KPMG 150 years supporting the UK

Scottish National Investment Bank Plc

Report to the Audit Committee

Audit plan and strategy for the period ending 31 March 2021

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Report Date: 27 May 2021

Meeting Date: 1 June 2021

Introduction

About this report

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

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

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

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

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

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Introduction (Continued)

To the Audit Committee of Scottish National Investment Bank Plc

We are pleased to have the opportunity to meet with you on 1 June 2021 to discuss our audit of the financial statements of Scottish National Investment Bank Plc ("SNIB") and its subsidiaries ("the Group") as defined on page 6, as at and for the period ended 31 March 2021.

This report outlines our initial risk assessment and planned audit approach. Given the timing of our appointment, we have not yet completed all of our planning and risk assessment procedures and the audit approach may need to be revised. If there are any deviations from this Audit Plan these will be communicated to you in our Audit Highlights Memo at completion of the audit.

The engagement team

I am the engagement lead on the audit and am responsible for the audit opinion. I have over 20 years of experience with KPMG in the financial services industry and this will be my first year signing the audit opinion.

Other key members of the engagement team include Nina Aslibekyan (Senior Manager) with 7 years of experience.

Refer to page 14 for the team bios.

Scope definition

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

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

We will also perform work in accordance with the wider responsibilities embodied in the Code of Audit Practice approved by the Commission and the Auditor General (see page 35).

How we deliver audit quality

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

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

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

Yours sincerely,

Philip Merchant

27 May 2021

Overview of planned scope including materiality

Our materiality levels

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

Materiality is calculated as £710k based on 2.5% of total assets of £28.5m per the draft trial balance as at 31 March 2021. Materiality figures will be revised when the period end position is finalised.

To respond to aggregation risk from individually immaterial misstatements, we design our procedures to detect misstatements at a lower level of materiality, £460k.

Materiality

£710k
Materiality for the financial statements as a whole

£460k
Procedures designed to detect individual errors

£35k
Misstatements reported to the Audit Committee

We will report misstatements to the audit committee including:

- Corrected and uncorrected audit misstatements above £35k.
- Errors and omissions in disclosure (corrected and uncorrected).
- Other misstatements we include due to the nature of the item.

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

Control environment

We will execute a substantive audit approach as the most effective and efficient method of addressing the identified risks of material misstatement. We will test the design and implementation of controls over journal entries (see page 7). We will assess the impact of the COVID-19 pandemic on our planned audit approach (refer to page 16 for potential impacts).

Timing of our audit and communications

We will maintain communication led by Phil and Nina throughout the audit. We set out below the form, timing and general content of our planned communications:

- Audit committee meeting on 1 June 2021 where we present our initial audit plan;
- Status meetings with management throughout the duration of our fieldwork in June-August 2021;
- Audit committee meeting on 24 August 2021 where we communicate the findings of our work, any audit misstatements and significant control deficiencies.

A timeline is included in the appendix.

Our fees

We have provided a separate update on our proposed fees for 2021 audit to the directors and will be happy to discuss the proposed fees at the meeting.

Significant risks and other areas of audit focus

Our risk assessment draws upon our understanding of the business obtained during acceptance and planning procedures, knowledge of the industry and the wider economic environment in which SNIB operates.

We will use our planning meetings with senior management to update our understanding.

The risk map shows the identified significant risks and other areas of audit focus.

Due to the unprecedented levels of uncertainty there is an increased likelihood of significant risks emerging throughout the audit cycle that are not identified (or in existence) at the time we planned our audit. Where such items are identified we will amend our audit approach accordingly and communicate this to the Audit Committee.

Significant risks

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

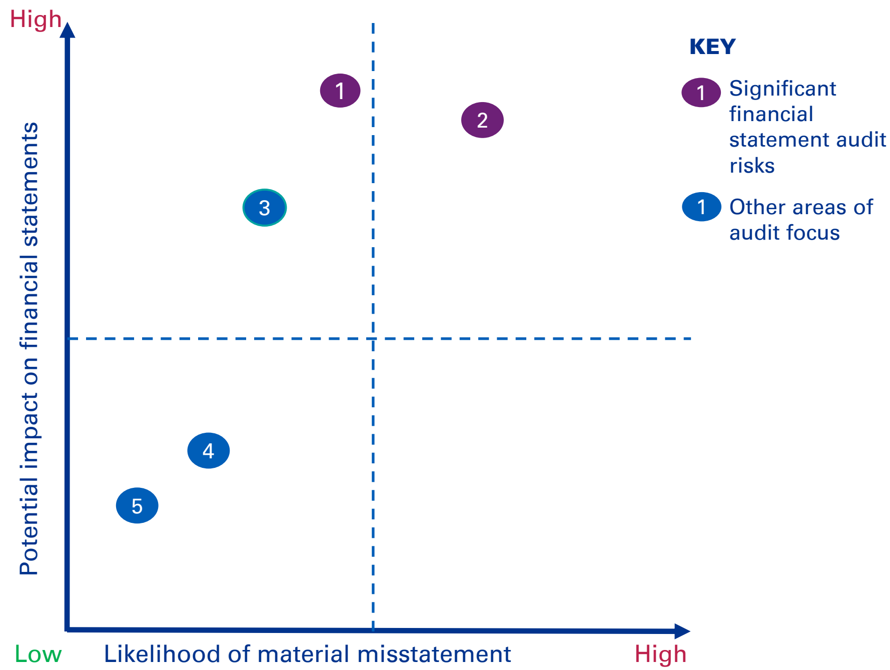
Valuation of unlisted investments is considered to be a significant risk due to a significant estimation uncertainty around the valuations and further complexity in relation to macroeconomic factors.

Going concern

We consider COVID-19 risks in context of going concern assessment rather than as a separate risk, we do not consider going concern to be a significant risk.

Cash

We have included cash as an other area of audit focus in recognition of the increased scrutiny over the risk of existence of cash balances following recent market events.



Significant Risks
1 Management override of controls
2 Valuation of unlisted investments

Other Areas of Audit Focus
3 Going concern and the impact of COVID-19
4 Expenses
5 Cash

Group scoping

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

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

	Scottish National Investment Bank plc (Parent)	Scottish Investments Limited (SIL)	Scottish Investments Services Limited (SISL)
Significant Risks			
1. Management override of controls	Y	Y	Y
2. Valuation of unlisted investments		Y	
Other Areas of Audit Focus			
3. Going concern and the impact of COVID-19	Y	Y	Y
4. Expenses			Y
5. Cash	Y	Y	Y

Audit risks and our audit approach

1 Management Override of Controls [a]

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

Significant audit risk

The risk

- Professional standards require us to communicate the fraud risk from management override of controls as significant.
- Management is in a unique position to perpetrate fraud because of their ability to manipulate accounting records and prepare fraudulent financial statements by overriding controls that otherwise appear to be operating effectively.
- We have not identified any specific additional risks of management override relating to this audit.

