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SCOTTISH FIRE AND RESCUE SERVICE

Working together for a safer Scotland

Scottish Fire and Rescue Service

Planning report to the Audit and Risk Assurance Committee on the 2020/21 audit

Issued on 11 March 2021 for the meeting on 24 March 2021

Contents

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 annual report and accounts.
- A strong understanding of your internal control environment.
- A well planned and delivered audit that raises findings early with those charged with governance.

I have pleasure in presenting our planning report to the Audit and Risk Assurance Committee ("ARAC") of Scottish Fire and Rescue Service ("SFRS") for the 2020/21 audit. I would like to draw your attention to the key messages of this paper:

Audit plan

We have updated our understanding of SFRS, including discussion with management and review of relevant documents. This has included consideration of the impact the COVID-19 pandemic has had on SFRS. Based on these procedures, we have developed this plan in collaboration with management to ensure that we provide an effective audit service that meets your expectation and focuses on the most significant areas of importance and risk to SFRS.

Key risks

We have taken an initial view as to the significant audit risks SFRS faces. These are presented as a summary dashboard on page 11.

Audit dimensions

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

In carrying out our annual risk assessment, we have considered the arrangements in place for each dimension, building on our findings and conclusions from previous years' audits as well as planning guidance published by Audit Scotland. Our significant risks are presented on pages 24 to 27.

As part of our work on the audit dimensions, we will consider the arrangements in place to secure Best Value (BV) as well as other wider scope requirements set out on pages 24 to 27.

Introduction (continued)

The key messages in this report (continued)

Regulatory change

The implementation of the new standard on leases, IFRS 16, has been deferred again for another year, as a result of COVID-19, with a revised implementation date of 2022/23 and will require adjustments to recognise on balance sheet arrangements currently treated as operating leases. We have shared our recent research on IFRS 16 on page 31.

Our audit approach reflects changes to International Standards on Auditing (UK) on going concern (ISA (UK) 570) and management estimates (ISA (UK) 540), and Practice Note 10, effective for this year, which is detailed on pages 19-22.

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.

As part of our planning discussions with management, we have shared our "*Key Lessons from 2019/2020 Audits*" to help prepare for the 2020/21 audit, ensuring a focus on quality.

Added value

Our aim is to add value to SFRS 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 SFRS promote improved standards of governance, better management and decision making and more effective use of resources.

We have also shared our recent research, informed perspectives and best practice from our work across the wider public sector on pages 30 to 35 of this paper.

Pat Kenny
Audit Director

Responsibilities of the Audit and Risk Assurance Committee (ARAC)

Helping you fulfil your responsibilities

Why do we interact with the ARAC?

- To communicate audit scope
- To provide timely and relevant observations
- To provide additional information to help you fulfil your broader responsibilities

We use this symbol to highlight areas of our audit where the ARAC needs to focus attention.

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

Oversight of external audit

- At the start of each annual audit cycle, ensure that the scope of the external audit is appropriate.
- Implement a policy on the engagement of the external auditor to supply non-audit services.

Integrity of reporting

- Impact assessment of key judgements and level of management challenge.
- Review of external audit findings, key judgements, level of misstatements.
- Assess the quality of the internal team, their incentives and the need for supplementary skillsets.
- Assess the completeness of disclosures, including consistency with disclosures on business model and strategy and, where requested by the Service, provide advice in respect of the fair, balanced and understandable statement.

Internal controls and risks

- Review the internal control and risk management systems (unless expressly addressed by separate risk committee).
- Explain what actions have been, or are being taken to remedy any significant failings or weaknesses.

Oversight of internal audit

- Consider annually whether the scope of the internal audit programme is adequate.
- Monitor and review the effectiveness of the internal audit activities.

Whistle-blowing and fraud

- Ensure that appropriate arrangements are in place for the proportionate and independent investigation of any concerns raised by staff in connection with improprieties.

Your control environment

What we consider when we plan the audit

We expect management and those charged with governance to recognise the importance of a strong control environment and take proactive steps to deal with deficiencies identified on a timely basis.

Responsibilities of management

Auditing standards require us to only accept or continue with an audit engagement when the preconditions for an audit are present. These preconditions include obtaining the agreement of management and those charged with governance that they acknowledge and understand their responsibilities for, amongst other things, internal control as is necessary to enable the preparation of annual accounts that are free from material misstatement, whether due to fraud or error.

Responsibilities of the ARAC

As explained further in the Responsibilities of the Audit and Risk Assurance Committee slide on the previous page, the ARAC is responsible for:

- Reviewing the internal control and risk management systems (unless expressly addressed by a separate risk committee).
- Explaining what actions have been, or are being taken to remedy any significant failings or weaknesses.

As stakeholders tell us that they to wish to understand how external audit challenges and responds to the quality of an entity's control environment, we are seeking to enhance how we plan and report on the results of the audit in response. We will be placing increased focus on how the control environment impacts the audit, from our initial risk assessment, to our testing approach and how we report on misstatements and control deficiencies.

Reliance on controls	We will seek to undertake design and implementation testing on controls in respect of our identified significant risk areas. In accordance with forthcoming revisions to ISAs, we will assess inherent risk and control risk associated with accounting estimates.
Performance materiality	We set performance materiality as a percentage of materiality to reduce the probability that, in aggregate, uncorrected and undetected misstatements exceed materiality. We determine performance materiality, with reference to factors such as the quality of the control environment and the historical error rate. Where we are unable to rely on controls, we may use a lower level of performance materiality.

Our audit explained

We tailor our audit to your business and your strategy

Identify changes in your business and environment

SFRS continues to face significant financial pressures with a risk of reduced funding in future years, emphasising a need for ongoing transformation of services. There have been restrictions on the provision of some services due to COVID-19, which is discussed in further detail on pages 15-17.

Scoping

Our scope is in line with the Code of Audit Practice issued by Audit Scotland.

More detail is given on page 10.

In our final report

In our final report to you, we will conclude on the significant risks identified in this paper, report to you our other findings, and detail those items we will be including in our audit report, including key audit matters if applicable.

