



Commissioner for Ethical Standards in Public Life in Scotland

Planning report to the Commissioner's Office on the 2021/22 audit

Issued on 25 February for the meeting on 15 March 2022 (updated 25 March 2022)

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

I have pleasure in presenting our planning report to the Commissioner for Ethical Standards in Public Life in Scotland ('the Commissioner's Office') for the 2021/22 audit. I would like to draw your attention to the key messages of this paper:

Audit plan

We have updated our understanding of the Commissioner's Office, including discussion with management and review of relevant documents. This has included consideration of the continuing impact the COVID-19 pandemic is having on the Commissioner. Based on these procedures, we have developed this plan in collaboration with the Commissioner's Office 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 Commissioner's Office. The Commissioner remains on an extended period of leave. We have therefore discussed this plan with the Acting Commissioner and Acting Accountable Officer.

Key risks

We have taken an initial view as to the significant financial statement audit risks the Commissioner's Office faces, as required by auditing standards. These are presented as a summary dashboard on page 10.

Audit dimensions

The Code of Audit Practice sets our four audit dimensions which set a common framework for all public sector audits in Scotland. Our planned audit work is risk-based and proportionate. Our initial assessment builds upon our work in prior years, and in particular the conclusions from our 2020/21 audit where we applied an expanded wider scope. We have also considered the Commissioner's Office's key priorities and risks as well as any risks identified by Audit Scotland.

As a result of the significant issues identified in our 2020/21 audit, the Auditor General for Scotland reported to the Scottish Parliament's Public Audit Committee in January 2022 under section 22 of the Public Finance and Accountability (Scotland) Act 2000. In view of these issues, we have concluded that it remains appropriate to apply the expanded wider scope requirements to specifically follow-up on the recommendations made in 2020/21. This will be our key area of focus for the 2021/22 audit. Further consideration is made on pages 18 to 21.

Introduction (continued)

The key messages in this report (continued)

Regulatory change

IFRS 16, Leases, comes into effect on 1 April 2022, therefore will be first implemented in financial year 2022/23. This will require adjustments to recognise on balance sheet arrangements currently treated as operating leases. Further details are provided on page 23 and as part of the 2021/22 audit, we will evaluate the adequacy of the arrangements in place for compliance with the new standard.

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.

Managing transition to 2022/23 audits

2021/22 is the final year of the current audit appointments. We will minimise disruption to all parties, and maximise the transfer of knowledge of the Commissioner's Office, by working in partnership with Audit Scotland and the incoming auditors.

Added value

Our aim is to add value to the Commissioner's Office 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 Commissioner's Office 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 26 to 27 of this plan.

Pat Kenny
Audit Director

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 the Annual Report and Accounts that are free from material misstatement, whether due to fraud or error.

Responsibilities of the Commissioner's Office

The Commissioner's Office 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.