Planned response

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

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

Audit risks and our audit approach (continued)

2 Valuation of unlisted investments

Risk that the carrying value of unlisted investments is materially misstated

Significant audit risk

The risk

- The Group's portfolio of unlisted investments makes up over 80% of the total assets (based on the draft trial balance as at 31 March 2021). Unlisted investments are measured at fair value, which is established in accordance with the International Private Equity and Venture Capital Valuation Guidelines by using measurements of value such as prices of recent orderly transactions, earnings multiples and net assets. There is a significant risk over the judgement and estimates inherent in the valuation and therefore one of the key areas that our audit will focus on.
- The effect of these matters is that, as part of our risk assessment, we determined that the valuation of unlisted investments has a high degree of estimation uncertainty, with a potential range of reasonable outcomes greater than our materiality for the financial statements as a whole.

Planned response

- **Methodology choice:** In the context of observed industry best practice and the provisions of the International Private Equity and Venture Capital Valuation Guidelines, we will challenge the appropriateness of the valuation basis selected;
- **Our valuations experience:** We will challenge management on key judgements affecting investee company valuations, such as the choice of benchmark for earnings multiples. We will compare key underlying financial data inputs to external sources, investee company audited accounts and management information as applicable. We will challenge the assumptions around sustainability of earnings based on the plans of the investee companies and whether these are achievable. Our work will include consideration of events which occur subsequent to the period end up until the date our audit report;
- **Comparing valuations:** Where a recent transaction is used to value a holding, we will obtain an understanding of the circumstances surrounding the transaction and whether it is considered to be on an arm's length basis and suitable as an input into a valuation;
- **Our Corporate Finance expertise:** To incorporate the increased valuation uncertainty, arising from Covid-19, we will consider requesting the expertise of KPMG Corporate Finance specialists to assist the audit team in qualitatively assessing the valuation method for a selection of unlisted investments and the appropriateness of the valuation approach in considering COVID-19 impact on unlisted investments; and
- **Assessing transparency:** We will consider the appropriateness, in accordance with relevant accounting standards, of the disclosures in respect of unlisted investments and the effect of changing one or more inputs to reasonably possible alternative valuation assumptions.
- Additional considerations are required in line with the revised UK auditing standard for Estimates, ISA UK 540, as notes on pages 21 to 22 of this report.

Audit risks and our audit approach (continued)

3 Going concern

Ability of the business to continue as a going concern

Significant audit risk

The risk

- Management's assessment of the Group's ability to continue as a going concern involves consideration of all factors affecting the Group, including the impact of COVID-19.
- There is a risk that management's assessment of the Group's ability to continue as a going concern does not appropriately consider the impact of the COVID-19 pandemic, including plausible but severe downside scenarios on the dividend income of the Company and carrying value of assets.
- The risk that disclosures in the financial statement and the annual report are not adequate with regard to the effect of COVID-19 risks on the Company's financial position, performance, business model and strategy.

Planned response

- Evaluate how management's risk assessment process identifies business risks relating to events and conditions that may cast significant doubt on the ability to continue as a going concern (refer to page 19 for the new Going Concern Standard requirements);
- Evaluate any models management uses in its assessment and evaluate how the information system captures events and conditions that may cast significant doubt on ability to continue as a going concern;
- Evaluate whether management's assessment has failed to identify events or conditions that may cast significant doubt on going concern and whether the method used by management is appropriate;
- Assess management's going concern assessment including the plausible but severe downside scenarios particularly whether those downside scenarios reflect plausible impacts of COVID-19 on the business;
- Evaluate whether sufficient and appropriate audit evidence has been obtained to conclude whether a material uncertainty exists and the appropriateness of management's use (or otherwise) of the going concern basis of accounting;
- Evaluate whether there is adequate support for the assumptions underlying management's assessment, whether they are realistic and achievable and consistent with the external and/or internal environment and other matters identified in the audit;
- Challenge management's plans for future actions, and verify the reliability and relevance of data used. Determine whether the outcome of these plans is likely to improve the situation and whether management's plans are feasible;
- Additional effort is required in line with the revised UK auditing standard for Going Concern, ISA UK 570, as notes on pages 19 and 20 of this report.

Audit risks and our audit approach (continued)

4 Expenses

Expenses may be materially misstated

Other areas of audit focus

The risk

- Expenses could be recorded in the incorrect period (cut-off), at the incorrect amount (accuracy) or not recorded at all (completeness).
- We expect that as the Group builds up their investment portfolio expenses will become immaterial and will be removed from other areas of audit focus.

Planned response

- We will trace a sample of administrative expenses and staff costs transactions back to the supporting documentation and to bank statements.
- We will review a sample of payments made post period end to identify expenses that may have been omitted in the period.

Audit risks and our audit approach (continued)

5 Cash

Cash balances may be materially misstated.

Other areas of audit focus

The risk

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

Planned response

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

Wider scope

Approach

We are required to assess and provide conclusions in the Annual Audit Report in respect of four wider scope dimensions: financial sustainability, financial management, governance and transparency and value for money. We set out below an overview of our approach to wider scope requirements of our annual audit. We will provide narrative on these and other areas in the Annual Audit Report where relevant.

Risk assessment

We consider the relevance and significance of the potential business risks faced by public bodies, and other risks that apply specifically to SNIB. These are the significant operational and financial risks in achieving statutory functions and objectives, which are relevant to auditors' responsibilities under the Code of Audit Practice. In doing so, we consider:

- SNIB's own assessment of the risks it faces, and its arrangements to manage and address those risks;
- any work of other stakeholders; and
- the impact that COVID-19 has had during the year.

Identification of significant risks

The Code identifies a matter as significant if, in the auditor's professional view, it is reasonable to conclude that it would be of interest to the audited body or the wider public.

Significance has both qualitative and quantitative aspects.

If we identify any significant wider scope risks, we will highlight the risk to SNIB and consider the most appropriate audit response in each case, including to consider the results of work by SNIB and other stakeholders.

Concluding on wider scope

At the conclusion of the wider scope procedures we will consider the results of the work undertaken and assess the assurance obtained against each of the wider scope audit dimensions.

If any issues are identified that may be significant to this assessment, and in particular if there are issues that indicate we may need to consider qualifying our wider scope conclusion, we will discuss these with management as soon as possible. Such issues will also be considered more widely as part of KPMG's quality control processes, to help ensure the consistency of auditors' decisions.

Reporting

Our wider scope risk assessment is in progress. At this stage, we have not identified any significant risks relating to wider scope. We will update our assessment throughout the year and should any issues present themselves we will report them in our Annual Audit Report.

We will report on the results of our work in relation to wider scope through our Annual Audit Report. This will summarise any specific matters arising, and the basis for our overall conclusion.

Appendices

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Professional and Industry Experience

Phil has over 20 years of experience in Financial Services with KPMG. He is head of the Financial Services audit practice in Scotland and has a range of assurance and advisory experience across the investment management and banking sectors.

Phil's primary responsibility is to provide audit services to his Financial Services client base including statutory audits, CASS audits and controls reports. Phil's clients include asset managers, listed investment trusts and VCTs, authorised funds, pension schemes and private equity managers and funds.