Identify changes in your business and environment → Determine materiality → Scoping → Significant risk assessment → Conclude on significant risk areas → Other findings → Our audit report

Determine materiality

We will use a materiality level of £8.531m (2019/20: £10.425m) in planning our audit. This is based on forecast gross expenditure. We will report to you any misstatements above £0.250m (2019/20: £0.250m).

Further details on our materiality considerations are provided on page 9.

Significant risk assessment

We have identified significant audit risks in relation to SFRS. More detail is given on pages 11 to 13. These are consistent with our prior year audit.

Quality and Independence

We confirm all Deloitte network firms and engagement team members are independent of Scottish Fire and Rescue Service. We take our independence and the quality of the audit work we perform very seriously. Audit quality is our number one priority.

Continuous communication and reporting

Planned timing of the audit

As the audit plan is executed throughout the year, the results will be analysed continuously and conclusions (preliminary and otherwise) will be drawn. The following sets out the expected timing of our reporting to and communication with you.

Planning	Interim	Year end fieldwork	Reporting
• Planning meetings • Discussion of the scope of the audit • Discussion of audit fees • Discussion of fraud risk assessment • Update our understanding of key business cycles	• Carry out detailed risk assessments • Review of Board and ARAC papers and minutes • Complete wider scope procedures • Issue separate report on wider scope conclusions	• Audit of Annual Report and Annual Accounts, including Annual Governance Statement • Year-end audit field work • Year-end closing meetings	• Reporting of control deficiencies • Final ARAC meeting • Issue final Annual Audit Report to the Service and the Auditor General for Scotland • Submission of audited annual accounts to Audit Scotland • Audit feedback meeting
2020/21 Audit Plan	Report on audit dimensions and best value	Final report to the ARAC	
December 2020 - March 2021	March – July 2021	September 2021	October 2021

Ongoing communication and feedback

Materiality

Our approach to materiality

Basis of our materiality benchmark

- The Audit Director has determined materiality as £8.531m (2019/20: £10.425m) and performance materiality as £5.971m (2019/20: £8.340m), based on professional judgement, the requirements of auditing standards and the financial measures most relevant to users of the annual accounts.
- We have used 1.8% (2019/20: 2.0%) of forecast gross expenditure as the benchmark for determining materiality and applied 70% (2019/20: 80%) as performance materiality. We have judged expenditure to be the most relevant measure for the users of the accounts.
- The approach is consistent with previous years. However, the percentages applied have been revisited to take into account our knowledge of the Service and our understanding of the control environment, including the increased fraud risks as a result of the COVID-19 pandemic.
- In line with previous years, we will refresh our materiality calculations at the year-end to reflect the actual outturn for the year.

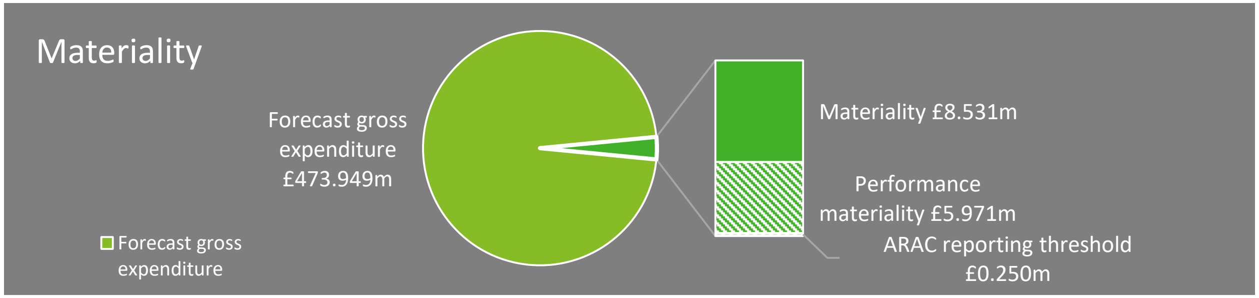
Reporting to those charged with governance

- We will report to you all misstatements found in excess of £0.250m (2019/20: £0.250m).
- 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 the ARAC must not exceed £0.250m.

Our Annual Audit Report

We will:

- Report the materiality benchmark applied in the audit of the Service;
- Provide comparative data and explain any changes in materiality compared to prior year;
- Explain any normalised or adjusted benchmarks we use; and
- Explain the concept of performance materiality and state what percentage of materiality we used, with our rationale.



Although materiality is the judgement of the Audit Director, the ARAC 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 work	Planned output	Timeline
1. Auditing the annual accounts	Annual Audit Plan	24 March 2021
	Independent auditor's report	28 October 2021
2. Audit dimensions	Annual Audit Plan	24 March 2021
	Report on audit dimensions	8 July 2021
	Annual Audit Report to the ARAC	7 October 2021
3. Other wider scope audit work	Assurance Statement on WGA return	TBC*
	Fraud Returns	Quarterly (30 November 2020, 28 February 2021, 31 May 2021 and 31 August 2021)

* In previous years SFRS has been below the threshold for this return. It is our expectation that this will be the same in the current period and we will report to ARAC any changes to this when final guidance is issued.

Significant risks

Significant risk dashboard

Risk	Fraud risk	Planned approach to controls	Level of management judgement	Page no
Operating within the expenditure resource limits	✓	DI	⚠	12
Management override of controls	✓	DI	⚠	13

Level of management judgement

⚠ High degree of management judgement

⚠ Some degree of management judgement

⚠ Limited management judgement

Controls approach adopted

DI Assess design and implementation

Significant risks (continued)

Operating within the expenditure resource limits

Risk identified and key judgements

Under Auditing Standards there is a rebuttable presumption that the fraud risk from revenue recognition is a significant risk. In line with previous years, we do not consider this to be a significant risk for SFRS as there is little incentive to manipulate revenue recognition with the majority of revenue being from the Scottish Government which can be agreed to confirmations supplied.

We therefore consider the fraud risk to be focused on how management operate within the expenditure resource limits set by the Scottish Government. There is a risk that SFRS could materially misstate expenditure in relation to year end transactions, in an attempt to align with its tolerance target or achieve a breakeven position.