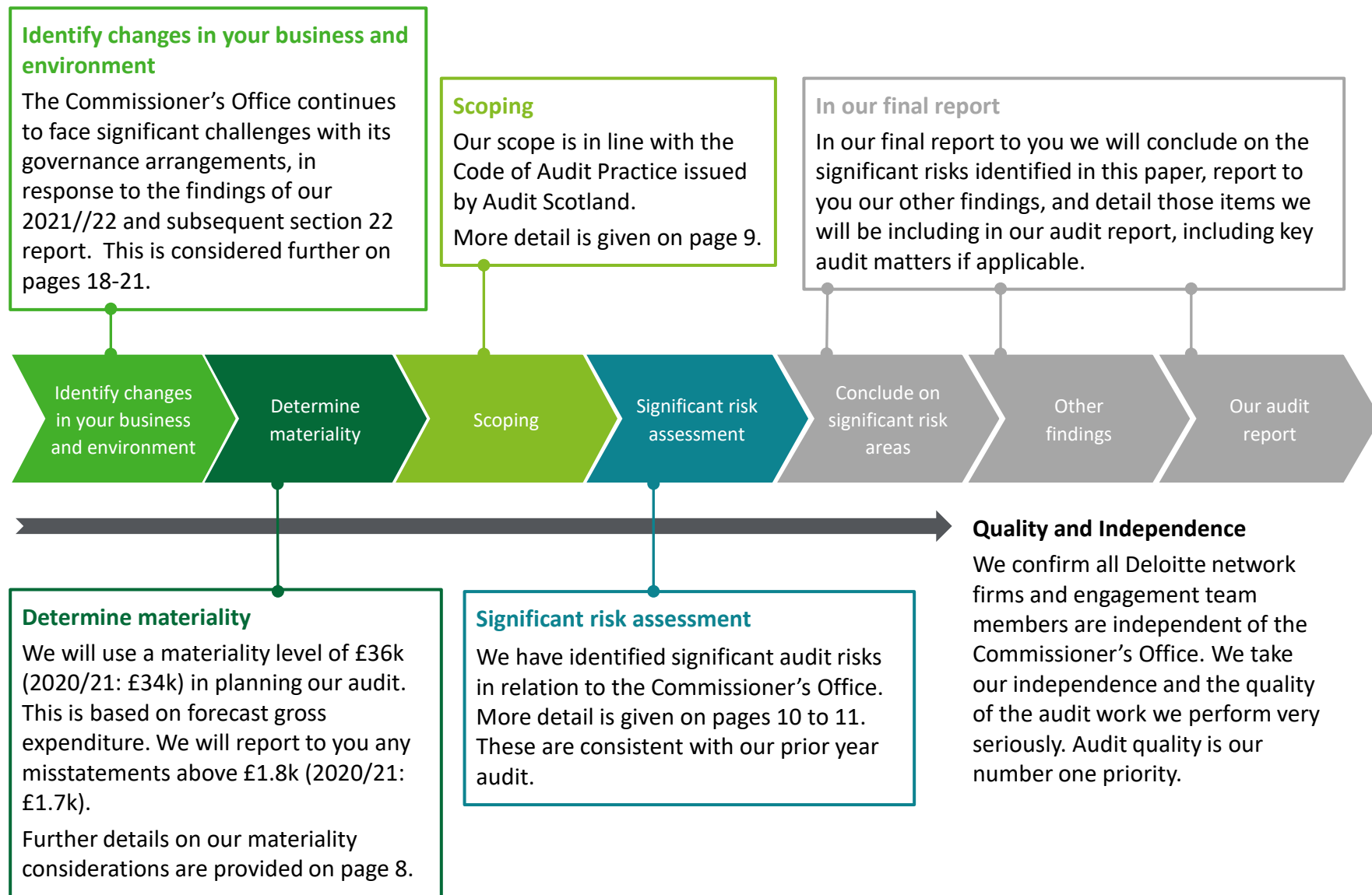
Performance materiality



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

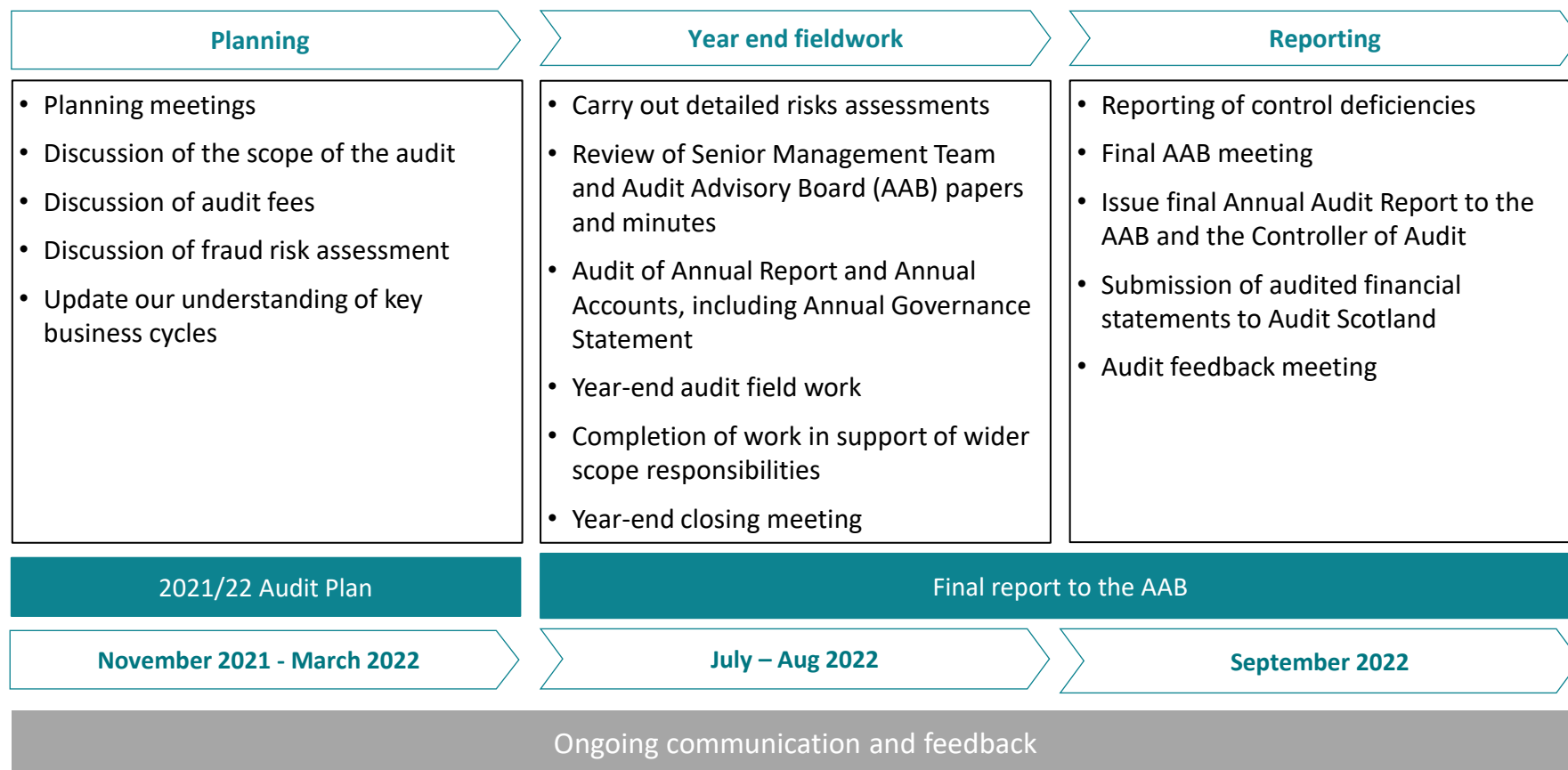
We tailor our audit to your business and your strategy



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.



Materiality

Our approach to materiality

Basis of our materiality benchmark

- The Audit Director has determined materiality as £36k (2020/21: £35k) and performance materiality as £25k (2020/21: £23k), based on professional judgement, the requirements of auditing standards and the financial measures most relevant to users of the Annual Report and Accounts.
- We have used 3.5% (2020/21: 3.5%) of forecast gross expenditure as the benchmark for determining materiality and applied 70% (2020/21: 65%) as performance materiality. We have judged expenditure to be the most relevant measure for the users of the accounts. The percentages applied have been revisited to take into account our knowledge of the Commissioner's Office in 2021/22.
- **Reporting to those charged with governance**
- We will report to you all misstatements found in excess of £1.8k (2020/21: £1.75k).
- We will report to you misstatements below this threshold if we consider them to be material by nature.

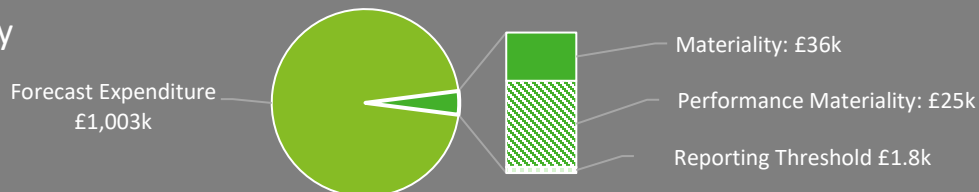
consistent with Audit Scotland guidance which states that the threshold for clearly trivial above which we should accumulate misstatements for reporting and correction to the Commissioner's Office must not exceed £250k.

Our Annual Audit Report

We will:

- Report materiality.
- 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.