Representative Clients

— BMO Asset Management

— Aberdeen Standard Investments

— Investment Trusts managed by ASI, Invesco, Premier Miton and AVI

Education, Licenses & Certifications

— Bachelor of Accountancy (Honours), University of Glasgow

— Member of The Institute of Chartered Accountants of Scotland

Nina Aslibekyan, Senior Manager

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Professional and Industry Experience

Nina has 7 years of experience in Financial Services with Big-4 accounting firms. Nina's portfolio includes statutory and CASS audit engagements to a variety of clients across financial services including asset managers and listed investment trusts and VCTs.

Representative Clients

— BMO Asset Management

— Aberdeen Standard Investments

— Investment Trusts managed by ASI, Baillie Gifford and BMO

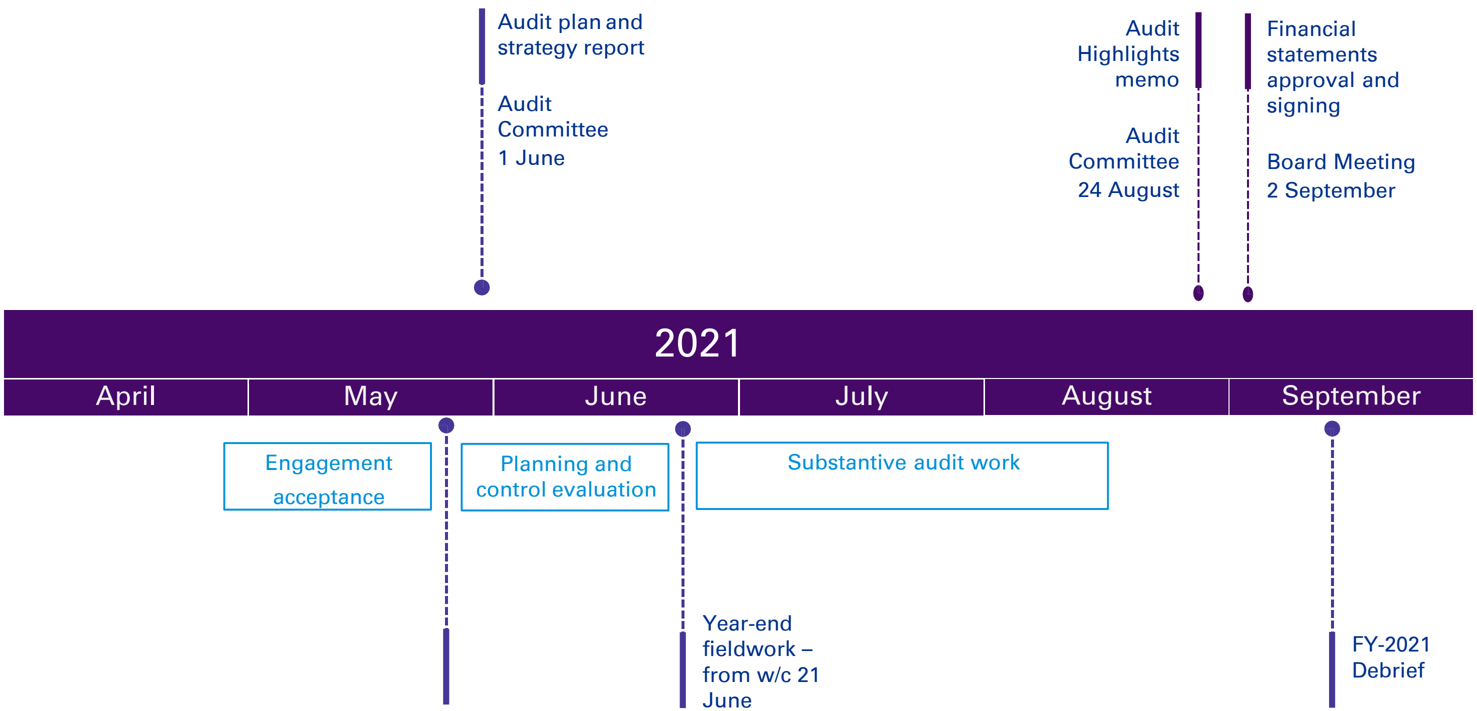
— Northern Venture Capital Trusts

Education, Licenses & Certifications

— BSc Economics and Finance, University of London

— ACCA

Timeline



Audit plan and strategy report
Audit Committee 1 June
Audit Highlights memo
Audit Committee 24 August
Financial statements approval and signing
Board Meeting 2 September
2021
April
May
June
July
August
September
Engagement acceptance
Planning and control evaluation
Substantive audit work
Year-end fieldwork – from w/c 21 June
FY-2021 Debrief

COVID-19: Audit implications

SNIB is directly and indirectly impacted by the COVID-19 coronavirus pandemic, and the increased economic uncertainty and risk may have significant accounting and disclosure implications.

The table below identifies the specific areas of our audit that are expected to be affected by the COVID-19 pandemic, and how our audit may differ from the prior year. We expect to engage in more frequent communications with the audit committee and management due to the increased risks of material misstatement, the anticipated challenges in completing our audit and the rapidly developing events.

Planned scope and timing **See page 4**	– Given the rapidly changing environment, the scope and timing of our audit may need to be modified further to respond to new events or changing conditions. If we make significant changes, then we will communicate these to you.
Subsequent events disclosures	– Due to the rapidly evolving situation, determining whether subsequent events should be reflected (adjusting) vs. disclosed (non-adjusting) in the financial statements may require significant judgement, and more subsequent events are likely to be identified. – Our audit procedures will be adjusted to respond to the increased risks of material misstatement.
Accounting estimates **See page 21**	– The risk of material misstatement relating to fair values of unlisted investments may be heightened due to the degree of estimation uncertainty resulting from current economic conditions. – To assess the risks, we will understand how management has understood the range of possible measurement outcomes, selected reasonable assumptions (including considering alternatives) and data sources and selected a point estimate and the related disclosures for the financial statements. – We will evaluate the methods, assumptions and data used to derive the estimates for fair value to obtain evidence that they are appropriate in the context of the financial reporting framework and are, when appropriate, based on conditions and events at the measurement date. We will consider whether management has appropriately addressed the increased estimation uncertainty when selecting the point estimate. – We may increase the involvement of KPMG specialists to assist in these evaluations. – We will evaluate whether related disclosures comprise required disclosures, including significant assumptions about the future and other major sources of estimation uncertainty, and whether they include the information necessary to achieve the fair presentation of the financial statements as a whole. – We will communicate our views about significant qualitative aspects of accounting estimates.

COVID-19: Audit implications (continued)

Going concern **See pages 9 and 19**	– Management's assessment of the entity's ability to continue as a going concern may be more challenging due to the unprecedented level of uncertainty about future economic conditions and earnings, particularly in the shorter term. – Macroeconomic risks (downgrading of UK credit rating by Fitch, reduction of base interest rate, revised economic growth forecasts, increased market volatility) have to be monitored closely for any impact on Company's reporting, going concern etc. – Sensitivity analysis and stress-testing will be performed to support going concern with a reasonable range of negative scenarios resulting from COVID-19 reflecting the risks outlined. – The rapidly changing conditions, our enhanced procedures under the revised ISA (UK) 570 on your risk assessment process and fact that we need to perform procedures through to the date of the auditors' report will mean significantly more audit effort in this key area.

