



South Ayrshire Council

Planning report to the Audit and Governance Panel on the 2020/21 audit

Issued on 17 March 2021 for the meeting on 24 March 2021

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Introduction

The key messages in this report

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

- A robust challenge of the key judgements taken in the preparation of the annual 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 Governance Panel ('the Panel') of South Ayrshire Council ('the Council') 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 the Council, including discussion with management and review of relevant documents. This has included consideration of the impact the COVID-19 pandemic has had on the Council. Based on these procedures, we have developed this plan in collaboration with the Council 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 the Council.

Key risks

We have taken an initial view as to the significant audit risks the Council 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 26 to 29.

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 25 to 32.

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, with a revised implementation date of 2022/23 and will require adjustments to recognise on balance sheet arrangements currently treated as operating leases.

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.

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 the Council through our external audit work by being constructive and forward looking, by identifying areas of improvement and by recommending and encouraging good practice. In this way, we aim to help the Council 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 34 to 40 of this paper.

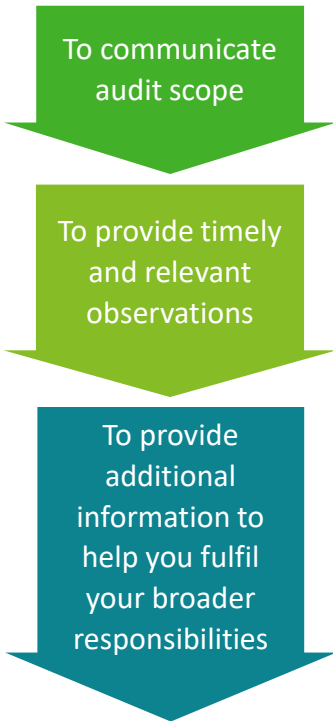
Pat Kenny
Audit Director

Responsibilities of the Audit and Governance Panel

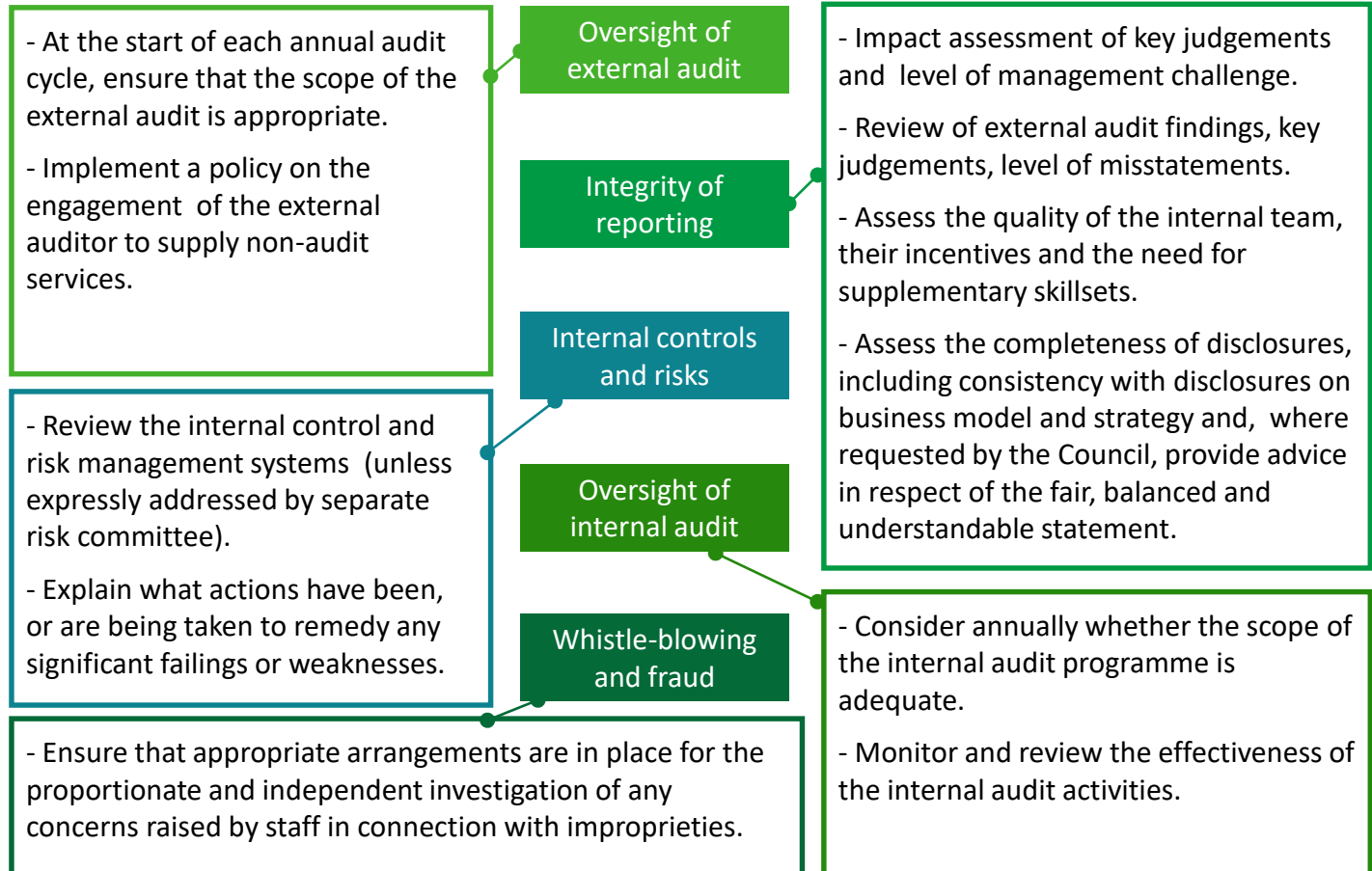
Helping you fulfil your responsibilities

Why do we interact with the Audit and Governance Panel?