Materiality



Although materiality is the judgement of the Audit Director, the Commissioner's Office must satisfy itself 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	Proposed reporting timeline to the Commissioner	Audit Scotland/ statutory deadline
1. Auditing the annual accounts	Annual Audit Plan	February/ March 2022	28 Feb 2022
	Independent auditor's report	September/ October 2022	31 Oct 2022
2. Audit dimensions	Annual Audit Plan	February/ March 2022	28 Feb 2022
	Annual Audit Report	September/ October 2022	31 Oct 2022
3. Other wider scope audit work	Fraud Returns	N/A	30 Nov 2021*, 28 Feb 2022 *, 31 May 2022, 31 Aug 2022

*These returns have been submitted by the deadline.

Significant risks

Significant risk dashboard

Risk	Fraud risk	Planned approach to controls	Level of management judgement	Page no
Management override of controls		DI		11
Operating within the expenditure resource limits		DI		12

Level of management judgement



High degree of management judgement



Some degree of management judgement



Limited management judgement

Controls approach adopted



Assess design & implementation

Significant risks

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 Report and 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 Report and 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 Report and 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 Report and 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 Report and 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)

Operating within the expenditure resource limits



Risk identified and key judgements

Under Auditing Standards there is a rebuttable presumption that the fraud risk from revenue recognition is a significant risk. In line with previous years, we do not consider this to be a significant risk for the Commissioner's Office as there is little incentive to manipulate revenue recognition with the majority of revenue being from the Scottish Parliamentary Corporate Body ('SPCB') which can be agreed to confirmations supplied.

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

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



Deloitte response and challenge

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

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

Coronavirus (COVID-19) outbreak

Impact on our audit

The COVID-19 pandemic had a significant impact on the 2019/20 and 2020/21 audit process.

Requirements

A key element of the reporting requirements for the Commissioner's Office, which will continue for 2021/22, is 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 Commissioner's Office plans to mitigate those effects should be included in the narrative reporting (including where relevant the Annual Governance Statement), including in the discussion on Principal Risks and Uncertainties impacting an organisation.

Actions

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 Commissioner's Office 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.

Impact on the Commissioner's Office and management actions

We will consider the key impacts on the Commissioner's Office such as:

- Interruptions to service provision
- Supply chain disruptions
- Unavailability of personnel

Impact on Annual Report and Accounts

We will consider the impact of the outbreak on the Annual Report and Accounts, discussed further on the next slide including:

- Narrative reporting, including disclosures on financial sustainability
- Principal risk disclosures

Impact on our audit

We will continue to assess the impact on the audit including:

- Resource planning
- Timetable of the audit
- Impact on our risk assessment
- Logistics including meetings with entity personnel

Coronavirus (COVID-19) outbreak (continued)

Impact on our audit (continued)

Impact on Annual Report and Accounts

Narrative and other reporting issues

The following areas will need to be considered by the Commissioner's Office :

- 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 Commissioner's Office will need to report the impact on material transactions including decisions made on the measurements of assets and liabilities.

Going concern assessment

The Annual Report and Accounts should include disclosure on the basis of the Commissioner's Office assessment of going concern, including related uncertainties.

The Commissioner's Office 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 Commissioner's Office 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 ongoing uncertainty about the UK's future relationship with the EU

The UK-EU Trade and Cooperation Agreement (the 'Deal') agreed on 24 December 2020 has brought certainty and clarification about many (but importantly not all) of the changes arising from the UK's departure from the EU. Commissioners should update their assessments of the impact of Brexit on their operations and business model, and on the Annual Report and Accounts (both the recognition and measurement of assets and liabilities and the related disclosures).

Clear disclosure should be provided of the key assumptions used in cash flow forecasts and the significant judgements and estimates made in recognising and measuring the amounts in the Annual Report and Accounts.

ACTION: Depending upon events through to the date of signing, we would expect to see Annual Report and Accounts 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 Commissioner's Office closer to the time areas where disclosures may be appropriate, ensuring this is done on a proportionate basis.

Reporting hot topics (continued)

Increased focus on quality reporting



Climate-related risks

The PRI and other investors groups have published an open letter confirming their view that climate-related risks are material factors that should be reflected appropriately in Annual Report and Accounts statements. The IIGCC has also published a report reiterating their expectations for the Paris Agreement to be considered in drawing up accounts.