Obtaining sufficient appropriate audit evidence	– We will liaise with management closer to time, however there may be delays to the completion of our audit to enable us to obtain sufficient appropriate audit evidence to support our audit opinion. For example, we may need additional time to:
	    – modify our audit procedures when expected audit evidence is unavailable;
	    – obtain more persuasive audit evidence when evaluating management's assessment of the entity's ability to continue as a going concern; or
	    – collate external confirmations or perform alternative audit procedures.
	– We will need to consider the implications for our audit opinion if we are unable to obtain sufficient appropriate audit evidence to conclude that the financial statements as a whole are free from material misstatement.

Reporting Timelines	– The reporting may be affected as per FRC guidance or by disruptions to the audit process.
Front Half disclosures	– Companies should consider the possible impact of COVID-19 on their business in their reporting of emerging and principal risks and uncertainties. Where mitigating actions can be taken, these should also be reported alongside the description of the risk itself.
Operational risks and disruption to the business, third party dependency	– As part of the governance and internal controls performed by the Board, the Board will need to consider the increased operational risk, service levels, KPI's and business continuity plans as well as any changes to or increases in the frequency of reporting and attestations it seeks from the key service organisations in the execution of its internal controls and oversight obligation. The activities of the Board in this area will need to be considered by us as part of the audit in our considerations of the Board's oversight of internal controls.

Confirmation of independence

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

To the Audit Committee

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

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

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

— general procedures to safeguard independence and objectivity;

— independence and objectivity considerations relating to the provision of non-audit services; and

— independence and objectivity considerations relating to other matters.

General procedures to safeguard independence and objectivity

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

— instilling professional values;

— communications;

— internal accountability;

— risk management;

— independent reviews.

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

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

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

Application of the FRC Ethical Standard 2019

That standard became effective for the first period commencing on or after 15 March 2020, except for the restrictions on non-audit and additional services that became effective immediately at that date, subject to grandfathering provisions.

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

Confirmation of audit independence

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

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

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

Yours faithfully

KPMG LLP

KPMG LLP

Revision to the Going Concern auditing standard (1)

In September 2019 the FRC published a revised UK auditing standard for Going Concern ISA UK 570. This responds to recent enforcement cases and well-publicised corporate failures where the most recent auditor's report had not included a material uncertainty on going concern. The revised standard is applicable for periods commencing on or after **15 December 2019**, including short periods**.**

The key changes

The key changes in comparison to the current standard are:

- Enhanced coverage of going concern in the audit report, including:
  - A positive statement from the auditor that the use of the going concern basis is appropriate and the auditor has not identified a material uncertainty on going concern.
  - For listed companies and certain others (including large private companies) an explanation (similar to a key audit matter) of how the auditor evaluated management’s assessment and key observations.
- More detailed audit requirements on risk assessment procedures, including on the entity and its environment; the applicable financial reporting framework; and the entity’s system of internal control.
- Additional audit procedures when events or conditions are identified which have not been identified or disclosed to the auditors by management.
- Under the new standard detailed substantive procedures will be required in all cases, whereas in the current standard there are reduced requirements if no events or conditions are identified that may cast significant doubt on the entity’s ability to continue as a going concern.
- For UK Corporate Governance Code adopters, additional audit procedures on the viability statement.
- Requirement to consider reporting material uncertainties to external regulatory and enforcement authorities.

The engagement team will discuss the requirements of the Company under this standard with management during audit planning.

Revision to the Going Concern auditing standard (2)

Change	Impact on your processes	Impact on our audit procedures
Risk assessment procedures and related activities	For many entities, it is likely that the controls over going concern will need to be improved to provide the increased level of detail required by the audit team. Where this isn't provided, it is likely that control deficiencies will be identified.	In addition to work which the auditor previously undertook understanding the entity and its environment, the new standard requires auditors to perform more detailed risk assessment procedures including specific work on the entity's system of internal control and risk assessment processes as the specifically pertain to going concern.
Removal of the gateway to assess whether events or conditions exist	For many entities this will entail greater granularity in their going concern assessments and more detailed consideration of the impacts of plausible downside scenarios.	The auditor will perform an evaluation of management's going concern assessment in all cases, not only when events or conditions which may cast significant doubt as to the entity's ability to continue as a going concern have been identified.
Increased challenge due to change in emphasis in the report	We will expect you to have appropriately designed, performed and documented your assessment of Going Concern. As a result of the changes to the audit, you may see a need and an opportunity to improve the quality of your process and documentation	The FRC intends that auditors increase their scrutiny of going concern. Whilst much of our detailed work will remain unchanged with continued emphasis to robustly challenge management's assessment of going concern which includes thoroughly testing the adequacy of the supporting evidence, evaluating the risk of management bias. The change in the nature of the report is likely to result in more challenges being raised.
Specified procedures on viability reports and potential impact on going concern periods	This may require the company to prepare more robust cash flow forecasts covering the whole period of the viability statement.	Whilst the standard does not per se change the going concern period, which remains at a minimum of 12 months, It includes more specific procedures on the viability statement. In addition, where events and conditions beyond 12 months but within the period covered by the viability statement, are identified, the auditor may need to extend their going concern considerations and detailed work over the full period of the viability statement.

Adoption of ISA 540 (Revised) *Auditing Accounting Estimates and Related Disclosures*

We expect the changes summarised below to impact our work over valuation of unlisted investments.

Impact of key changes in ISA 540 (Revised)

Key change	Impact on the audit team	Impact on management
More emphasis on the need for the auditor to exercise professional scepticism	We perform audit procedures in a manner that is not biased toward obtaining audit evidence that may be corroborative or toward excluding audit evidence that may be contradictory. We consider all information obtained and whether it corroborates or contradicts management's judgements and decisions regarding accounting estimates.	We may increasingly challenge aspects of how management derive the accounting estimates
More granular assessments regarding the risk accounting estimates are materially misstated	We first consider the conditions and events that are likely to cause management's accounting estimates to be materially misstated. We then consider whether the system of internal control management have designed and implemented is likely to prevent material misstatements, or if a material misstatement occurs, is likely to detect and correct it.	We may place more emphasis on obtaining an understanding of the nature and extent of management's estimation process and key aspects of the related policies and procedures.
Focus on appropriately responding to the levels of estimation uncertainty, complexity and subjectivity in accounting estimates	For each identified risk of material misstatements relate to the accounting estimate, we assess the degree of estimation uncertainty, complexity, and subjectivity involved in making that accounting estimate to determine the level of audit response.	If we determine the risk of the accounting estimate being materially misstated is higher, the work effort will increase, which in turn will likely impact how much, and the type of, information management need to provide us.