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



We use this symbol to highlight areas of our audit where the Audit and Governance Panel needs to focus attention.



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 Audit and Governance Panel

As explained further in the Responsibilities of the Audit and Governance Panel slide on the previous page, the Audit and Governance Panel 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 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.

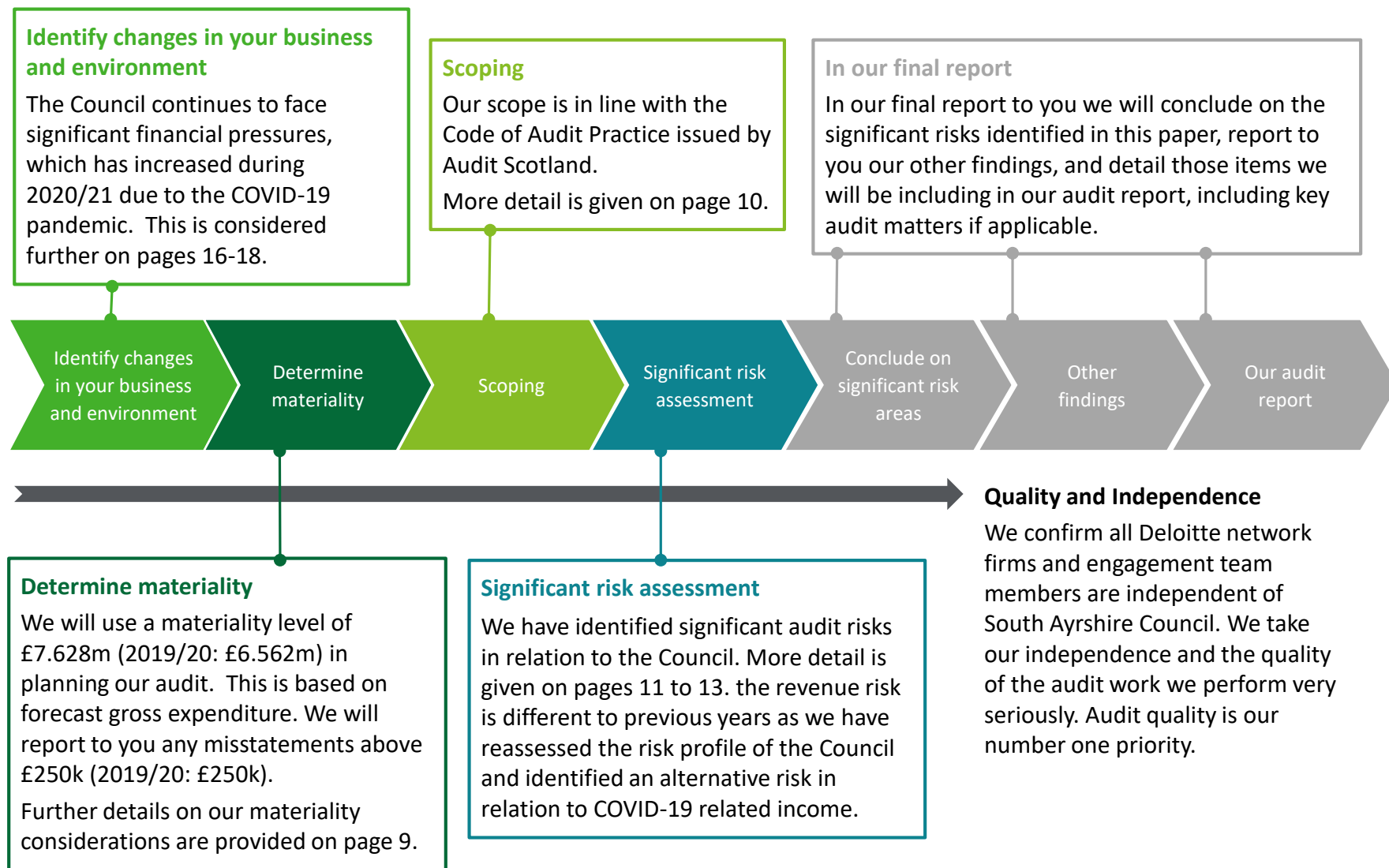
Performance materiality



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

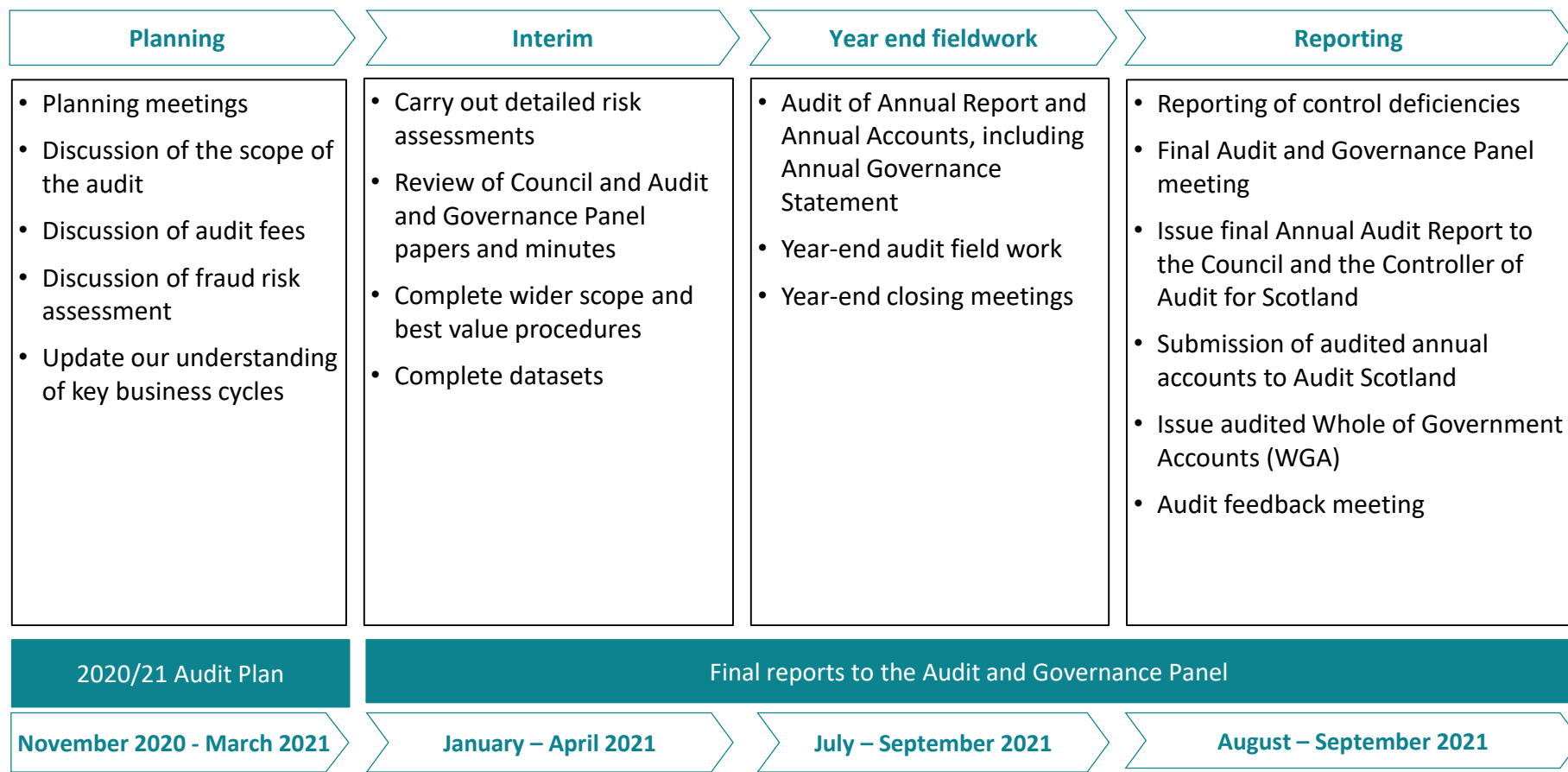
We tailor our audit to your business and your strategy



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.



Ongoing communication and feedback

Materiality

Our approach to materiality

Basis of our materiality benchmark

- The Audit Director has determined materiality for the group as £7.628m (2019/20: £6.562m) and performance materiality as £5.339m (2019/20: £4.921m), 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: 1.6%) of forecast gross expenditure as the benchmark for determining materiality and applied 70% 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 Council and our understanding of the control environment, including the increased fraud risks as a result of the pandemic.
- For the audit of South Ayrshire Council (council only), a materiality of £7.246m (2019/20: £6.233m) and performance materiality of £5.072m (2019/20: £4.674m) have been determined.

Reporting to those charged with governance

- We will report to you all misstatements found in excess of £250k (2019/20: £250k).
- 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 Audit and Governance Panel must not exceed £250k.

