audit has been designed to be compatible with these requirements.

The Partnership uses the corporate financial systems of Shetland Island Council as well as the Council's internal audit function. We will review their reports and meet with them to discuss their work. We will discuss the work plan for internal audit, and where they have identified specific material deficiencies in the control environment we consider adjusting our testing so that the audit risk is covered by our work.

Using these discussions to inform our risk assessment, we can work together with internal audit to develop an approach that avoids inefficiencies and overlaps, therefore avoiding any unnecessary duplication of audit requirements on the Partnership and Council's staff.

### Approach to controls testing

Our risk assessment procedures will include obtaining an understanding of controls considered to be 'relevant to the audit'. This involves evaluating the design of the controls and determining whether they have been implemented ("D&I").

The results of our work in obtaining an understanding of controls and any subsequent testing of the operational effectiveness of controls will be collated and the impact on the extent of substantive audit testing required will be considered.

### Promoting high quality reporting to stakeholders

We view the audit role as going beyond reactively checking compliance with requirements: we seek to provide advice on evolving good practice to promote high quality reporting.

We will utilise the Code of Practice on Local Authority Accounting in the UK Disclosure Checklist to support the Partnership in preparing high quality drafts of the Annual Report and annual accounts, which we would recommend the Partnership complete during drafting.

The Disclosure Checklist reflects the cutting clutter agenda and includes a "not material" column. We would encourage the Partnership to exclude disclosure if the information is not material.

Obtain an understanding of the Partnership and its environment including the identification of relevant controls.

Identify risks and controls that address those risks.

Carry out "design and implementation" work on relevant controls.

If considered necessary, test the operating effectiveness of selected controls

Design and perform a combination of substantive analytical procedures and tests of details that are most responsive to the assessed risks.

# Significant risks Dashboard



Risk	Material	Fraud risk	Planned approach to controls testing	Level of management judgement	Page no.
Completeness and accuracy of income			Design and implementation		14
Management override of controls			Design and implementation		15

Some degree of management judgement

Limited management judgement

# Significant risks (continued)

## Risk 1 – Completeness and accuracy of income

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**Risk identified**

ISA 240 states that when identifying and assessing the risks of material misstatement due to fraud, the auditor shall, based on a presumption that there are risks of fraud in income recognition, evaluate which types of income, income transactions or assertions give rise to such risks.

The main component of income for the Partnership is income received from Shetland Islands Council, which is a deficit funding arrangement based on fare income. The significant risk is pinpointed to the recognition of this income, being completeness and accuracy of income received from the Council given the reliance of the Partnership on this income and the high volume of transactions involved.

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**Our response**

We will perform the following:

- Test the income to ensure that the correct amounts have been input and received in accordance with that agreed as part of budget process;
- Test the reconciliations performed by the Partnership at 31 March 2018 to confirm all income is correctly recorded in the ledger;
- Compare income recorded with expectations, based on amounts agreed as part of budget process;
- Confirm that the reconciliations performed during 2017/18 have been reviewed on a regular basis; and
- Assess management’s controls around recognition of income received from the Council.

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**Deloitte Comment**

No issues were identified with regards to income in the prior year audit. In the current year, we have completed our design & implementation over controls around income and have not identified any issues. We identified no issues which would affect the recognition of income during our planning work.

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# Significant risks (continued)

## Risk 2 – Management override of controls

We will use computer assisted audit techniques to support our work on the risk of management override

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**Risk identified**

In accordance with ISA 240 (UK and Ireland) management override is a significant risk. This risk area includes the potential for management to use their judgement to influence the annual accounts as well as the potential to override the Partnership's controls for specific transactions.

The key judgments in the annual accounts are those which we have selected to be the significant audit risk around expenditure recognition. This is inherently the areas in which management has the potential to use their judgment to influence the annual accounts.