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Adoption of ISA 540 (Revised) *Auditing Accounting Estimates and Related Disclosures*

Impact of key changes in ISA 540 (Revised)		
Key change	**Impact on the audit team**	**Impact on management**
Audit work effort based on the selected approach(es) (testing management's process, developing own estimate, subsequent events), including a more detailed understanding of the significant matters considered in making key judgments and decisions affecting accounting estimates	Our audit response is more specifically directed at the components of an accounting estimate. These include methods (including models), assumptions and data, including our understanding and documentation of key elements of the entity and its environment, the linkage of audit procedures to the assessed risks, and significant judgments relating to our determination of whether the accounting estimates and related disclosures are reasonable.	Management may use experts to assist with the related work during the audit and need to document key judgments and decisions to provide a basis for more efficient and effective discussions between management and us.
More emphasis on auditing accounting estimate disclosures in the financial statements	In particular, we focus on the sufficiency of disclosures regarding estimation uncertainty.	More information on disclosures related to estimation uncertainty was requested from management.
More detailed written representations	We request written representations from management regarding the reasonableness of the methods, significant assumptions and the data used in determining the monetary amounts of accounting estimates, including the related disclosures, in accordance with the applicable financial reporting framework. We also consider and requested representations about specific accounting estimates, including in relation to the methods, assumptions, or data used.	New or changed representations included compared with previous years.

FRC's areas of focus

The areas of focus from the FRC's Annual Review of Corporate Reporting 2019/20, annual letter to CEOs, CFOs and audit committee chairs along with five thematic reviews issued in 2020 should be considered for reporting in the current financial period. The reports identify where the FRC believes companies should be improving their reporting.

Covid-19 and Brexit	Disclosures should address risk, judgement and uncertainty in the face of the ongoing impact of Covid-19, and geopolitical tensions. Covid-19 disclosures should be sufficient for users to understand the impact on a company's performance, cash flows and financial position. Investors expect clear information around: available cash and other resources; key actions management has taken or is planning; the longer term impacts on the business model; and the board's assessment of going concern and viability. Regarding the impact of the UK's EU exit, the FRC expects companies to explain company-specific risks and uncertainties, including the potential impacts on different parts of their business and financial statement effects.
Forward-looking information	Disclosure of forward-looking information should be specific to the entity and provide insights into the board's assessment of business prospects and the methods and assumptions underlying that assessment. A clear explanation of any material changes in the business model should be provided and should be appropriately reflected in the financial statement disclosures of, for example, operating segments, or the allocation and impairment testing of goodwill.
Improving the quality of annual reports	Boards should take a step back and consider the disclosure objectives of accounting standards and legislation when evaluating the quality of their reports and the needs of investors. The FRC expects companies to perform more robust reviews prior to issuing their Annual reports to avoid basic errors.
Going concern	Going concern disclosures should explain the basis of any significant judgements, including whether there are any associated material uncertainties, and the matters considered when confirming the preparation of the financial statements on a going concern basis including availability of cash, undrawn facilities and compliance with covenants. Consistency should exist between the business model, going concern disclosures, the viability statement and financial statement assumptions and estimates, notably for impairment testing at group and parent company level.
Judgements and Estimates	Companies need to critically assess whether their company specific disclosures about significant judgements applied in the preparation of the financial statements, sources of estimation uncertainty and other assumptions made, enable users to understand management's exercise of judgement and views about the future. The FRC noted a lack of quantification of estimation uncertainties were a hinderance to achieving this.

FRC's areas of focus (continued)

Alternative Performance Measures (APMs)	'Adjusted for Covid-19' alternative performance measures should only be necessary in exceptional circumstances. Allocation of items such as impairment charges between Covid-19 and non-Covid-19 are likely to be highly subjective and therefore generally unreliable. APM disclosure should provide rationale for APMs (including multi-year restructuring programmes), avoid over-prominence being given to APMs and ensure appropriate reconciliations and labelling are provided.
Impairment of Assets	Users of accounts are likely to have a focus on impairment in the light of the economic effects of the Covid-19 pandemic. Impairment disclosures need to be more transparent and company specific. Where impairment indicators are present the disclosures should indicate whether impairment tests have been performed including the approach taken where parent company net assets are assessed for impairment. Improvements in the quantified disclosures of key assumptions applied in calculating the recoverable amount are also sought.
Revenue	Provide clear descriptions of performance obligations, the timing of revenue recognition (including variable consideration) and explanations of any significant judgements made by management. Ensure the accounting policies provide a clear understanding of how the requirements of the standard have been applied to their own particular circumstances.
Financial risk management and cash flow disclosures	Disclosures should provide an understanding of the company's financial risk management, particularly the potential impact of debt covenants on liquidity and the use of factoring and reverse factoring in working capital financing. Cash Flows was the main source of restatements arising from monitoring activities. Companies need to focus on ensuring cash flows are accurately presented in line with IAS 7 requirements and there is consistency between the statement, notes to accounts including changes in financing liabilities and the strategic report.
Climate change	The FRC have reported that users expect companies to provide full information about the future impact of climate change on the business and how the company's activities impact the environment. They should describe the environmental policies in the strategic report, give a balanced description of how policies and targets are included in business plans, provide disclosures in relation to the impact of climate related risks and how that affects disclosure in relation to CGUs, useful economic lives of assets, fair value of assets and liabilities and timing of cash outflows.

Mandatory communications

Type	Statements
Management's responsibilities (and, where appropriate, those charged with governance)	Prepare financial statements in accordance with the applicable financial reporting framework that are free from material misstatement, whether due to fraud or error. Provide the auditor with access to all information relevant to the preparation of the financial statements, additional information requested and unrestricted access to persons within the entity.
Auditor's responsibilities	Our engagement letter communicates our responsibilities to form and express an opinion on the financial statements that have been prepared by management with the oversight of those charged with governance. The audit of the financial statements does not relieve management or those charged with governance of their responsibilities.
Auditor's responsibilities - Fraud	This report communicates how we plan to identify, assess and obtain sufficient appropriate evidence regarding the risks of material misstatement of the financial statements due to fraud and to implement appropriate responses to fraud or suspected fraud identified during the audit.
Auditor's responsibilities – Other information	Our engagement letter communicates our responsibilities with respect to other information in documents containing audited financial statements. We will report to you on material inconsistencies and misstatements in other information.
Independence	Our independence confirmation letter on page 18 discloses matters relating to our independence and objectivity including any relationships that may bear on the firm's independence and the integrity and objectivity of the audit engagement partner and audit staff.

Newly effective standards

We encourage the Management to assess the expected impact of the newly effective standards on the financial statements.

	Expected impact				Effective for years beginning 1 January
Standards	**High**	**Moderate**	**Low**	**None**	**2020**
Amendments to References to Conceptual Framework in IFRS Standards			●		✓
*Definition of a Business (Amendments to IFRS 3)**				○	✓
Definition of Material (Amendments to IAS 1 and IAS 8)			●		✓
Interest Rate Benchmark Reform (Amendments to IFRS 9, IAS 39 and IFRS 7)				○	✓