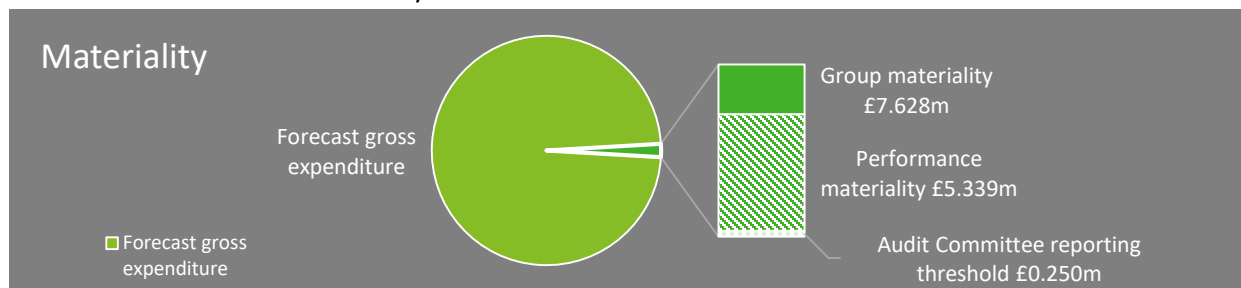
Our Annual Audit Report

We will:

- Report group materiality, council only materiality and the range we use for component materialities;
- 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.

Group scoping

The significant components for the group comprise South Ayrshire Council and South Ayrshire Integration Joint Board. Full audit procedures will be performed on each entity. All non-significant components will be covered by desktop reviews at the group level.



Although materiality is the judgement of the Audit Director, the Audit and Governance Panel 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	29 September 2021
2. Audit dimensions, Best Value, Statutory Performance Information and Strategic Audit Priorities	Annual Audit Plan	24 March 2021
	Annual Audit Report	29 September 2021
3. Contributing to performance audits	Dataset for overview report	March 2021 (submission deadline 8 May 2021)
4. Other wider scope audit work	Current issues returns	15 January, 26 March, 23 July and 22 October 2021
	Assurance Statement on WGA return	TBC
	Fraud Returns	Quarterly (30 November 2020, 28 February 2021, 31 May 2021 and 31 August 2021)
	Certify grant claims	As required

Significant risks

Significant risk dashboard

Risk	Fraud risk	Planned approach to controls	Level of management judgement	Page no
Management override of controls				12
Recognition of COVID-19 related income				13

Level of management judgement



High degree of management judgement



Some degree of management judgement



Limited management judgement

Controls approach adopted



Assess design and implementation

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.

Significant risks (continued)

Recognition of COVID-19 related income



Risk identified and key judgements

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

We have assessed the income streams of the Council, the complexity of the recognition principles and the extent of any estimates used, and concluded that, with the exception of the funding received in 2020/21 in response to the COVID-19 pandemic, there is no significant risk of fraud.

During 2020/21, the Council has received additional funding in relation to COVID-19 mobilisation costs, although all funding has not yet been confirmed. In addition, there are a number of business support schemes designed to help eligible businesses during the COVID-19 pandemic that are being administered by Councils on behalf of the Scottish Government.

We have pinpointed the significant risk to the completeness and occurrence of the funding for COVID-19 mobilisation costs and the completeness and accuracy of the agency arrangement disclosures.

The key judgements for management are assessing:

- Any conditions associated with the mobilisation cost funding; and
- Whether the Council is acting as a principal or agent in administering the business support schemes.



Deloitte response and challenge

We will perform the following:

- Assess the design and implementation of the controls in relation to the accounting treatment of all COVID-19 related funding;
- Test a sample of funding for COVID-19 mobilisation costs and confirm these have been recognised in accordance with any conditions applicable; and
- Test the agency arrangement disclosures to confirm, where it is concluded that the Council is acting as an agent, that:
 - Transactions have been excluded from the Comprehensive Income and Expenditure Statement;
 - The Balance Sheet reflects the debtor or creditor position at 31 March 2021 in respect of cash collected or expenditure incurred on behalf of the principal; and
 - The net cash position at 31 March 2021 is included in the financing activities in the Cash Flow Statement.

Other areas of focus

Expenditure recognition



Risk identified and key judgements

In accordance with Practice Note 10 (*Audit of financial statements of public sector bodies in the United Kingdom*), in addition to the presumed risk of fraud in revenue recognition set out in ISA (UK) 240, as discussed further on page 13, auditors of public sector bodies should also consider the risk of fraud and error on expenditure. This is on the basis that most public bodies are net spending bodies, therefore the risk of material misstatement due to fraud related expenditure may be greater than the risk of material misstatement due to fraud related to revenue recognition.

We have considered this risk for the Council and concluded that we are satisfied that the control environment is strong and there is no history of errors or audit adjustments. This has therefore not been assessed as a significant risk area, but will continue to be an area of audit focus in line with Practice Note 10.



Deloitte response and challenge

We will perform the following procedures to address the risk:

- Detailed analytical procedures on all invoices processed in the year to assess the risk of a material misstatement; and
- Testing of creditors balances at the year-end to assess completeness of expenditure.

Other areas of focus (continued)

Pension liability



Risk identified and key judgements

The Council participates in two defined benefits schemes:

- Scottish Teachers' Superannuation Scheme, administered by the Scottish Government; and
- The Strathclyde Pension Fund, administered by Glasgow City Council.

The net pension liability has decreased from £155.657m in 2018/19 to £94.090m in 2019/20. The decrease was a result of changes in assumptions, specifically driven by reduced inflation assumptions, resulting in a reduction in the value of pension liabilities, partly offset by a reduction in the return on Scheme assets, resulting in the change in the value of the pension assets. The liability also continues to be affected by the McCloud and Goodwin legal cases.