In November 2020, the FRC published its review of climate-related considerations which includes the FRC's expectations of companies, financial statements and auditors. The FRC highlights that "the implications of climate change will affect a wide range of board companies. In developing a company's strategic direction, the Commissioner's Office "should be taking into account all the possible effects of climate change" and that "corporate reporting should address the company's impact on the environment, the resilience of its business model and the impact of climate change on its financial statements." The [FRC's year-end letter to CEOs, CFOs and Audit Committee Chairs](#) highlights that "users expect companies to provide full information about the future impact of climate change on the business and how the company's activities affect the environment" and that financial statements should explain the impact of climate-related risks, policies and strategies on measurement and disclosure.

The path to mandatory TCFD reporting is also clear:

- TCFD disclosures are required under a new listing rule for all premium listed companies, initially, on a comply or explain basis **from 1 January 2021**;

- The UK Government has published a consultation on requiring mandatory climate-related disclosures for publicly quoted companies, large private companies and LLPs in line with the four pillars of TCFD and its roadmap towards mandatory climate-related disclosures across the economy by 2025; and
- The European Commission (EC) has published proposals for a Corporate Sustainability Reporting Directive (CSRD) that would make sustainability reporting mandatory for all EU listed and large companies. The EU has stated that its approach to standard-setting should take account of existing standards and frameworks, including TCFD. TCFD is already included in voluntary guidance on the Non-Financial Reporting Directive.

ACTION: Climate change is a strategic issue and should be on the Commissioners agenda. We therefore expect the narrative within the Annual Report and Accounts to include the following, whilst ensuring this is proportionate to the Commissioners Office:

- An explanation of how climate change is assessed as a strategic issue
- Clarity of whether climate change represents a principal or emerging risk and how it is being managed
- If climate-related targets or metrics are disclosed, an explanation of how those targets or metrics fit into strategic targets/ approach.
- An assessment of the readiness to make disclosures in line with the four areas recommended by the TCFD.

Audit quality

Our commitment to audit quality



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

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

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

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

Our engagement team is selected to ensure that we have the right subject matter expertise and industry knowledge. 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 Annual Report and Accounts. The audit dimensions provide a common framework for all the audit work conducted for the Auditor General and for the Accounts Commission.



As a result of a number of significant issues identified in our 2020/21 audit, the Auditor General for Scotland reported to the Scottish Parliament's Public Audit Committee (PAC) in January 2022 under section 22 of the Public Finance and Accountability (Scotland) Act 2000. This report drew the Parliament's attention to the issues relating to weaknesses in leadership and governance that were identified in our 2020/21 audit. In view of these issues, we have concluded that it remains appropriate to apply expanded wider scope requirements to specifically follow-up on the recommendations made in 2020/21. Based on the findings of our 2021/22 audit, it will be for the Auditor General for Scotland to decide whether a further report to the PAC under section 22 is considered appropriate. Our planned work is summarised on pages 19 and 20, which will specifically focus on following up on the progress made with the recommendations raised in our 2020/21 audit report and the subsequent section 22 report.

In addition to the audit dimensions work, we are also required to carry out the following areas of work, if required:

- Preliminary enquiries on all correspondence received; and
- Submission of fraud returns.

Wider scope requirements (continued)

Audit dimensions (continued)

Audit dimension	Financial sustainability
Significant risks identified	<p>In our 2020/21 audit report, we concluded that while the Commissioner's Office had set a balanced budget for 2021/22, given the lack of business planning in place, there was a risk to short term financial balance. We also reported that there was no medium or long-term financial planning in place, or a comprehensive workforce plan. This therefore remains a significant risk and will be a key area of focus for our audit work.</p>
Planned audit response	<p>We will consider the final outturn position for 2021/22 to consider whether short term financial balance has been achieved.</p> <p>We will also assess the development of the 2022/23 budget and the progress being made in developing a medium-term financial plan and workforce plan. In particular, we will follow-up on the recommendations made in our 2020/21 audit report.</p>

Wider scope requirements (continued)

Audit dimensions (continued)