*Not yet endorsed

KPMG's Audit quality framework

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

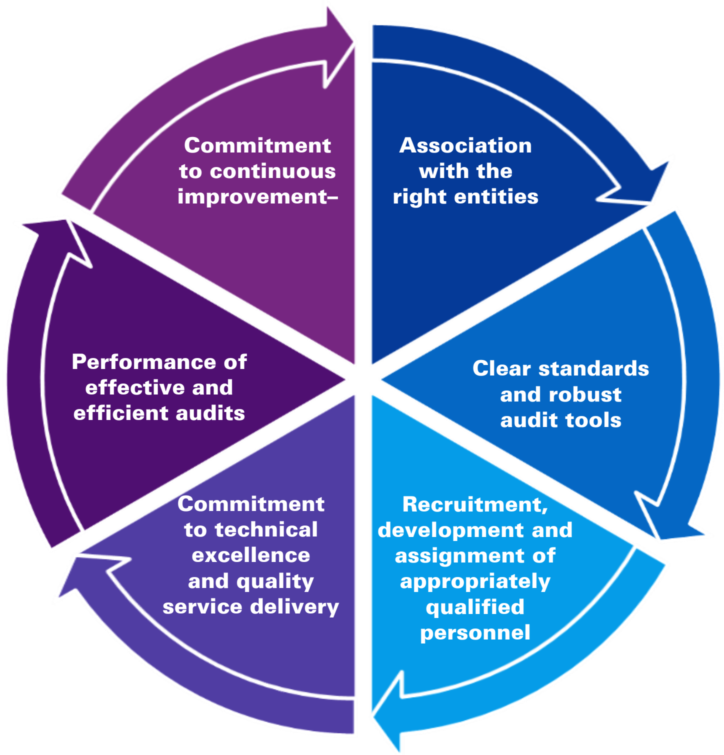
To ensure that every partner and employee concentrates on the fundamental skills and behaviours required to deliver an appropriate and independent opinion, we have developed our global Audit Quality Framework.

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

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

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

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



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

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

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

Our Audit Quality Scorecard

The figure below identifies the performance of KPMG over FY20 to date in respect of key measures of audit quality and factors that aid the firm in the pursuit of audit quality.

01 Engaging with our stakeholders

Institutional investors and investor associations attending KPMG meetings and events

59 ↑48%

Value of assets under management of institutional investors we engage with

£7tn > FTSE350 market cap

Members of our UK Audit Committee Institute

2,800

FTSE 100 companies who attend our Audit Committee Institute events

70%

Market share of the FTSE350 (YTD FY20)

23% ↓1 %

FTSE350 audit bids won (YTD FY20)

75% ↑45%

Audit Committee Institute survey on audit quality:

Audit committees believe they receive high quality audits

89%

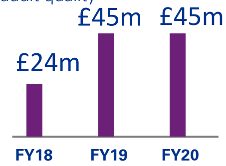
More evidence of auditors demonstrably challenging management

82%

Based on responses from 80 FTSE250 audit committee chairs and refer to the profession overall.

02 Investing in our business

Incremental investment in audit quality



Audit professionals working in transformation, data & analytics, information risk management and new technology

817 ↑21%

Partners and Directors

386 ↑6%

Top talent retention

90%

Quality through diversity

45% ↑1%

Women

30% ↑1%

BAME

Upskilling our people

FY18 65 hours

FY19 82 hours

Average number of hours of mandatory training

Number of audit professionals attending the 2019 KPMG Audit University

3,397

Colleagues completing a professional qualification (e.g. ICAEW, ICAS)

515 ↑67%

"The Audit University is not a 'typical' training course. All colleagues, and partners, came together to learn about ways to improve audit quality. It was great to hear so many different perspectives."

Assistant Manager in Audit

03 Measuring our progress

External monitoring

Audit engagements rated 'good or limited improvement required' by the FRC's AQR in 2020

61% ↓15%

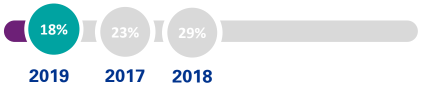
Audit engagements rated 'satisfactory or generally acceptable' by the ICAEW's QAD in 2020

90% ↑20%

"We have seen considerable focus on audit quality at the top of the firm and there have been a number of improvements to the audit practice as a result."

FRC 2020 AQR report on KPMG UK

Unsatisfactory rating in internal Quality Performance Reviews of audit engagements



Favourable employees responses in our Global People Survey to:

KPMG's commitment to quality is apparent in what we do on a day-to-day basis

84% ↑6%

I have access to the tools and resources I need to do my job effectively

81% ↑4%

I am satisfied with the learning and development available to improve my knowledge and skills

77% ↑2%

Document Classification: KPMG Public

Document Classification: KPMG Confidential

Audit reform – update

Audit reform is not just about auditors. The role and responsibility, behaviour, training and qualifications of auditors is important. But in addition, investors need to increase their engagement to ensure better stewardship; boards and executive teams need to raise the standard for all companies to the standard of the best; and the FRC needs to radically change what it does and how it does it.

Sir Jon Thompson (Chief Executive of the FRC) at KPMG's recent ACI event

There have been a number of inquiries into audit reform over the past two years with over 150 recommendations in total. The FRC have synthesised all the recommendations into six projects – irrespective of where the recommendation came from:

Transforming the FRC	Corporate reporting
Audit scope & regulation	Corporate governance
Corporate regulation	Market reform

A consultation from BEIS is expected by the end of 2020, bringing together the Government's planned response to all the recommendations, although there is a risk that there will be further disruptions to the timetable due to COVID-19.

Currently, the expectation is that legislation could be introduced as soon as 2021 and ARGA (the body replacing the FRC) to have powers in 2022. However, some of the bigger public policy issues might need to be phased in. For example, a stronger framework for reporting on internal controls would potentially need an extra year to fully embed.

What do we expect from this Government consultation?

We anticipate that the consultation will call for views on the following recommendations:

- increased audit and assurance to be required over the annual report to cover alternative performance measures, risks, forward looking reporting and ESG reporting
- introduction of a stronger framework for internal control reporting in the UK
- introduction of a business resilience statements, to replace the existing going concern and viability statements
- increased reporting in relation to fraud risks
- increased transparency within auditor reports, particularly in relation to judgements and estimates
- introduction of managed shared audits (instead of joint audits) to increased competition within the audit market
- introduction of an audit committee regulatory framework – potentially defining minimum audit committee standards, work programmes, scope, membership and qualifications
- proposal to hold all relevant directors to account for their duties to prepare and approve true and fair corporate reports, not just those who are members of professional bodies
- introduction of a three year rolling Audit and Assurance Policy covering the Audit Committee's approach to the appointment of auditors, the scope and materiality of the audit, the assurance budget and the relationship of any audit to identified risks, which shareholders would be invited to comment on
- publication of audit quality review reports on individual audits.

Restoring trust in audit and corporate governance

"By restoring trust in our corporate governance regime and encouraging greater transparency, we will provide investors with clarity and certainty, cement the UK's position as the best place in the world to do business, and protect jobs across the country"

Business Secretary Kwasi Kwarteng

The department of Business, Energy & Industrial Strategy (BEIS) launched their consultation on *Restoring trust in audit and corporate governance* (the Consultation) in March 2021 , bringing together the Government's planned response to all 150+ recommendations from the three previous independent reviews into the audit industry; the Kingman review into the Financial Reporting Council, the CMA's market study into the audit market and Brydon's review into the quality and effectiveness of audit. There are 98 questions within the consultation and the deadline for responses is 8 July 2021.

The FRC are running a number of of webinars and roundtables throughout April and May 2021 for all stakeholders.