Hymans Robertson LLP are the Council's appointed actuary, who produce a detailed report 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 actuary supporting the basis of reliance upon their work;
- Review and challenge the assumptions made by Hymans Robertson;
- Obtain assurance from the auditor of the pension fund over the controls for providing accurate data to the actuary;
- Consider the impact of the Triennial Review of the pension fund;
- Assess the reasonableness of the Council's share of the total assets of the scheme with the Pension Fund annual accounts;
- Review and challenge the calculation of the impact of the McCloud and Goodwin cases on pension liabilities; and
- Review the disclosures within the accounts against the Code.

Coronavirus (COVID-19) outbreak

Impact on our audit

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.

Requirements

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 the Council'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 Key Risks 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 the Council's operations, including on its income streams, 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 Council and management actions	Impact on annual report and annual accounts	Impact on our audit
<p>We will consider the key impacts on the Council such as:</p> <ul style="list-style-type: none">• Interruptions to service provision• Supply chain disruptions• Unavailability of personnel• Reductions in service income	<p>We have considered the impact of the outbreak on the annual report and annual accounts, discussed further on the next slide including:</p> <ul style="list-style-type: none">• Narrative reporting, including disclosures on financial sustainability• Principal risk disclosures• Impact on property, plant and equipment valuations• Impairment of non-current assets• Allowance for expected credit losses• Events after the reporting period and relevant disclosure	<p>We will continue to assess the impact on the audit including:</p> <ul style="list-style-type: none">• 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.

The Council will need to consider the approach to its valuation (including any changes as a result of the pandemic and consequent service and organisational changes on the "modern equivalent asset" assumed in valuations). Councils 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, the Council will need to consider the level of provision required for expected credit losses under IFRS 9.

Narrative and other reporting issues

The following areas will need to be considered by the Council:

- 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, the Council 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 the Council's going concern assessment, including related uncertainties.

The Council 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 the Council 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 the Council 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 the Council
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 the Council
Identification of inherent risk factors; separate assessment of inherent risk and control risk	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.	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.
Objectives-based work effort requirements	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 should expect more challenge of the evidence provided in support of accounting estimates, use of external data sources and your consideration of contradictory evidence.
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 the Council
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 15, the pension liability valuations are provided by the Council’s appointed actuary, who produce a detailed report outlining the estimated liability at the year-end and key assumptions applied. Management should ensure that the information provided by the actuary 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 local 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 the Council.

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 liability.

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 addition, the wider scope of audit in local government comprises the statutory duty of auditors to be satisfied that bodies have made proper arrangements to secure **Best Value (BV)** and to publish **statutory performance information**. The Commission also sets out five **Strategic Audit Priorities** that it expects auditors to consider in local government audits.

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. 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.

Wider scope requirements (continued)

Audit dimensions

Audit dimension	Significant risks identified	Planned audit response
Financial sustainability	<p>The projected full year impact of the pandemic is a net overspend of £1.541m, which is based on expenditure of £6.890m and COVID-19 general funding confirmed to date of £5.349m. The Council expects that the remaining shortfall will be funded by the Scottish Government.</p> <p>The Council has historically achieved short-term financial balance and had made some progress prior to the pandemic with its updated 10-year Financial Strategy which set out possible scenarios depending on future settlements. There however remains an estimated funding gap of between £2.4m and £14.8m by 2022/23 and a significant further gap thereafter. There therefore remains a significant risk that robust long-term planning arrangements are not in place to ensure that the Council can manage its finances sustainably and deliver services effectively, identify issues and challenges early, and act on them promptly.</p> <p>As reported in our 2019/20 annual audit report, significant work is still required to make the level of transformational change needed based on the current financial forecasts.</p>	<p>We will assess the progress being made by the Council in reviewing its Financial Strategy during 2020/21, particularly in terms of reflecting the impact of COVID-19 and other demand pressures.</p> <p>We will review the Council's progress in developing its "Strategic Change Programme – Preparing for the Future". In particular, we will consider how the pandemic has impacted on the plans and progress to date.</p> <p>We will also consider the work that the Council has done to review the lessons learned from its response to the pandemic and how this experience will inform the transformation agenda.</p>
Financial management	<p>We have not identified any significant risks in relation to financial management during our planning.</p> <p>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.</p>	<p>We will continue to review the financial management arrangements. Using Audit Scotland's publication "COVID-19 Emerging Fraud Risks", we will assess what action the Council has taken to minimise risk to its control environment and internal controls.</p>

Wider scope requirements (continued)

Audit dimensions (continued)