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**Planned audit challenge**

In considering the risk of management override, we plan to perform the following audit procedures that directly address this risk:

- We will test journals, using our data analytics tool, to focus our testing on higher risk journals;
- We will review accounting estimates for bias that could result in material misstatements due to fraud;
- We will obtain an understanding of the business rationale of significant transactions that we become aware of that are outside of the normal course of business for the entity, or that otherwise appear to be unusual, given our understanding of the entity and its environment.

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**Deloitte Comment**

We did not identify in our prior year audit work any transactions which appeared unusual or outside the normal course of business. In addition, we have completed design & implementation work in this area for the current year audit and have not identified any issues.

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# Wider scope requirements

## Audit dimensions

The Code of Audit Practice sets our four audit dimensions which set a common framework for all public sector audits in Scotland. These are financial sustainability, financial management, governance and transparency and value for money. Due to the relative size and scale of the functions delivered by the Partnership, we have concluded that the full wider scope of audit is not appropriate. In accordance with paragraph 53 of the Code, our work in this area will therefore be restricted to concluding following:

Audit dimension	Areas to be considered	Impact on the 2017/18 Audit
<p>The appropriateness of the disclosures in the <b>governance statement</b>.</p>	<ul style="list-style-type: none"> <li>The completeness of the disclosures in meeting the requirements of the new guidance note issued by CIPFA <i>Delivering good governance in local government: framework 2016</i>.</li> <li>Inconsistencies between the disclosures or information that is materially incorrect and audit knowledge.</li> </ul>	<p>We will review the draft governance statement and assess whether there are any inconsistencies or omissions based on other audit evidence obtained throughout the audit. Our work in 2016/17 triggered a review of the statutory powers transferred to the Partnership from the Council. The outcome of this work will be followed up as part of our 2017/18 audit work.</p> <p><b>Audit Risk:</b> The governance statement is not consistent with the wider disclosure of the accounts or compliant with the CIPFA guidance note.</p>
<p><b>Financial sustainability</b> looks forward to the medium and longer term to consider whether the body is planning effectively to continue to deliver its services or the way in which they should be delivered.</p>	<ul style="list-style-type: none"> <li>The financial planning systems in place across the shorter and longer terms.</li> <li>The arrangements to address any identified funding gaps.</li> <li>The affordability and effectiveness of funding and investment decisions made.</li> </ul>	<p>We will monitor the Partnership's actions in respect of its short and medium term financial plans, including progress towards outcome based planning/ budgeting. From our work performed in 2016/17, we noted that there was no medium or long term financial plan in place. We are monitoring the partnership's work on this and will continue to do so as part of our 17/18 audit.</p> <p><b>Audit Risk:</b> A lack of forward financial planning, leading to Partnership's projects being delayed or cancelled.</p> <p>We will monitor the Partnership's savings plans to assess whether the impact has been fully identified, mitigated and planned for.</p> <p><b>Audit Risk:</b> Insufficient review of savings plans could impact on achievement of its corporate priorities.</p>



# Wider scope requirements (continued)

## Specific risks

As part of the 2017/18 planning guidance, Audit Scotland have identified the following areas as significant risks faced by the public sector. While we have not identified any specific risks in relation to these areas for the Partnership, we will continue to monitor these areas as part of our audit work.

Risk	
<b>EU withdrawal</b>	<p>There remains significant uncertainty about the detailed implications of EU withdrawal. Nonetheless, given the potential timetables involved, it is critical public sector bodies are working to understand, assess and prepare for the impact on their business. Key aspects of this are likely to include three broad areas:</p> <ul style="list-style-type: none"><li>- Workforce</li><li>- Funding</li><li>- Regulation</li></ul>
<b>New Financial Powers</b>	<p>The provisions of the 2012 and 2016 Scotland Acts and the accompanying Fiscal Framework agreement are leading to fundamental changes to the Scottish public finances. New tax raising, borrowing and social security powers provide the Scottish Parliament with more policy choice, but also mean the Scottish budget is subject to greater volatility, uncertainty and complexity. There is also a stronger link between the performance of the Scottish economy (relative to the rest of the UK) and available funding.</p> <p>The changes are likely to impact across public sector bodies to varying degrees, both directly (for example where an organisation's activities include additional responsibilities as a result of the new powers) and indirectly (for example as a result of potential changes to the way the Scottish Government manages its overall budget).</p>