The significant risk is therefore pinpointed to the completeness of accruals made by management at the year end and invoices processed around the year end as this is the area where there is scope to manipulate the final results. Given the financial pressures across the whole of the public sector, there is an inherent fraud risk associated with the recording of accruals around year end.

Deloitte response and challenge

We will evaluate the results of our audit testing in the context of the achievement of the limits set by the Scottish Government. Our work in this area will include the following:

- Evaluating the design and implementation of controls around monthly monitoring of financial performance;
- Obtain independent confirmation of the resource limits allocated to SFRS by the Scottish Government;
- Perform focused testing of accruals made at the year end; and
- Performing focused cut-off testing of invoices received and paid around the year end.

Significant risks (continued)

Management override of controls

Risk identified

Management is in a unique position to perpetrate fraud because of their ability to manipulate accounting records and prepare fraudulent annual accounts by overriding controls that otherwise appear to be operating effectively.

Although management is responsible for safeguarding the assets of the entity, we planned our audit so that we had a reasonable expectation of detecting material misstatements to the annual accounts and accounting records.

Deloitte response and challenge

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

Test the appropriateness of journal entries recorded in the general ledger and other adjustments made in the preparation of the annual accounts. In designing and performing audit procedures for such tests, we plan to:

- Test the design and implementation of controls over journal entry processing;
- Make inquiries of individuals involved in the financial reporting process about inappropriate or unusual activity relating to the processing of journal entries and other adjustments;
- Select journal entries and other adjustments made at the end of a reporting period; and
- Consider the need to test journal entries and other adjustments throughout the period.

Review accounting estimates for biases and evaluate whether the circumstances producing the bias, if any, represent a risk of material misstatement due to fraud. In performing this review, we plan to:

- Evaluate whether the judgments and decisions made by management in making the accounting estimates included in the annual accounts, even if they are individually reasonable, indicate a possible bias on the part of the entity's management that may represent a risk of material misstatement due to fraud. If so, we will re-evaluate the accounting estimates taken as a whole; and
- Perform a retrospective review of management judgements and assumptions related to significant accounting estimates reflected in the annual accounts of the prior year.

For significant transactions that are outside the normal course of business for the entity, or that otherwise appear to be unusual given our understanding of the entity and its environment and other information obtained during the audit, we shall evaluate whether the business rationale (or the lack thereof) of the transactions suggests that they may have been entered into to engage in fraudulent financial reporting or to conceal misappropriation of assets.

Other areas of focus

Pension liability

Risk identified and key judgements

SFRS participates in two types of defined benefits schemes:

- Local Government Pension Schemes (LGPS); and
- Firefighters Pension Schemes (FFPS).

The net pension liability has increased from £3,881m in 2018/19 to £4,471m in 2019/20. The increase was as a result of changes in assumptions resulting in an actuarial loss of £477m in 2019/20 compared to an actuarial gain of £164m in 2018/19; this was due to a change in assumptions, including a reduction in the discount rate which dropped from 2.9% to 1.8%. The liability also continues to be affected by the McCloud and Goodwin legal cases, as well as Guaranteed Minimum Pension (GMP) indexation.

SFRS uses a number of actuaries for the 8 LGPS (Hymans Robertson LLP, Barnett Waddingham LLP and Mercer) and the FFPS (the Government's Actuary Department, GAD). They all produce detailed reports outlining the estimated liability at the year-end along with the associated disclosure requirements.

The pension liability valuation is an area of audit focus due to the material value and significant assumptions used in the calculation of the liability. The valuations are prepared by a reputable actuary using standard methodologies which have been considered as appropriate in previous years and no significant changes in the membership of the scheme or accrued benefits are expected in the current year. As a result, we have not identified this as a significant risk.

Deloitte response and challenge

We will perform the following procedures to address the risk:

- Assess the independence and expertise of the actuaries supporting the basis of reliance upon their work;
- Review and challenge the assumptions made by actuaries;
- Obtain assurance from the auditor of the pension funds over the controls for providing accurate data to the actuaries;
- Consider the impact of the Triennial Review of the LGPS pension funds and the Quadrennial Review of the FFPS;
- Assess the reasonableness of SFRS's share of the total assets of the scheme with the Pension Fund financial statements;
- Review and challenge the calculation of the impact of the McCloud, Goodwin, and GMP cases on pension liabilities; and
- Review the disclosures within the accounts against the FReM.

Coronavirus (COVID-19) outbreak

Impact on our audit

Requirements	The COVID-19 pandemic had a significant impact on the 2019/20 audit process, despite impacting relatively late in the year. We would expect there to be guidance as we approach year-end on accounting and disclosure requirements for 2020/21, where the impact has been much more extensive on all organisations. A key element of this will be communicating risks and governance impacts in narrative reporting, consistent with the Financial Reporting Council's guidance to organisations on the importance of communicating the impact of COVID-19 and related uncertainties, including their impact on resilience and going concern assessments. Entity-specific explanations of the current and expected effects of COVID-19 and SFRS's plans to mitigate those effects should be included in the narrative reporting (including where relevant the Annual Governance Statement), including in the discussion on Principal Risks and Uncertainties impacting an organisation.
Actions	While there may be greater clarity as we approach year-end, we would expect organisations as part of their reporting to conduct a thorough assessment of the current and potential future effects of the COVID-19 pandemic including: • Consideration of the impact across SFRS's operations, including on its supply chains and cost base, and the consequent impacts on financial position; • The scenarios assumed in making forecasts and on the sensitivities arising should other potential scenarios materialise (including different funding scenarios); and • The effect of events after the reporting date, including the nature of non-adjusting events and an estimate of their financial effect, where possible.