Audit dimension	Significant risks identified	Planned audit response
Governance and transparency	<p>Following the changes made to the governance arrangements in response to the pandemic, including the use of teleconference rather than face to face meetings, there is a risk that revised arrangements are not appropriate or operating effectively. Council and Panel meetings resumed from June 2020. All meetings now take place through a combination of teleconferencing and in person.</p> <p>The governance arrangements for health and social care integration is an area of particular interest to the Auditor General and Accounts Commission. There is a risk that the arrangements are not operating effectively (including services delivered by, or in partnership with, others). In particular, as highlighted in our 2019/20 annual audit report, some specific issues remain in relation to the decision to close the Kyle Day Centre and the progress in addressing the findings from the Significant Case Review (SCR). These raised concerns that the IJB leadership at a strategic level was not sufficiently focused to drive forward the required changes.</p> <p>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 panel members have not considered how sustainable any changes to the risk appetite will be in the longer term.</p>	<p>We will review the work of the Council and Panels to assess whether the arrangements are operating effectively, including assessing whether there is effective scrutiny, challenge and informed decision making.</p> <p>We will also continue to review the governance arrangements for the IJB, particularly focussing on how the partnerships have responded to the pandemic. We will also review what progress has been made with implementing actions identified from the SCR and lessons learned from the closure of the Kyle Day Centre.</p> <p>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 long-term.</p>

Wider scope requirements (continued)

Audit dimensions (continued)

Audit dimension	Significant risks identified	Planned audit response
Value for money	<p data-bbox="343 318 1244 572">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. The pandemic has had a significant impact on the Council's operations in terms of having to reduce or cease certain services, for example the closure of schools and sports and leisure centres.</p> <p data-bbox="343 622 1244 953">Performance reporting to the Council and Panels temporarily ceased between April and June 2020 due to the suspension of normal governance arrangements during this period, as noted on page 27. Normal performance reporting resumed from late summer. In addition, regular reporting on the impact of COVID-19 has been taken to the Council and Leadership Panel, which has included updates on the COVID-19 recovery plan. There is a risk that performance reporting has not been timely, reliable, balanced, transparent and appropriate to users' needs.</p>	We will review the performance reports presented to the Council to assess the extent of openness and transparency during the year.

Wider scope requirements (continued)

Best value and Strategic Audit Priorities

Considering Best Value arrangements

We have a duty to be satisfied that local government bodies have made proper arrangements for securing BV.

2020/21 is year five of the extended six-year approach to auditing BV in councils. BV audit work is integrated with the annual audit and we will work closely with Audit Scotland's Performance Audit and Best Value (PABV) team to plan, perform and report on the BV audit work.

A key feature of the approach to auditing BV is the Controller of Audit providing a Best Value Assurance Report (BVAR) to the Accounts Commission for each Council once over the audit appointment. As part of the 2020/21 audits, a BVAR will be reported for South Ayrshire Council, with planned publication in 2021. Our BV audit work will be integrated into our audit approach, including our work on the audit dimensions discussed on pages 26 to 28.

Strategic Audit Priorities

In its 2019-24 strategy, the Accounts Commission sets out five Strategic Audit Priorities (SAPs):

- Having clear priorities with a focus on outcomes, supported by effective leadership and long-term planning;
- The strategic appraisal of options to re-shape services in line with priorities. This should consider good practice, innovation and collaborative working with partners;
- Ensuring that members and officers have the right knowledge, skills and support to design, develop and deliver effective services in the future;
- Empowering local communities and involving them in the design and deliver of local services and planning for their local area; and
- Reporting councils' performance in a way that enhances accountability to citizens and communities, helping them contribute better to the delivery of improved outcomes.

In recognition of the demands on auditors' time and the challenges of remote auditing, the Commission has agreed that auditors are not required to specifically consider and report on the SAPs as part of the 2020/21 audit. The SAPs continue to be important but the work on the audit dimensions will be used to inform progress.

Wider scope requirements (continued)

Statutory Performance Information

Statutory Performance Information

The Accounts Commission has a statutory responsibility to define the performance information that councils must publish. This responsibility links with the Commission's BV audit responsibilities. In turn, councils have their own responsibilities, under their BV duty, to report performance to the public.

The Accounts Commission issued a revised **2018 Statutory Performance Information Direction** in December 2018 which requires a council to report on:

- Performance in improving local public services provided by the Council (on its own and with its partners and communities), and progress against agreed desired outcomes;
- Its own assessment and independent audit assessments of how it is performing against its duty of BV, and how it plans to improve these assessments; and
- How it (with its partners where appropriate) has engaged with and responded to its diverse communities.

As 2019/20 was the first year of the direction, we evaluated the effectiveness and appropriateness of the arrangements at the Council to fulfil the above requirements and concluded that *"The Council has appropriate arrangements in place to comply with the SPI Direction including its public performance reporting requirements"*. As noted on page 28, the COVID-19 pandemic is expected to have had a substantial impact on performance reporting. We will therefore consider the effectiveness and appropriateness of the current arrangements as part of our audit dimensions work.

Wider scope requirements (continued)

Other requirements

Contributing to performance audits

As in previous years, the Accounts Commission will publish two overview reports (financial and performance) covering the local government sector.

The reports use information from the audited accounts and Annual Audit Reports. However, we will also be requested to provide important supplementary information collected as a dataset.

The local government dataset is expected to be available in March 2021, with a submission deadline of 8 May 2021.

Shared Risk Assessment and Joint Scrutiny Planning

We continue to play a key role in the Shared Risk Assessment (SRA) process which is the vehicle for scrutiny bodies to share intelligence and agree scrutiny risks at each council. As the local auditor, we lead the Local Area Network (LAN), which comprises representatives from the main local government scrutiny bodies.