# Wider scope requirements (continued)

## Specific risks (continued)

Risk	
<b>Ending of public sector pay cap</b>	<p>Pay increases in the public sector have been frozen and then capped at 1% for seven years. Politicians in both Westminster and Holyrood are talking about ending the public sector pay cap.</p> <p>When introducing the Programme for Government 2017-18, the First Minister confirmed that the Scottish Government will lift the 1% public sector pay cap. It remains unclear which public sector workers will benefit from lifting the cap, when the increases will take effect, and how such increases will be funded.</p> <p>All public bodies need to consider the potential impact of the ending the pay cap as they prepare their budgets and consider their financial sustainability.</p>
<b>Response to cyber security risks</b>	<p>Audit Scotland will issue further guidance in relation to this risk, setting out the risk context for public bodies, the new cyber resilience requirements being introduced by the Scottish Government and questions that auditors can pose to bodies to understand the risk and mitigating action in a local context. We will share this with management when this is available.</p>
<b>Openness and transparency</b>	<p>There are signals of changing and more challenging expectations for openness and transparency in public business. In view of this direction of travel, Audit Scotland noted that 2016/17 annual audit reports highlighted the need for public bodies to keep this area under review and to consider whether there is scope to enhance transparency.</p>

# Wider scope requirements (continued)

## Performance audits

<b>Performance Audit</b>	
In accordance with Audit Scotland planning guidance, we will be requested to provide information to support performance audits on the following subjects during the year:	
<b>Performance audit title</b>	<b>Appointed auditor input</b>
Digital – cross cutting	No formal return. Audit Scotland will provide information and guidance on current issues and risks to consider as part of planning process.

# Audit Quality

## Our commitment to audit quality



Our objective is to deliver a distinctive, quality audit to you. Every member of the engagement team will contribute, to achieve the highest standard of professional excellence.

In particular, for your audit, we consider that the following steps will contribute to the overall quality:

We will apply professional scepticism on material issues and significant judgements identified, by using our expertise in the central government sector and elsewhere to provide robust challenge to management.

We have obtained a deep understanding of your business, its environment and of your processes in income recognition and expenditure enabling us to develop a risk-focused approach tailored to the Partnership.

Our engagement team is selected to ensure that we have the right subject matter expertise and industry knowledge. We will involve specialists to support the audit team in our work.

In order to deliver a quality audit to you, each member of the core audit team has received tailored learning to develop their expertise in audit skills, delivered by Pat Kenny, Audit Director. This is a Director led programme encouraging teams from across our practice to engage and discuss current sector and audit issues, sharing best practice and expertise. This is in addition to a practice wide local government training day held prior to the end of the financial year to share key issues from across the country, to update on regulatory changes and provide early warning of issues other teams may have faced at the interim testing phase.



### **Engagement Quality Control Review**

We have developed a tailored Engagement Quality Control approach. Our dedicated Professional Standards Review (PSR) function will provide a 'hot' review before any audit or other opinion is signed. PSR is operationally independent of the audit team, and supports our high standards of professional scepticism and audit quality by providing a rigorous independent challenge.

# Purpose of our report and responsibility statement

## Our report is designed to help you meet your governance duties

### What we report

Our report is designed to establish our respective responsibilities in relation to the financial statements audit, to agree our audit plan and to take the opportunity to ask you questions at the planning stage of our audit. Our report includes:

- Our audit plan, including key audit judgements and the planned scope;
- Key regulatory and corporate governance updates, relevant to you.

### What we don't report

As you will be aware, our audit is not designed to identify all matters that may be relevant to the Partnership.

Also, there will be further information you need to discharge your governance responsibilities, such as matters reported on by management or by other specialist advisers.

Finally, the views on internal controls and business risk assessment in our final report should not be taken as comprehensive or as an opinion on effectiveness since they will be based solely on the audit procedures performed in the audit of the financial statements and the other procedures performed in fulfilling our audit plan.