Coronavirus (COVID-19) outbreak (continued)

Impact on our audit (continued)

Impact on the Service and management actions	Impact on annual report and annual accounts	Impact on our audit
We will consider the key impacts on SFRS such as: • Interruptions to service provision • Supply chain disruptions • Unavailability of personnel	We have considered the impact of the outbreak on the annual report and annual accounts, discussed further on the next slide including: • Narrative reporting, including disclosures on financial sustainability • Principal risk disclosures • Impact on property, plant and equipment valuations • Impairment of non-current assets • Events after the reporting period and relevant disclosure	We will continue to assess the impact on the audit including: • Resource planning • Timetable of the audit • Impact on our risk assessment • Logistics including meetings with entity personnel

Impact on annual report and annual accounts	
Impact on Property, Plant and Equipment	The Royal Institute of Chartered Surveyors issued a practice alert, as a result of which valuers identified a material valuation uncertainty at 31 March 2020 for most types of property valuation. This practice alert was withdrawn in September 2020. Valuation reports at March 2020 typically identified a need to consider potential impairments in future periods, and this year's valuations may reflect more significant movements. SFRS will need to consider the approach to its valuation, including any changes as a result of the pandemic and consequent service and organisational changes. Boards will also need to consider whether there are any indications of impairment of assets requiring adjustment at 31 March 2021.

Coronavirus (COVID-19) outbreak (continued)

Impact on our audit (continued)

Impact on annual report and annual accounts	
Expected credit losses	While most debtors are with public sector entities (where significant changes in recoverability are not expected), for non-public sector debtors, SFRS will need to consider the level of provision required for expected credit losses under IFRS 9 Financial Instruments.
Narrative and other reporting issues	The following areas will need to be considered by SFRS: • Narrative reporting as well as the usual reporting requirements will need to cover the effects of the pandemic on services, operations, performance, strategic direction, resources and financial sustainability. • Reporting judgements and estimation uncertainty, SFRS will need to report the impact on material transactions including decisions made on the measurements of assets and liabilities.
Going concern assessment	The annual accounts should include disclosure on the basis of SFRS's going concern assessment, including related uncertainties. SFRS also needs to report on the impact of financial pressures and its financial sustainability in the narrative report, as well as any relevant liquidity reporting requirements under IFRS 7 Financial Instruments: Disclosures.
Events after the reporting period and relevant disclosures	Events are likely to continue to move swiftly, and SFRS will need to consider the events after the reporting period and whether these events will be adjusting or non-adjusting and make decisions on a transaction by transaction basis.

Reporting hot topics

Increased focus on quality reporting

Deloitte view

The expectations of corporate reporting, reflected in the Financial Reporting Council's ('the FRC') monitoring and enforcement priorities, are increasing. While the focus is primarily on corporate entities, we highlight these areas where improved disclosures would help meet stakeholder expectations.

The potential impacts of Brexit

Depending upon events, organisations may be preparing annual reports against the backdrop of continued uncertainty around the UK's future relationship with the EU. Even with a deal agreed, the future basis of UK-EU trade will affect the longer-term viability period of 3-5 years and a longer consideration of prospects.

ACTION: Depending upon events through to the date of signing, we would expect to see annual reports reflecting at least:

- relevant risks and uncertainties, and actions taken to manage those risks; and
- consideration of whether there is any impact on critical accounting judgements and areas of estimation uncertainty.

We will discuss with SFRS closer to the time areas where disclosures may be appropriate.

Climate-related risks

The report by the Intergovernmental Panel on Climate Change (IPCC) has made it clear that prompt and decisive action on climate change is required from governments, businesses and individuals alike.

The recommendations of the Taskforce on Climate-related Financial Disclosure (TCFD) are gaining momentum. The government has proposed mandatory TCFD disclosures by 2022, and the FRC is undertaking a major review of how organisations assess and report the impact of climate change. The FRC expects organisations to disclose how they have taken climate change into account in assessing the resilience of the business model, its risks, uncertainties and viability both in the immediate and longer term.

Investors are challenging companies that are not factoring the effects of the Paris Climate Agreement into their critical accounting judgements and are not disclosing comprehensively these judgements, assumptions, sensitivities and uncertainties.

ACTION: Clearly articulate how your organisation is addressing climate change e.g.

- whether this is a principal risk and how it is being managed; and
- its impact on the business model, the viability statement and the key assumptions and projections in impairment reviews and valuations (including in assessing remaining asset lives).

Revisions to auditing standards coming into effect

ISA (UK) 570 – Going concern

The FRC issued a revised going concern standard in September 2019, that takes effect for periods commencing on or after 15 December 2019. For public sector bodies, this will be March 2021 year ends and later.

The revision was made in response to recent enforcement cases and well-publicised corporate failures where the auditor's report failed to highlight concerns about the prospects of entities which collapsed shortly after.

We have summarised below the key areas of change in the standard – however, the Public Audit Forum is also consulting on changes to Practice Note 10, with the intention of reflecting public sector considerations in the approach to going concern, and so the ultimate impact of ISA (UK) 570 changes will be affected by this.

The key changes affect:

- Risk assessment procedures and related activities, increasing consideration of the entity's business model, operations and financing;
- The auditor's evaluation of management's assessment of the going concern assumption (which therefore requires a clearly documented assessment to be prepared by management);
- Enhanced professional scepticism requirements, including around the evaluation of the sufficiency and appropriateness of audit evidence;
- Considering the appropriateness of disclosures; and
- Reporting in enhanced audit reports.

"The revised standard means UK auditors will follow significantly stronger requirements than those required by current international standards."

FRC's press release, 30 September 2019

Revisions to auditing standards coming into effect (continued)

ISA (UK) 540 – Auditing Accounting Estimates and Related Disclosures

Since 2015, the International Auditing and Assurance Standards Board (IAASB) has sought to identify audit issues relating to accounting estimates for financial institutions and other entities. Initially, this focused on the impact of IFRS 9 *Financial Instruments*, because it would fundamentally change the way that banks and other entities account for loan assets and other credit exposures.

However, the IAASB concluded that most, if not all, issues identified for expected credit losses would be equally relevant when auditing other complex accounting estimates. Accordingly, a holistic revision of ISA 540 was undertaken and the new standard takes effect for periods commencing on or after 1 January 2020. For public sector bodies, this will be March 2021 year ends and later.

We summarise on the next few slides how this will impact our audit.