The COVID-19 pandemic has impacted on the work of all local government scrutiny during 2020 and will continue to affect plans going forward. As a result, a National Scrutiny Plan for 2020 has not been published. The Strategic Scrutiny Group is considering how scrutiny partners can best respond in a co-ordinated way to the challenges and changes brought about by COVID-19. We will provide management with any updates as this develops.

Current issues returns

Timely communication by auditors of intelligence is important in helping Audit Scotland to maintain a good level of awareness across the public sector and to keep the Auditor General, the Controller of Audit and Accounts Commission informed.

Current Issue Returns for local government represent an important source of intelligence for reporting to the Commission's Financial Audit and Assurance Committee.

Other areas

We are required to also carry out the following areas of work:

- Assurance on approved grant claims and other financial returns
- Assurance on WGA returns
- Preliminary enquiries on all correspondence received
- Consider and report on any statutory objections received
- Submission of fraud returns

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 Audit and Governance Panel, 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 the Council.

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.

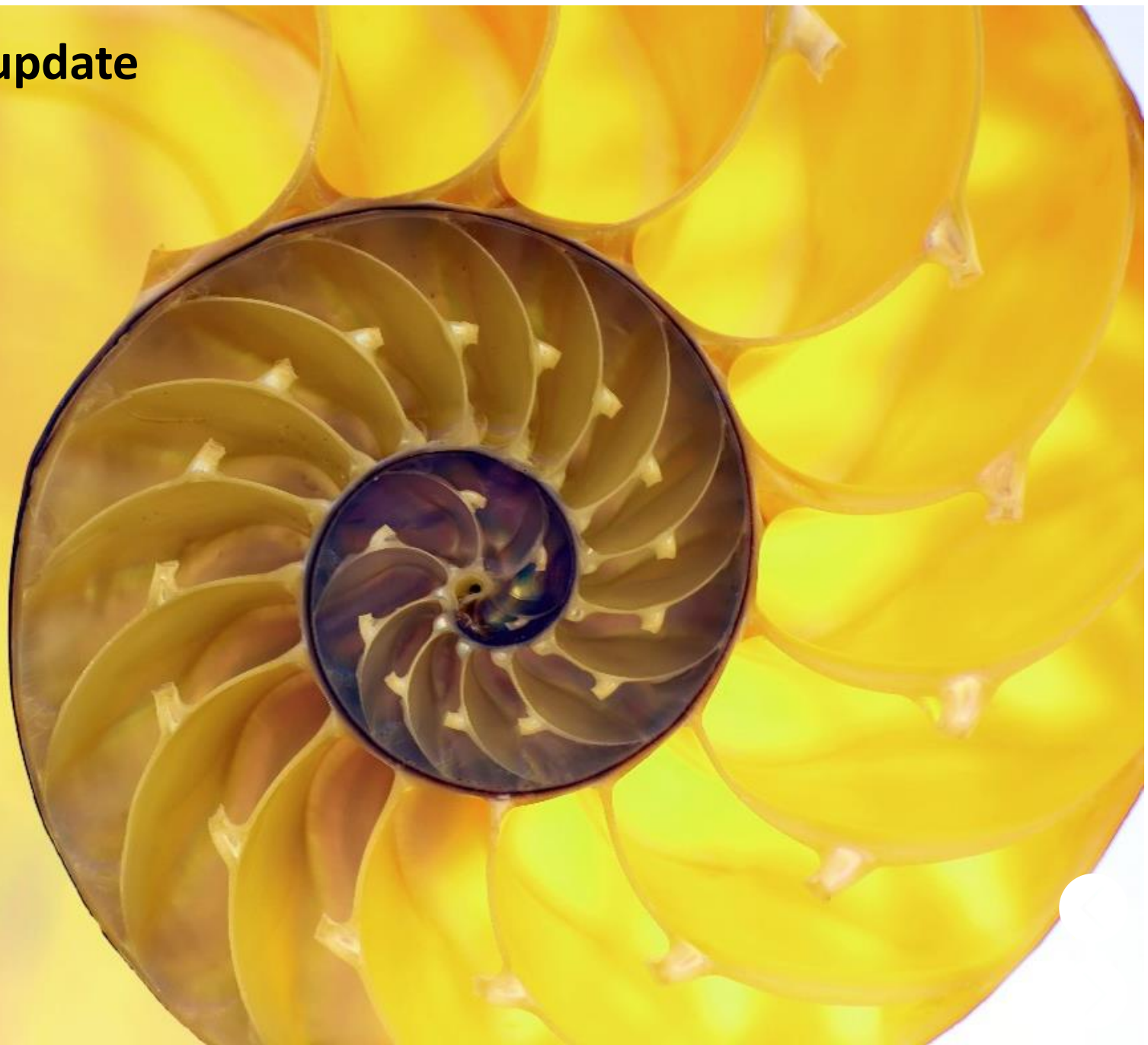
Other relevant communications

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



Pat Kenny
for and on behalf of Deloitte LLP
Glasgow | 17 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.

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What does climate change mean for business?