### Other relevant communications

We will update you if there are any significant changes to the audit plan.

This report has been prepared for the Partnership, as a body, and we therefore accept responsibility to you alone for its contents. We accept no duty, responsibility or liability to any other parties, since this report has not been prepared, and is not intended, for any other purpose. Except where required by law or regulation, it should not be made available to any other parties without our prior written consent.

We welcome the opportunity to discuss our report with you and receive your feedback.



**Pat Kenny, CPFA**

for and on behalf of Deloitte LLP

Glasgow

25 January 2018

# **Technical update**

Information on sector developments



# IFRS 9 *Financial Instruments*

## In a nutshell

- In July 2014, the IASB published a final version of IFRS 9. This version supersedes all previous versions.
- IFRS 9 *Financial Instruments* will replace IAS 39 *Financial Instruments: Recognition and Measurement*, and has three main impacts
  - *Classification and measurement* - introduces new approach for the classification of financial assets driven by cash flow characteristics and the business model in which an asset is held. This classification determines how financial assets are accounted for in the annual accounts and, in particular, how they are measured on an ongoing basis.
  - *Amortised cost and impairment of financial assets* - introduces an “expected losses” impairment model where entities are required to account for expected credit losses from when financial instruments are first recognised.
  - *Hedge accounting* - introduces new general hedge accounting model that aligns the accounting treatment with risk management activities and allows for better reflection of the hedging activities in the annual accounts.
- The key practical change in IFRS 9 for most bodies is the introduction of a new approach to recognising impairments of debtors and other financial instruments.
- CIPFA/ LASAAC has advised that representatives from central and devolved governments, including the Scottish Government, have confirmed that they would be willing to consider representations from local authorities for a statutory mitigation.

## Potential impact on the Partnership

IFRS 9 is expected to have relatively limited impact, but will at least affect the process of assessing impairment of debtors and other financial assets. As part of the process of adoption, the Partnership will need to consider the impact on policies, processes, systems and people.

## Effective date

The Standard has a mandatory effective date for annual periods beginning on or after 1 January 2018, with earlier application permitted. CIPFA/ LASAAC has confirmed that it has approved the full adoption of IFRS9 into the accounting code and therefore will apply to local authority annual accounts from 2018/19.



Find out more on our  
website UK Accounting  
Plus  
[https://www.iasplus.com  
/en-gb/standards](https://www.iasplus.com/en-gb/standards)

# General Data Protection Regulation

The EU GDPR will come into effect from 25 May 2018, and will effectively supercede the existing Data Protection Act.

## Issue

The EU General Data Protection Regulation (“GDPR”) will come into effect in 2018, replacing the Directive that formed the basis for the Data Protection Act. The GDPR is expected to remain in effect for the foreseeable future, notwithstanding Brexit.

The key new concept is of “accountability” – being able to **demonstrate** compliance, with specific actions required with an evidence trail.

- Data Protection Impact Assessments are required for high risk processing of data, and there are specific requirements for transparency and fair processing of data. There are tighter rules where consent is the basis for processing data.
- There are requirements to keep records of data processing activities, with the removal of most charges for providing copies of records to patients or staff who request them.
- Penalties for breaches of the regulation are significantly higher than existing arrangements (up to €10m for data breaches and up to €20m for breaches of the principles), and apply to any breach of the regulation, not just data breaches.
- All public authorities are required to appoint a suitably qualified and experienced Data Protection Officer.
- There is a legal requirement to notify security breaches to the Information Commissioner within 72 hours.

Getting ready to comply with the GDPR can start with reducing the risk of the data breaches – and reducing that risk doesn’t need to be complicated. The biggest causes of data breaches can be avoided by making sure the basics are in place: keep all operating systems and software up to date, implement encryption for sensitive data, and educate all employees about the risk of phishing and other social engineering attacks.

Your organisation might also consider the [Cyber Essentials scheme](#) and the [10 Steps to Cyber Security](#), both developed by Government to ensure any organisation can protect themselves from common cyber-attacks.