> *"There is a clear need to update ISA 540 to support better quality audits of increasingly complex accounting estimates"*
>
> FRC letter to the IAASB, July 2017

Area of change	Impact on our audit	Impact on SFRS
Assessment of oversight and governance relating to estimates.	In connection with our planning work to understand the entity and its environment, including internal control, we will specifically enquire regarding management's processes, and the oversight and governance of those processes relating to accounting estimates.	You will need to consider the adequacy of your processes and controls over estimates, and documentation thereof.

Revisions to auditing standards coming into effect (continued)

ISA (UK) 540 – Auditing Accounting Estimates and Related Disclosures (continued)

Area of change	Impact on our audit	Impact on SFRS
Identification of inherent risk factors; separate assessment of inherent risk and control risk. Objectives-based work effort requirements.	Recognising a spectrum of inherent risk, we will assess risks of material misstatement in estimates with reference not only to estimation uncertainty, but also complexity, subjectivity or other inherent risk factors, and the interrelationship among them. We will specifically assess control risk relating to estimates, which may require us to evaluate the design and determine implementation of an increased number of internal controls. Our subsequent audit procedures will be responsive to this assessment, and designed to obtain evidence around the methods, significant assumptions, data and (where applicable) the selection of a point estimate and related disclosures about estimation uncertainty.	You will need to provide clear documented rationale for (a) the selection and application of the method, assumptions and data in making the accounting estimate, including any changes in the current year, and controls relating to those aspects; and/or (b) the selection of a point estimate and related disclosures for inclusion in the annual accounts.
Enhanced "stand back" requirement, to evaluate the audit evidence obtained.	We will specifically design our procedures, to enhance our application of professional scepticism, so that they are not biased towards finding corroborative evidence; our overall evaluation of the evidence obtained will weigh both corroborative and contradictory evidence.	You should expect more challenge of the evidence provided in support of accounting estimates, use of external data sources and your consideration of contradictory evidence.

Revisions to auditing standards coming into effect (continued)

ISA (UK) 540 – Auditing Accounting Estimates and Related Disclosures (continued)

Area of change	Impact on our audit	Impact on SFRS
Enhanced requirements about whether disclosures are "reasonable".	The extant ISA 540 required us to evaluate whether disclosures were "adequate". The change to "reasonable" will involve greater consideration of the overall meaning conveyed through disclosures. For example, where estimation uncertainty associated with an estimate is multiple times materiality, we will consider whether the disclosures appropriately convey the high degree of estimation uncertainty and the range of possible outcomes.	You should expect more challenge on disclosures relating to estimates, particularly for where you have selected a point estimate from a range and those with high estimation uncertainty.
New requirements when communicating with those charged with governance.	In accordance with ISA (UK) 260 and ISA (UK) 265, our communications from the audit have included significant qualitative aspects of your accounting practices and significant deficiencies in internal control. With the revised ISA (UK) 540, these communications will specifically include matters regarding accounting estimates and take into account whether the reasons for our risk assessment relate to estimation uncertainty, or the effects of complexity, subjectivity or other inherent risk factors.	You should expect increased reporting in relation to accounting estimates which may be mirrored in our Annual Audit Report.

Areas where we consider the impact to be greatest:

Key areas impacted will include property valuations and pension liability valuations:

- Property valuations are based on valuation reports provided by qualified valuers. We expect to receive reports setting out the basis for the valuations, including the assumptions and valuation methodologies.
- As detailed on page 14, the pension liability valuations are provided by SFRS's appointed actuaries, who produce detailed reports outlining the estimated liability at the year-end and key assumptions applied. Management should ensure that the information provided by the actuaries is available in advance of the 2020/21 audit fieldwork.

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 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 and expenditure recognition, payroll expenditure and capital expenditure enabling us to develop a risk-focused approach tailored to SFRS.

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

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) and other sector experts. This includes sector specific matters and audit methodology updates.

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.

Wider scope requirements

Overview

The Code of Audit Practice sets out four audit dimensions that frame the wider scope of the audit of the accounts. The audit dimensions provide a common framework for all the audit work conducted for the Auditor General and for the Accounts Commission.

In carrying out our annual risk assessment, we have considered the arrangements in place, building on our findings and conclusions from previous years' audits as well as planning guidance published by Audit Scotland, and as part of our work will consider work that has been completed by other review bodies. The following pages summarise the significant risks identified and our planned audit response.

The risk profile of public bodies for the 2020/21 audits is significantly affected by the COVID-19 pandemic. The pandemic has highlighted the importance of many long-standing issues that auditors across the public sector have previously reported on, such as the need for good governance, openness and transparency and effective longer-term planning to deliver better outcomes. The risks and challenges associated with these issues have become greater due to the pandemic. Audit Scotland's COVID-19 Guide for Audit and Risk Committees https://www.audit-scotland.gov.uk/uploads/docs/report/2020/as_200825_covid19_guide_audit_risk_comm.pdf sets out the key short term risks and challenges facing public bodies. They are heightened further because of the uncertainty around the UK's exit from the European Union and increasing budget pressures.

In accordance with Audit Scotland planning guidance, in assessing risks in 2020/21, and in order to deliver a high quality audit, we have focussed on risks related to governance and transparency, financial sustainability, and counter-fraud arrangements.

Considering Best Value arrangements	Other areas
The Scottish Public Finance Manual (SPFM) explains that accountable officers have a specific responsibility to ensure that arrangements have been made to secure BV. We will consider these arrangements when planning and reporting on the audit dimensions, discussed on pages 25 to 27.	We are required to also carry out the following areas of work: • Preliminary enquiries on all correspondence received • Submission of fraud returns

Wider scope requirements (continued)
Audit dimensions

Audit dimension	Significant risks identified	Planned audit response
Financial sustainability	The financial impact of the pandemic includes a number of different areas of forecast underspend relating to services that have been reduced or ceased, for example: • Employee costs £1.128m forecast underspend – due to recruitment of trainees slowing down and not keeping pace with retirements; and • Transport £0.437m forecast underspend – relating to drop in fuel prices and fewer Automatic Fire Alarms. SFRS has historically achieved short-term financial balance. Given that the latest budget monitoring report is forecasting a year-end underspend of £1.548m, we do not foresee any challenges in the short-term. However, the reason for these short-term underspends is due to both a slow down in recruitment, as well as reduced travel, subsistence and fuel due to the pandemic. The ability to recruit at a sufficient pace to keep up with retirements and demand for services therefore poses a risk for future service delivery. There is therefore a risk that the Service is not financially sustainable in the medium to longer term.	We will review progress being made by SFRS in refreshing its long term financial strategy during 2020/21, particularly in terms of reflecting the impact of COVID-19 and other demand pressures.
	There is a risk that the workforce strategy is not supported by a detailed workforce plan and is not clearly linked to the long term financial strategy.	We will also review workforce planning and linkages with the long term financial strategy.