Understanding the role of finance professionals

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. These effects are now compounded by the accelerating pace of policy and regulatory change as humanity recognises the challenge we face and the drastic and rapid actions we all must take in order to protect our planet and our own livelihoods.

Discover how to think through the challenges and futureproof your business through [learning](#), [interviews](#) and [resources](#).

The time to act is now!

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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, the Council will need to include disclosures on the expected impact of the standard, but not make any adjustments in the annual accounts 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.

CIPFA/ LASAAC will shortly be issuing for consultation proposals on how housing secure tenancy agreements should be treated under IFRS 16. The proposals in this consultation are expected in the 2022/23 accounting code.

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 local 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 Audit and Governance Panel reviews 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 Audit and Governance Panel receives 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 Code of Practice on Local Authority Accounting

2020/21

Background

The accounting code has been issued by the CIPFA/ LASAAC Local Authority Code Board and its financial reporting framework is based on International Financial Reporting Standards (IFRS) as adopted by the European Union, adapted for the local government context where necessary.

The 2020/21 accounting code has been prepared on the basis of accounting standards and other pronouncements in effect for accounting periods commencing on or before 1 January 2020 (except for IFRS 16 Leases discussed on page 35).

The changes in the 2020/21 accounting code are summarised in the Foreword. The most significant changes impacting the Council are:

- ***The total line in the Comprehensive Income and Expenditure Statement*** – the line description used now needs to provide clarity regarding the use of positive and negative signage. For example, where brackets are used to represent an overall surplus the description “Total comprehensive (income) and expenditure” may be used.
- ***Amendments to reflect changes to the definition of material in IAS 8*** – it now states that information is material if omitting, misstating or obscuring it could reasonably be expected to influence decisions that users make on the basis of those annual accounts.
- ***The implementation of amendments to IAS 19 Employee Benefits*** – it creates an exception to the rule that financial assumptions are based on market expectations at 31 March. Where a pension scheme amendment, curtailment or settlement occurs during the year the amended assumptions, as used for the re-measurement of the net defined benefit liability, are to be applied in relation to the benefits for the remainder of the year.

Changes to the Code of Practice on Local Authority Accounting 2020/21 (continued)

Background (continued)

- **Amendments relating to financial instruments** – as summarised below:
 - Gains and losses on financial instruments classified as fair value through the profit or loss have been added to the items included in the financing and investment income and expenditure line of the Comprehensive Income and Expenditure Statement.
 - Clarification has been added regarding the extent of the exemption from recognising a loss allowance for expected credit losses on a financial asset where the counterparty is central government. It has been clarified that the exemption does not apply to credit impaired assets or NDPBs unless explicitly covered by a guarantee given by their sponsor division.
 - Clarification has been added in respect of the application of the interpretation of IFRS 9 that the options that characterise clauses within a LOBO contract should not be separately accounted for. It has been clarified that this interpretation only applies where the specific derivative elements are separable. It does not apply to a compound embedded derivative if separation of the exempted derivative is not permitted by IFRS 9.
 - Clarification has been added that the modification of financial liabilities follows the principles specified for the modification of financial assets, i.e. when the change in terms is not substantial, it is not accounted for as an extinguishment.
 - The wording of the definition for a soft loan has been amended to include loans where the interest rate is specified at below zero (i.e. negative interest).

Next steps

We recommend that management review the changes to the accounting code at the earliest opportunity. We are happy to have early discussion on this to agree and apply the required changes.

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 uncharted 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:

		Debit/ (credit) CIES £m	Debit/ (credit) MIRS £m	Debit/ (credit) net assets £m	Debit/ (credit) reserves £m	If applicable, control deficiency identified
Pension Liability – McCloud current service costs	[1]	0.394	(0.394)	(0.394)	0.394	N/A
Total		0.394	(0.394)	(0.394)	0.394	

[1] The Council's pension actuary, Hymans Robertson, did not make any allowance within the current service costs for the impact of McCloud and therefore it did not fully represent the cost of the benefits accruing for current service. The Council's pension actuary estimated that the potential impact of this was an £0.394m understatement of the liability. As the pension liability is fully mitigated by statutory adjustments, this misstatement had no impact on the overall General Fund position in 2019/20.

We obtained written representations from the Council confirming that after considering all these uncorrected items, both individually and in aggregate, in the context of the consolidated 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 recognition of COVID-19 related income, 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 personnel from Regulatory 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 the Council and will reconfirm our independence and objectivity to the Audit and Governance Panel for the year ending 31 March 2021 in our final report to the Audit and Governance Panel.

Fees

The audit fee for 2020/21, in line with the fee range provided by Audit Scotland is £284,280, as analysed below:

	£
Auditor remuneration	176,350
Audit Scotland fixed charges:	
Pooled costs	16,770
Audit support costs	81,460
Contribution to PABV	9,700
Total proposed fee	284,280



In addition, the audit fee for the charitable trusts audit is £1,000.

There are no non-audit services fees proposed for the period.

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 the Council, its directors, senior managers and affiliates, and have not supplied any services to other known connected parties.

Our approach to quality

AQR team report and findings

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 is 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 and Governance Panel 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)."





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