Audit dimension	Governance and Transparency, Value for Money
Significant risks identified	<p data-bbox="488 395 1866 501">In our 2020/21 audit report, we identified significant weaknesses in the governance and scrutiny and value for money arrangements in place. This was also highlighted in the Auditor General for Scotland's report to the PAC, published in December 2021 and considered by PAC in January 2022.</p> <p data-bbox="488 546 1070 575">The most specific risks include the following:</p> <ul data-bbox="488 586 1866 918" style="list-style-type: none">• A breakdown in the key relationships between the Commissioner, Standards Commission and AAB;• A lack of a comprehensive and compliant investigations manual;• An ineffective risk management framework;• A lack of an internal audit function;• A lack of openness and transparency;• A lack of a performance management framework;• A lack of a formal training programme for staff;• A lack of clarity with regard to the whistleblowing policy and reporting routes for concerns about a Commissioner. <p data-bbox="488 963 1866 1146">As reported in our 2020/21 annual audit report and from our early planning discussions as part of the 2021/22 audit, management have accepted all of the recommendations and are actively taking these forward as a matter of priority. There does, however, remain a significant risk given the significance of the issues reported and the need for input from the Scottish Parliamentary Corporate Body and the Parliament to address some of them.</p>
Planned audit response	We will assess the progress made by the Commissioner's Office on each of the recommendations made within our audit report for 2020/21.

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 Report and 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 Commissioner's Office, 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 Commissioner's Office.

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 Report and Accounts and the other procedures performed in fulfilling our audit plan.