Currently, the expectation is that legislation for ARGA (the Audit, Governance and Reporting Authority, the body replacing the FRC) to have statutory powers will be introduced in 2023. However, some of the bigger public policy issues will be phased in. For example, a stronger framework for reporting on internal controls.

What is included within the Government consultation?

The proposals impact all parties within the corporate reporting ecosystem; regulators, shareholders, directors and auditors. The key proposals include:

- increasing the UK public interest entity (PIE) definition to cover the largest private companies and potentially third sector entities with a public benefit purpose
- introduction of a stronger framework for internal control reporting in the UK – the consultation proposes three options, which are not mutually exclusive
- increased reporting by directors and auditors on material fraud
- introduction of resilience statements
- increased reporting in relation to dividends and capital maintenance
- a new duty for auditors to take a wider range of information into account in reaching audit judgements
- introduction of a new Audit and Assurance Policy for PIEs as a means to better articulate the extent to which the annual report and other disclosures have been scrutinised and audit tendering policies. Shareholders views should be taken into account
- a strengthened regulator (ARGA) with more pro-active role in identifying and assessing serious issues relating to a company's corporate reporting or audit. This includes publication on individual AQR and CRR reports.
- proposals for ARGA to be able to hold all relevant PIE directors to account in relation to breaches of their corporate reporting and audit duties, not just those who are members of professional bodies
- introduction of managed shared audits for FTSE 350 companies to increased competition within the audit market
- introduction of additional audit committee requirements on audit committees in relation to the appointment and oversight of auditors

Strengthening the UK Internal controls framework

The consultation sets out three options for strengthening the UK's internal controls framework. They are not mutually exclusive.

Option A. Require an explicit directors' statement about the effectiveness of the internal control and risk management systems	**Option B.** Require auditors to report more about their views on the effectiveness of companies' internal control systems	**Option C**. Require auditors to express a formal opinion on the directors' assessment of the effectiveness of the internal control systems
Essentially this would be strengthening the existing UK framework by requiring the board to explain the outcome of their annual review of the risk management and internal control systems and make a statement as to whether they consider the systems to have operated effectively. Additionally, they would disclose the benchmark system, if any, that has been used to make the assessment; explain how the directors have assured themselves that it is appropriate to make a statement; and if deficiencies have been identified, set out the remedial action taken and over what timeframe.	Under this option, the auditors' report would be required to say more about the work that they already undertake to understand the company's internal control systems and how that work has influenced the approach taken to the audit – but without requiring a formal attestation of their effectiveness. This option could be reinforced by placing an explicit duty on the board to disclose to the auditor and audit committee any significant internal control.	This option would require the auditor to undertake additional audit and assurance work to be in a position to express a formal opinion on the directors' assessment - potentially limited to key internal controls over financial reporting, or a sub-set of that. It would have similarities to section 404(b) of the US's Sarbanes-Oxley Act which requires the company's auditor to attest to and report on management's assessment of the internal control structure and procedures for financial accounting.

The Government's initial preferred approach is Option A – a directors' statement about the effectiveness of the internal controls, but (unlike the US's approach which mandates external auditor attestation based on size of company) leave the decision on whether the statement should be assured by an external auditor to the directors, audit committee and shareholders.

We expect that the earliest legislation could come in is 2023 with a subsequent transition period before implementation is required.

Public interest entities

The current definition of a PIE covers predominantly publicly listed companies, but Government are consulting on options for expanding the PIE definition to cover the largest private companies and potentially third sector entities with a public benefit purpose. Government recognises that any changes to the PIE definition would need to be introduced at an appropriate pace to provide companies with the time they need to prepare. To achieve this Government envisages a significant lead-time before introducing a new PIE definition.

PIEs have greater reporting requirements, are part of the FRC (and therefore ARGAs) inspection regime, greater regulatory requirements for auditors, and more significant restrictions on non-audit services which can be provided by the statutory auditor.

Large private companies

Option 1: Government could adopt the test used to identify those large companies which are already required to include a corporate governance statement in their directors' report. That provision covers all companies with either:

- more than 2,000 employees; or
- a turnover of more than £200 million and a balance sheet of more than £2 billion

Option 2: Government has also considered adopting a narrower test which incorporates the threshold for additional non-financial reporting requirements for existing PIEs, and would mean the definition of a PIE was only extended to large companies with both:

- over 500 employees, and
- a turnover of more than £500 million

Other entities

Lloyds Syndicates - Government are seeking views on whether Lloyds Syndicates should also be included within the definition of PIE

Third sector entities - Government are seeking views on whether third sector entities should also be included within the definition of PIE, for example universities, charities and housing associations could also be included within the definition of a PIE, with an appropriate threshold applied.

Other proposals

Resilience Statement

A new Resilience Statement –addressing business resilience over the short, medium and long-term –is proposed initially for premium listed, and then other PIEs within two years.

The short-term section of the Statement would incorporate companies' existing going concern statement, including disclosure of any material uncertainties considered by management during their going concern assessment, which were subsequently determined not to be material after the use of significant judgement and/or the introduction of mitigating action.

The medium-term section of the Statement would incorporate the existing viability statement requirements to provide an assessment of the company's prospects and resilience, and to address matters which may threaten the company's ability to continue in operation and meet its financial liabilities as they fall due. The mandatory assessment period should be five years. The Government initially intends to require companies to include at least two reverse stress testing scenarios.

The long-term section of the Statement would set out what the directors consider to be the main long-term challenges to the company and its business model, and how these are being addressed. These might include the impact of long-term changes in demographics, technology and consumer preferences

Company Directors

Government intends to legislate to provide ARGA with the necessary powers to investigate and sanction breaches of corporate reporting and audit-related responsibilities by PIE directors.

The proposed regime will give the ARGA new powers to take civil enforcement action against PIE directors in relation to breaches of existing PIE directors' duties relating to corporate reporting and audit (and any new duties which are introduced further to this consultation, for example in relation to internal controls). Existing duties include:

— the duty to keep adequate accounting records;

— the duty to approve accounts only if they give a true and fair view;

— the duty to approve and sign the annual accounts;

— the duty to approve the directors' report; and

— the duty to provide a statement as to disclosure to auditors and to provide information or explanations at the request of the auditor.

Audit Oversight Committees

Government proposes to require ARGA to impose additional requirements on audit committees in relation to the appointment and oversight of auditors.

Government also proposes to impose a duty on ARGA to monitor compliance with the new audit committee requirements, including powers to place an observer on audit committees if necessary. Furthermore, Government intends to provide ARGA with the ability to take action against the company directors and/or the audit committee for breaching the new requirements.

These should initially only apply in relation to audit committees of FTSE 350 companies.

Other proposals (cont.)

Audit & Assurance Policy

For PIEs, a new Audit and Assurance Policy is proposed as a means to better articulate to users the extent to which the annual report and other disclosures have been scrutinised, whether by the existing company auditor or someone else.

As a minimum, it is proposed that the Audit and assurance Policy includes:

- an explanation of what independent assurance, if any, the company intends to obtain in the next three years in relation to the annual report and other company disclosures beyond those required by statutory audit. This would include an explanation of what independent assurance, if any, the company plans to obtain in relation to: the company's Resilience Statement and the effectiveness of the company's internal controls framework; and
- a description of the company's internal auditing and assurance processes.