The Information Commissioner’s Office has also developed a useful [12 step guide](#) to help organisations consider their current data protection activities and what needs to be done to comply with the new regulations. They will be developing guidance over the coming months so keep an eye on [their website](#) for more information.

## Deloitte View

Privacy as a concept is broad and far-reaching. The GDPR impacts many areas of an organisation, and is not just a legal/compliance issue. The GDPR brings specific rights to the public, including the “right to be forgotten” and data portability.

The emphasis on organisational accountability will require proactive, robust privacy governance. A key challenge is the need to identify a suitably qualified Data Protection Officer, with an estimated need for 28,000 DPOs across Europe.

The requirements will change how information technologies are designed and managed, with a requirement for documented privacy risk assessments when implementing major new systems, with “Privacy by Design” now enshrined in law.

The requirement to notify security breaches within 72 hours will require new or enhanced incident response procedures.

Teams tasked with information management will need to provide clearer oversight on data storage, journeys and lineage. Greater clarity on what data is collected and where it is stored will make it easier to comply with the new data subject rights.

## Next steps

The Partnership should consider how it is obtaining assurance over the adequacy of the Partnership's action plans to ensure compliance with the GDPR.



# Appendices



# Prior year audit adjustments

## Uncorrected and disclosure misstatements

### **Uncorrected misstatements**

There were no uncorrected misstatements identified during the course of our prior year audit

### **Disclosure misstatements**

There were no uncorrected disclosure misstatements identified during the course of our prior year audit

# Fraud responsibilities and representations

## Responsibilities explained



### Your Responsibilities:

The primary responsibility for the prevention and detection of fraud rests with management and those charged with governance, including establishing and maintaining internal controls over the reliability of financial reporting, effectiveness and efficiency of operations and compliance with applicable laws and regulations.



### Our responsibilities:

- We are required to obtain representations from your management regarding internal controls, assessment of risk and any known or suspected fraud or misstatement.
- As auditors, we obtain reasonable, but not absolute, assurance that the annual accounts as a whole are free from material misstatement, whether caused by fraud or error.
- As set out in the significant risks section of this document, we have identified the risk of fraud in revenue recognition, the accuracy of accrued income, and management override of controls as a key audit risk for your organisation.

### Fraud Characteristics:



- Misstatements in the annual accounts can arise from either fraud or error. The distinguishing factor between fraud and error is whether the underlying action that results in the misstatement of the annual accounts is intentional or unintentional.
- Two types of intentional misstatements are relevant to us as auditors – misstatements resulting from fraudulent financial reporting and misstatements resulting from misappropriation of assets.

### We will request the following to be stated in the representation letter signed on behalf of the Partnership:

- We acknowledge our responsibilities for the design, implementation and maintenance of internal control to prevent and detect fraud and error.
- We have disclosed to you the results of our assessment of the risk that the annual accounts may be materially misstated as a result of fraud.
- We are not aware of any fraud or suspected fraud that affects the entity or group and involves:
  - (i) management;
  - (ii) employees who have significant roles in internal control; or
  - (iii) others where the fraud could have a material effect on the annual accounts.
- We have disclosed to you all information in relation to allegations of fraud, or suspected fraud, affecting the entity's annual accounts communicated by employees, former employees, analysts, regulators or others.



# Fraud responsibilities and representations

## Inquiries

We will make the following inquiries regarding fraud:



### **Management:**

- Management's assessment of the risk that the annual accounts may be materially misstated due to fraud, including the nature, extent and frequency of such assessments.
- Management's process for identifying and responding to the risks of fraud in the entity.
- Management's communication, if any, to those charged with governance regarding its processes for identifying and responding to the risks of fraud in the entity.
- Management's communication, if any, to employees regarding its views on business practices and ethical behaviour.
- Whether management has knowledge of any actual, suspected or alleged fraud affecting the entity.

### **Internal audit and Local Counter Fraud Specialist**

- Whether internal audit and the Partnership's local counter fraud specialist has knowledge of any actual, suspected or alleged fraud affecting the entity, and to obtain its views about the risks of fraud.