Wider scope requirements (continued)

Audit dimensions

Audit dimension	Significant risks identified	Planned audit response
Financial management	We have not identified any significant risks in relation to financial management during our planning. Since the start of the pandemic, the risk of fraud and error has increased as the control environment and internal control change. In accordance with Audit Scotland planning guidance, we will consider fraud as a particular focus area in 2020/21.	We will continue to review the financial management arrangements. Using Audit Scotland's publication "COVID-19 Emerging Fraud Risks", we will assess what action SFRS has taken to minimise risk to its control environment and internal controls.

Wider scope requirements (continued)
Audit dimensions (continued)

Audit dimension	Significant risks identified	Planned audit response
Governance and transparency	Following the changes made to the governance arrangements in response to the pandemic, there is a risk that revised arrangements are not appropriate or operating effectively. SFRS and its Committees have continued to meet virtually since the start of the pandemic. While risk management processes continue to be in place, the likelihood and impact of existing risks and the emergence of new risks will need to be monitored carefully. There is a risk that officers and the ARAC members have not considered how sustainable any changes to the risk appetite will be in the longer term.	We will review the work of SFRS and ARAC to assess whether the arrangements are operating effectively, including assessing whether there is effective scrutiny, challenge and informed decision making. We will review the work undertaken in relation to risk management including updates to the policies in place as a result of COVID-19 and whether these are appropriate for the longer-term.
Value for money	The pandemic is expected to have had a substantial impact on performance measures, particularly for services which have been temporarily suspended, are at a reduced level, or have had to adapt to new ways of working. There is a risk that performance reporting has not been timely, reliable, balanced, transparent and appropriate to users' needs. SFRS has had a high level transformation plan in place since 2019. There is a risk that continuous improvement is not achieved without proper direction.	We will review the performance reports presented to SFRS to assess the extent of openness and transparency during the year. We will also review what work has been done to progress service transformation to establish how continuous improvement is demonstrated.

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 annual accounts 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; and
- Key regulatory and corporate governance updates, relevant to you

Use of this report

This report has been prepared for the ARAC, 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.

What we don't report

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

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 annual accounts 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.

P. Kenny

Pat Kenny

for and on behalf of Deloitte LLP

Glasgow | March 2021

Technical update

What does climate change mean for business?

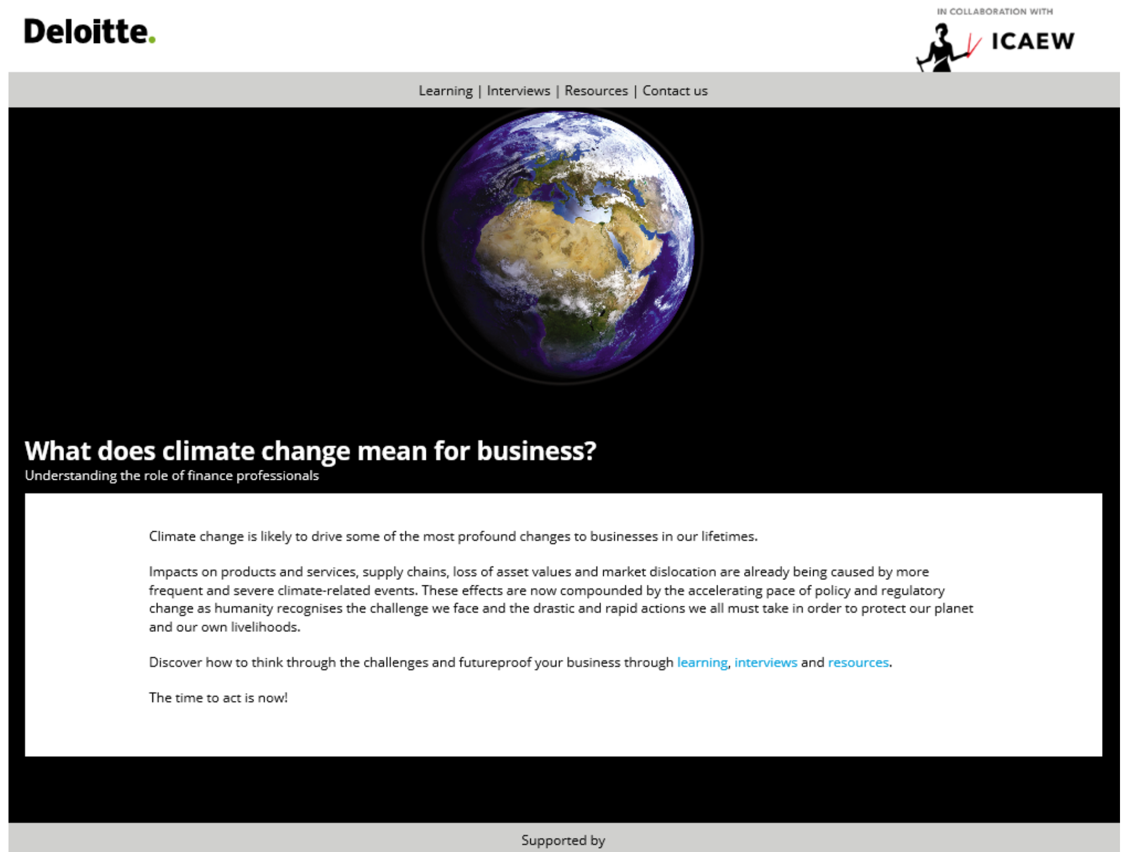
New website – learning, interviews and resources

Climate change is likely to drive some of the most profound changes to businesses in our lifetimes.