Engagement with shareholders

There are a number of proposed new measures to encourage and facilitate more meaningful engagement between a company and its shareholders on matters affecting audit quality. These include a formal mechanism by which shareholders of a quoted company can propose additional matters for emphasis within the scope of the company's external audit, and proposals for better communication to shareholders following the resignation or dismissal of the auditor of a PIE.

Dividends and capital maintenance

Proposals include:

- Companies (the parent company in the case of a group) should disclose the total amount of reserves that are distributable or, if this is not possible, the "known" distributable reserve;
- the parent companies should provide an estimate of distributable reserves across the group; and
- directors should state that any proposed dividend is within known distributable reserves and that the payment of the dividend will not, in the directors' reasonable expectation, threaten the solvency of the company within two years.

Audit Purpose & Scope

Government's proposals include:

- a new corporate auditing profession to operate independently of the professional accountancy bodies;
- new overarching principles for auditors, to reinforce good audit practice;
- a new duty on auditors to take a wider range of information into account in reaching audit judgements, in particular whether financial statements give a "true and fair view"; and
- new obligations on both auditors and directors relating to the detection and prevention of material fraud

Competition, choice and resilience

Government plans to increase choice, competition and resilience of the UK's statutory audit market through operational separation and the introduction of a managed shared audit regime for FTSE 350 companies (unless the statutory auditor is a smaller audit firm) with a reserve power for a managed market share cap.

Audit Scotland Code of Audit Practice

Responsibilities of management
Financial Statements
Audited bodies must prepare an annual report and accounts containing financial statements and other related reports. They have responsibility for: — preparing financial statements which give a true and fair view of their financial position and their expenditure and income, in accordance with the applicable financial reporting framework and relevant legislation; — maintaining accounting records and working papers that have been prepared to an acceptable professional standard and that support their financial statements and related reports disclosures; — ensuring the regularity of transactions, by putting in place systems of internal control to ensure that they are in accordance with the appropriate Council; — maintaining proper accounting records; and — preparing and publishing, along with their financial statements, an annual governance statement, management commentary (or equivalent) and a remuneration report that are consistent with the disclosures made in the financial statements. Management commentary should be fair, balanced and understandable and also clearly address the longer- term financial sustainability of the body. Further, it is the responsibility of management of an audited body, with the oversight of those charged with governance, to communicate relevant information to users about the entity and its financial performance, including providing adequate disclosures in accordance with the applicable financial reporting framework. The relevant information should be communicated clearly and concisely. Audited bodies are responsible for developing and implementing effective systems of internal control as well as financial, operational and compliance controls. These systems should support the achievement of their objectives and safeguard and secure value for money from the public funds at their disposal. They are also responsible for establishing effective and appropriate internal audit and risk-management functions. Audited bodies are responsible for providing the auditor with access to all information relevant to the preparation of the financial statements, additional information requested and unrestricted access to persons within the entity.

Audit Scotland Code of Audit Practice (continued)

Responsibilities of management
Prevention and detection of fraud and irregularities
Audited bodies are responsible for establishing arrangements for the prevention and detection of fraud, error and irregularities, bribery and corruption and also to ensure that their affairs are managed in accordance with proper standards of conduct by putting proper arrangements in place.
Corporate governance arrangements
Each body, through its chief executive or accountable officer, is responsible for establishing arrangements to ensure the proper conduct of its affairs including the legality of activities and transactions, and for monitoring the adequacy and effectiveness of these arrangements. Audited bodies should involve those charged with governance (including Audit Committees or equivalent) in monitoring these arrangements.
Financial position
Audited bodies are responsible for putting in place proper arrangements to ensure that their financial position is soundly based having regard to: — such financial monitoring and reporting arrangements as may be specified; — compliance with any statutory financial requirements and achievement of financial targets; — balances and reserves, including strategies about levels and their future use; — how they plan to deal with uncertainty in the medium and longer term; and — the impact of planned future policies and foreseeable developments on their financial position.
Best Value, use of resources and performance
The Scottish Public Finance Manual sets out that accountable officers appointed by the Principal Accountable Officer for the Scottish Administration have a specific responsibility to ensure that arrangements have been made to secure best value.

Audit Scotland Code of Audit Practice (continued)

Responsibilities of auditors
Appointed auditor responsibilities

Auditor responsibilities are derived from statute, this Code, ISAs, professional requirements and best practice and cover their responsibilities when auditing financial statements and when discharging their wider scope responsibilities. These are to:
— undertake statutory duties, and comply with professional engagement and ethical standards;
— provide an opinion on audited bodies' financial statements and, where appropriate, the regularity of transactions;
— review and report on, as appropriate, other information such as annual governance statements, management commentaries, remuneration reports, grant claims and whole of government returns;
— notify the Auditor General when circumstances indicate that a statutory report may be required;
— participate in arrangements to cooperate and coordinate with other scrutiny bodies (local government sector only);
— demonstrate compliance with the wider public audit scope by reviewing and providing judgements and conclusions on the audited bodies:
    — effectiveness of performance management arrangements in driving economy, efficiency and effectiveness in the use of public money and assets;
    — suitability and effectiveness of corporate governance arrangements; and
    — financial position and arrangements for securing financial sustainability.
Weaknesses or risks identified by auditors are only those which have come to their attention during their normal audit work in accordance with the Code, and may not be all that exist. Communication by auditors of matters arising from the audit of the financial statements or of risks or weaknesses does not absolve management from its responsibility to address the issues raised and to maintain an adequate system of control.
This report communicates how we plan to identify, assess and obtain sufficient appropriate evidence regarding the risks of material misstatement of the financial statements due to fraud and to implement appropriate responses to fraud or suspected fraud identified during the audit.

Audit Scotland Code of Audit Practice (continued)

Responsibilities of auditors
General principles
This Code is designed such that adherence to it will result in an audit that exhibits these principles.
Independent
When undertaking audit work all auditors should be, and should be seen to be, independent. This means auditors should be objective, impartial and comply fully with the FRC ethical standards and any relevant professional or statutory guidance. Auditors will report in public and make recommendations on what they find without being influenced by fear or favour. Our independence confirmation letter (**page 18**) discloses matters relating to our independence and objectivity including any relationships that may bear on the firm's independence and the integrity and objectivity of the audit engagement partner and audit staff. We confirm that, in our professional judgement, KPMG LLP is independent within the meaning of regulatory and professional requirements and that the objectivity of the Director and audit staff is not impaired.
Proportionate and risk based
Audit work should be proportionate and risk based. Auditors need to exercise professional scepticism and demonstrate that they understand the environment in which public policy and services operate. Work undertaken should be tailored to the circumstances of the audit and the audit risks identified. Audit findings and judgements made must be supported by appropriate levels of evidence and explanations. Auditors will draw on public bodies' self-assessment and self - evaluation evidence when assessing and identifying audit risk.
Quality focused
Auditors should ensure that audits are conducted in a manner that will demonstrate that the relevant ethical and professional standards are complied with and that there are appropriate quality-control arrangements in place as required by statute and professional standards.

Audit Scotland Code of Audit Practice (continued)

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

KPMG | 150 years supporting the UK