### **Those charged with governance**

- How those charged with governance exercise oversight of management's processes for identifying and responding to the risks of fraud in the entity and the internal control that management has established to mitigate these risks.
- Whether those charged with governance have knowledge of any actual, suspected or alleged fraud affecting the entity.
- The views of those charged with governance on the most significant fraud risk factors affecting the entity.



# Independence and fees



As part of our obligations under International Standards on Auditing (UK and Ireland), we are required to report to you on the matters listed below:

## Independence confirmation

We confirm the audit engagement team, and others in the firm as appropriate, Deloitte LLP and, where applicable, all Deloitte network firms are independent of the Partnership and will reconfirm our independence and objectivity to the Partnership for the year ending 31 March 2018 in our final report to the Partnership.

## Fees

The audit fee for 2017/18, in line with the fee range provided by Audit Scotland, is £9,913 as analysed below.

	2017/18 £	2016/17 £
Auditor remuneration	8,663	8,987
<i>Audit Scotland fixed charges:</i>		
Pooled costs	730	719
Audit support costs	520	490
<b>Total Fee</b>	<b>9,913</b>	<b>10,187</b>

Details of all non-audit services fees for the period will be presented in our final report.

## Non-audit services

We continue to review our independence and ensure that appropriate safeguards are in place in relation to any non-audit services provided including, but not limited to, the rotation of senior partners and professional staff and the involvement of additional partners and professional staff to carry out reviews of the work performed and to otherwise advise as necessary.

## Relationships

We have no other relationships with the Partnership, its directors, senior managers and affiliates, and have not supplied any services to other known connected parties.

# Our approach to quality

## AQR team report and findings



We maintain a relentless focus on quality and our quality control procedures and continue to invest in and enhance our overall firm Audit Quality Monitoring and Measuring programme.

In June 2017 the Financial Reporting Council ("FRC") issued individual reports on each of the six largest firms, including Deloitte, on Audit Quality Inspections which provides a summary of the findings of its Audit Quality Review ("AQR") team for the 2016/17 cycle of reviews.

The review performed by the AQR forms an important part of our overall inspection process. We perform causal factor analysis on each significant finding arising from both our own internal quality review and those of our regulators to identify the underlying cause. This provides insight which drives the developments in our quality agenda.

18 of the audits reviewed by the AQR were performed to a good standard with limited improvements required. We were disappointed that, despite the high standards we set and many areas of improvement in our quality record, the percentage of audits rated as requiring more than limited improvements has remained broadly similar to the previous year and that two reviews were identified as requiring significant improvement.

We have taken swift and decisive action to respond to the matters identified and will continue to monitor the implementation of these. We are firmly committed to achieving, and indeed exceeding, the FRC's objective that by 2019 90% of FTSE 350 audits reviewed will be assessed as requiring no more than limited improvements.

All the AQR public reports are available on its website.

### The AQR's 2016/17 Audit Quality Inspection Report on Deloitte LLP

"We reviewed selected aspects of 23 individual audits in 2016/17. In selecting which aspects of an audit to inspect, we took account of those areas identified to be of higher risk by the auditors and Audit Committees, our knowledge and experience of audits of similar entities and the significance of an area in the context of the audited financial statements. The communications with the Audit Committee and the audit of revenue were reviewed on nearly all of these audits..."

"The firm has taken the actions they committed to take following our last inspection. Some of the issues driving more adverse quality assessments this year are in similar areas to those reported last year, although some audits reviewed were undertaken before these actions had been carried out. Our main concern continues to be the adequacy of audit teams' challenge of management in key areas of judgment (particularly goodwill impairment) and further immediate action is required to improve audit quality in this area.