Impacts on products and services, supply chains, loss of asset values and market dislocation are already being caused by more frequent and severe climate-related events.

Discover how to think through the challenges and futureproof your business.

The time to act is now!



A4S ACCOUNTING FOR SUSTAINABILITY | CBI | CDSB Climate Disclosure Standards Board | CENTRE FOR CLIMATE CHANGE ENGAGEMENT HUGHES HALL | SASB

Visit: www.deloitte.co.uk/climatechange

Changes to accounting standards

IFRS 16 - Leases

Background

The implementation of the new standard has been deferred again for another year, with a revised implementation date of 2022/23 and will require adjustments to recognise on balance sheet arrangements currently treated as operating leases.

For 2021/22, SFRS will need to include disclosures on the expected impact of the standard, but not make any adjustments in the financial statements in respect of IFRS 16. However, many organisations have identified previously unidentified leases (or arrangements that contain a lease, such as service contracts) as part of their transition project, and so there may be some 2021/22 impact.

Separate to the financial reporting impact, but potentially more critical, budgets for 2022/23, particularly capital budgets, will need to reflect the impact of the new standard (and require submissions well ahead of year-end).

In the central government context relatively small effects from standards can have a significant impact against performance metrics and targets, and so it is important to clearly understand the impact of the standards.

While the deferral of implementation means there is no direct impact on the 2020/21 annual accounts, finance teams should use this additional time to continue their preparation for implementation.

Next steps

We recommend that the ARAC review the impact of IFRS 16, including calculating any adjustments that will be required as at 31 March 2022 for transition. We would suggest that the ARAC receive reporting from management on the implementation of the new standard, and we will report specifically on the findings from our audit work in this area.

Changes to the Government Financial Reporting Manual (FReM)

2020/21 Edition

Background

HM Treasury has issued a revised version of the FReM for the financial year 2020/21. The FReM is the technical accounting guide to the preparation of financial statement and complements guidance on the handling of public funds published by the Scottish Government.

The 2020-21 edition has a revised structure and is now separated into four sections:

- Part A: Principles, purpose and best practice.
- Part B: The form and content of government annual report and accounts.
- Part C: Application of accounting standards to government annual report and accounts.
- Part D: Further guidance for government annual report and accounts.

Other changes include:

- A new chapter addressing best practice in narrative reporting.
- Clearer guidance on the performance report, including specific mandatory requirements.
- Introduction of ‘comply or explain’ requirements in certain areas including the structure of the organisation, risks faced, unit cost data and relevant trend data.

A full amendments log has been published which explains the changes from 2019/20 and the reason for the change https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/853244/2020-21_Amendment_Record.pdf

In response to the continuing impact of COVID-19, HM Treasury has issued an addendum setting out minimum requirements for 2020/21. The addendum permits, but does not require, bodies to omit the performance analysis section of the Performance Report. Where relevant performance information has already been published elsewhere, bodies are encouraged to refer to the relevant publications. In addition, where unaudited information otherwise required to be included in the Accountability Report is already published elsewhere, bodies are permitted to refer to the relevant publication rather than including the information in their Accountability Report.

- Next steps

We recommend that management review the changes to the FReM at the earliest opportunity, including the addendum. In particular the new chapter on narrative reporting best practice and the guidance on the performance report should be reviewed to understand the mandatory requirements and those which require to ‘comply or explain’. This can then be compared with the published 2019/20 annual report and accounts to identify any amendments required. We are happy to have early discussion on this to agree proposed amendments.

The State of the State 2020-21

Government in the pandemic and beyond

Background and overview

Now in its ninth year, this report brings together Deloitte and Reform to reflect on new research into the issues facing government and public sector across the UK. This year, that research focuses on the impact of the coronavirus pandemic both on the public sector and the public it services. It comes as all nations of the UK face new lockdown measures designed to reduce transmission, manage demand on health services and ultimately saving lives.

At the heart of the report is our exclusive citizen survey, which offers insight into perceptions of public services and public spending beyond COVID-19, as well as a public perspective on the government's 'levelling up' agenda.

That survey is complemented by our interviews with public sector leaders. This year, we spoke to 40 senior figures in government and public services, producing the most extensive qualitative research of its kind.

Next steps

A summary of the key conclusions are provided on the next page. The full report is available at https://www2.deloitte.com/content/dam/Deloitte/uk/Documents/public-sector/deloitte-uk-state-of-the-state-2020.pdf

The State of the State 2020-21 (continued)

Government in the pandemic and beyond (continued)

The state according to the public

A survey of more than 5,000 members of the public shows how people feel about tax, spending and public service priorities amid the COVID-19 pandemic. We also explore attitudes towards data sharing with and across government, and unpick what the public across each nation and region wants to see levelled up.

58% of the public believe opportunities for young people will be worse as a result of coronavirus.

42% of the public believe that community spirit will have improved after the pandemic.

The state according to the people who run it

Over 40 senior public sector figures in England, Scotland, Wales and Northern Ireland talked with us about the issues that matter to them. We explore their views on the legacy of COVID-19, levelling up, EU Exit and creating a data-driven government.

Our interviews of **40** senior public sector figures found that many want to retain the agility of new ways of working; however, many sense a gravitational pull back to normality.

Fast forward to the past

Is automation making organisations less diverse?

Background and overview

Robotics and intelligent automation are in the process of transforming the nature of work and the skills required to do it. Whilst there is a clear risk of reinforcing structural inequalities there is also an opportunity to address diversity issues within automation programmes to ensure public sector organisations can capitalise on the benefits that both automation and diversity bring to business outcomes.

For many public sector organisations, implementing automation whilst considering diversity, is new and unchartered territory. We would like to encourage our public sector clients to consider and discuss this crucial issue.

Based on exclusive client interviews, insight from public sector projects and extensive desk research, our report explores the potential risks of not considering the implications of automation on workforce diversity and inequality. It also identifies the barriers to embedding diversity in automation programmes.

The report provides a practical four stage framework to integrate diverse groups to not only survive but thrive in a new automated and digital world.