#### The firm has enhanced its policies and procedures in the following areas:

- Strengthened the evidence of the Engagement Quality Control Review ("EQCR") partner and audit technical reviewer involvement.
- Updated Deloitte's audit methodology to include additional focus on risk assessment and the related audit response (effective from 31 December 2016 year-end audits).
- Introduced more focused coaching for audit teams throughout the audit process.
- Issued more timely and focused guidance and reminders to the audit practice on key audit matters, to facilitate appropriate consideration by audit teams at the key stages of the audit.
- Increased mandatory technical training for qualified staff through to partner level

**Our key findings in the current year** requiring action by the firm, which are elaborated further in section 2 together with the firm's actions to address them, are that the firm should:

- Improve the extent of challenge of management in key areas of judgment, in particular impairment reviews and valuation of acquired intangible assets.
- Strengthen the firm's audit of income recognition.
- Make further improvements to the audit of defined benefit pension scheme balances in corporate entities.
- Continue to seek to improve the consistency of the quality of communications with Audit Committees."

# Our approach to quality

Areas identified for particular attention	How we have addressed these as a firm	How addressed in our audit
Strengthen the firm's audit of income recognition.	<p>A key theme of the enhancements to our methodology in 2016, (deployed after these engagements reviewed by the AQR were complete), was to enhance our risk assessment procedures and, as a result, encourage our auditors to develop more robust responses to the largest most critical account balances, with a natural focus on revenue.</p> <p>This included the removal of capped sample sizes for very large balances and facilitation of a combination of test of details and substantive analytical procedures to enable more comprehensive audit responses to be designed.</p> <p>This theme has continued in 2017 when our Summer Technical Training showcased our investment in analytic tools applied to the audit of revenue, as well as training on the accounting and auditing of revenue as we prepare to audit the implementation of the new revenue standard IFRS 15 'Revenue from Contracts with Customers' which is effective for periods beginning on or after 1 January 2018.</p>	This is a significant audit risk and is addressed in page 14 of this paper.
Continue to seek to improve the consistency of the quality of communications with Audit Committees.	<p>We take our responsibilities for reporting to the Audit Committee very seriously. There is a natural follow on that if there is a failure in the underlying audit work we will inevitably fall short in our reporting on those areas. The majority of issues noted in the report linked directly to the review findings.</p> <p>We continue to stress the critical importance of reporting matters to the Audit Committee in the training we deliver and in the enhanced procedures we have established, in particular around key management estimates and judgments. We have issued refreshed Audit Committee reporting templates to the practice reflecting the observations of the reviews to ensure audit practitioners continue to focus on this critical aspect of our role.</p>	<p>We have reported to you in page 11 and 12 of this paper the scope of work and the planned approach to the audit.</p> <p>We would welcome any feedback on our approach to communicating with you.</p>



# Our approach to quality

Areas identified for particular attention	How we have addressed these as a firm	How addressed in our audit
Improve the extent of challenge of management in key areas of judgment, in particular impairment reviews and valuation of acquired intangible assets.	<p>We have developed an Impairment Centre of Excellence and have mandated its involvement in all public interest entity audits with a material goodwill or intangibles balance for years ending on or after 15 December 2016. The specialists within the Impairment Centre of Excellence, in addition to having significant experience auditing complex impairment issues, have had specialist training to be able to identify and respond to the issues raised in the AQR report.</p> <p>Our Summer Technical Training in 2017 included interactive workshops on this area including sharing anonymised findings from internal and external review to illustrate the types of challenge and extent of audit evidence that teams should seek to achieve in this area.</p>	The Partnership does not have a goodwill balance or a material intangible asset balance, and so this is not applicable for the Partnership's audit.
Make further improvements to the audit of defined benefit pension scheme balances in corporate entities.	<p>We have improved our procedures to ensure confirmations are obtained from asset custodians where appropriate. In December 2015 we introduced a detailed practice aid dedicated to all areas of corporate pension balance auditing together with increased training.</p> <p>We have also mandated consultation with our Pension Audit Centre of Excellence for years ending on or after 15 December 2016 and refreshed the practice aid. This ensures our audit teams have access to our experts in the audit of pension balances.</p>	The Partnership does not have an on balance sheet pension scheme, and so this is not applicable for the audit.







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