Next steps

The full report is available at https://www2.deloitte.com/content/dam/Deloitte/uk/Documents/public-sector/deloitte-uk-diversity-and-automation-brochure-landscape.pdf

Appendices

Prior year audit adjustments

Uncorrected misstatements

The following uncorrected misstatements were identified during the course of our prior year audit. The net impact of these was an increase of £2.715m in the net expenditure for the period.

		Debit/ (Credit) SOCNE £m	Debit/ (Credit) SOCITE £m	Debit/ (Credit) Net Assets £m	Debit/ (Credit) Reserves £m
Misstatements identified in prior year					
Pension liability understatement	[1]	2.715	(2.715)	(2.715)	2.715
Total		**2.715**	**(2.715)**	**(2.715)**	**2.715**

(1) Judgemental understatement of pension liability due to post year-end developments relating to the Goodwin Judgement, Guaranteed Minimum Pension (GMP), and errors in the Local Government Pension Scheme (LGPS) net investment assets identified by the pension fund auditors.

We obtained written representations from SFRS confirming that after considering all these uncorrected items, both individually and in aggregate, in the context of the annual accounts taken as a whole, no adjustments were required.

Our other responsibilities explained

Fraud responsibilities

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 risks of material misstatement due to fraud in relation to operating within the expenditure resource limit, and management override of controls.
- We will explain in our audit report how we considered the audit capable of detecting irregularities, including fraud. In doing so, we will describe the procedures we performed in understanding the legal and regulatory framework and assessing compliance with relevant laws and regulations.

Whilst this requirement has been in place for a few years for public interest entities (as defined by the EU Audit Regulation), recent changes to ISAs (UK) mean it will apply to **all** entities for periods **commencing on or after 15 December 2019.**

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.

Our other responsibilities explained (continued)

Fraud responsibilities (continued)

We will make the following inquiries regarding fraud and non-compliance with laws and regulations:

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 risks of fraud.
- Management’s communication, if any, to those charged with governance regarding its processes for identifying and responding to the risks of fraud.
- 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.
- We plan to involve management from outside the finance function in our inquiries, in particular Legal Services.

Internal audit

- Whether internal audit 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), 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 SFRS and will reconfirm our independence and objectivity to the ARAC for the year ending 31 March 2021 in our final report to the ARAC.
Fees	The proposed audit fee for 2020/21, in line with the fee range provided by Audit Scotland is £106,070, as analysed below. Auditor remuneration — £82,790 Audit Scotland fixed charges: Pooled costs — 19,060 Audit support costs — 4,220 **Total proposed fee — 106,070*** There are no non-audit services fees proposed for the period. *Deloitte are currently discussing the utilization of Deloitte Connect with management and any fee impact that this might have.
Non-audit services	In our opinion there are no inconsistencies between the FRC's Ethical Standard and the company's policy for the supply of non-audit services or any apparent breach of that policy. We continue to review our independence and ensure that appropriate safeguards are in place 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 SFRS, its directors, senior managers and affiliates, and have not supplied any services to other known connected parties.

Fee analysis:

	£
Auditor remuneration	82,790
Audit Scotland fixed charges:	
Pooled costs	19,060
Audit support costs	4,220
Total proposed fee	**106,070***

Our approach to quality

AQR team report and findings

Audit quality remains our number one priority and we have a relentless commitment to it. We continue to invest in and enhance our Audit Quality Monitoring and Measuring programme.

In July 2020 the Financial Reporting Council ("FRC") issued individual reports on each of the seven largest firms, including Deloitte, on Audit Quality Inspections providing a summary of the findings of its Audit Quality Review ("AQR") team for the 2019/20 cycle of reviews.

We greatly value the FRC reviews of our audit engagements and firm wide quality control systems, a key aspect of evaluating our audit quality.

We are pleased with our results for the inspections of FTSE 350 entities achieving 90% assessed as good or needing limited improvement, which included some of our highest risk audits. Our objective is for 100% of our audits to be assessed as good or needing limited improvement and we know we still have work to do in order to meet this standard. We are however, extremely disappointed one engagement received a rating of significant improvements required during the period. This is viewed very seriously within Deloitte and we have worked with the AQR to agree a comprehensive set of swift and significant firm wide actions.

We are also pleased to see the impact of our previous actions on prior year adjustments reflected in the results of current year inspections with no findings in these areas. In addition the FRC identified good practice examples including in: risk assessment, group oversight, our comprehensive IFRS9 expected credit loss audit programme and our audit committee reporting.

Embedding a culture of challenge in our audit practice underpins the key pillars of our audit strategy. We invest continually in our firm wide processes and controls, which we seek to develop globally, to underpin consistency in delivering high quality audits whilst ensuring engagement teams exercise professional scepticism through robust challenge.

All the AQR public reports are available on its website. https://www.frc.org.uk/auditors/audit-quality-review/audit-firm-specific-reports

Our approach to quality (continued)

AQR team report and findings (continued)

The AQR's 2019/20 Audit Quality Inspection Report on Deloitte LLP

"We reviewed 17 individual audits this year and assessed 13 (76%) as requiring no more than limited improvements. Of the ten FTSE 350 audits we reviewed this year, we assessed nine (90%) as achieving this standard."

"We have highlighted in this report aspects of firm-wide procedures which should be improved, including strengthening the monitoring of the firm's audit quality initiatives."

"Our key findings related principally to the need to:

- Improve the extent of challenge over cash flow forecasts in relation to the impairment of goodwill and other assets.
- Enhance the effectiveness of substantive analytical review and other testing for revenue.
- Improve the assessment and extent of challenge regarding management's estimates, particularly for model testing."

"The firm has taken steps to address the key findings in our 2019 public reports, with actions that included focused training and standardising the firm's audit work programs. We have identified improvements, for example in the audit of potential prior year adjustments and related disclosures, a key finding last year. We also identified good practice in a number of areas of the audits we reviewed (including effective group oversight and robust risk assessment) and in the firm-wide procedures (including the firm's milestone program, with expected dates for the phasing of the audit monitored by the firm)."