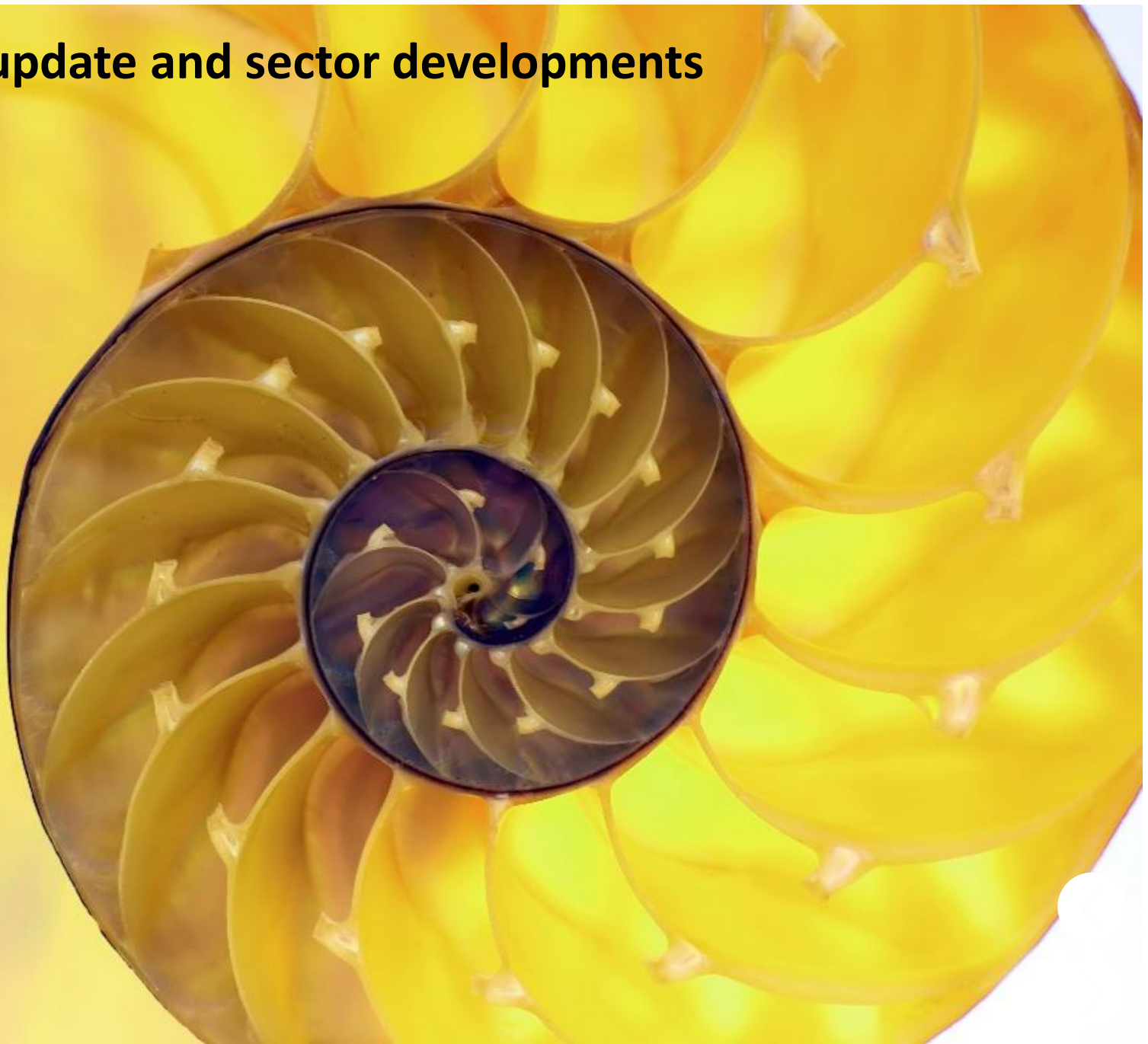
Other relevant communications

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



Pat Kenny
for and on behalf of Deloitte LLP
Glasgow | 25 February 2022

Technical update and sector developments



Changes to accounting standards

IFRS 16 - Leases

Background

IFRS 16 comes into effect on 1 April 2022. HM Treasury have decided that IFRS 16 will be adopted without retrospective restatement: this means that when it is implemented in 2022/23, Commissioners will recognise the cumulative impact of applying the standard as at 1 April 2022, with all adjustments to opening balances at that date taken through the General Fund.

IFRS 16 introduces a single lessee accounting model that results in more faithful representation of a lessee's assets and liabilities, and improves comparability between leased and purchased assets operated by Commissioners. The standard also introduces enhanced disclosures which are intended to improve transparency of financial reporting; full disclosure will be required in 2022/23 financial statements and beyond.

IAS 8 requires entities to disclose an assessment in their 2021/22 accounts of the possible impact of implementing IFRS 16. All Commissioners should be in a position to estimate this impact before 1 April 2022 and make these disclosures unless immaterial.

Next steps

We recommend that management update the AAB on the progress made with the implementation of the new standard, and we will report specifically on the findings from our audit work in this area.

Practical Challenges

There are a number of practical challenges that Commissioners need to consider in preparing for implementation of the new standard, including:

- **Additional cost of asset ownership** – IFRS 16 will increase the amount of fixed assets an organisation will need to maintain information regarding to inform valuation assessments for instance (revaluation or impairment)
- **Completeness of data** – Obtaining and assessing all of the relevant data. Completeness of the lease registers/ Assets records will require greater level of detail.
- **Estimates and judgements** – Separating lease and non-lease components, consideration of extension and termination options
- **Judgements around existing arrangements** – Lack of documentation in around the lease agreement in some cases will require judgements as to what extent arrangements represent and what accounting treatment is appropriate.
- **Lease Management** – after the initial implementation Boards will have to continue maintaining control of the lease arrangements. Regular reassessment reviews etc.

There are many colleagues within Commissioners and externally who can assist with challenges and issues you come across when implementing the new Standard – Finance, Estates teams, contract owners, HM Treasury, Other Boards/ IJB/ Local Authorities, National Bodies and Auditors.

Changes to the Government Financial Reporting Manual (FReM)

2021/22 Edition

Background

HM Treasury has issued a revised version of the FReM for the financial year 2021/22. The FReM is the technical accounting guide to the preparation of the Annual Report and Accounts.

The main changes in the 2021/22 edition of the FReM apply to the Remuneration and Staff Report and relate to:

- Additional guidance and reporting requirements for a single total figure of remuneration table (paragraphs 6.5.8e to 6.5.15)
- Revised disclosures for fair pay (6.5.19 to 6.5.24)

We have provided management with detailed guidance to help ensure compliance with the above. We have also provided management with a paper summarising the key sections of the FReM which we recommend is used as a 'checklist' to ensure that the mandatory requirements are met, from both the *letter* and the *spirit* of the requirements. These should be considered from the users of the accounts perspective, who may not necessarily be as informed/ knowledgeable as the entity on the matters being disclosed.

Next steps

We recommend that management review the changes to the FReM at the earlier opportunity, with particular reference to our detailed guidance note. We are happy to have early discussion on this to agree proposed amendments.

Climate change

Consideration of the impact on the audit annual report and accounts

Role of Audit

In June 2021, the Auditor General for Scotland published a blog “making climate change an audit priority” that sets out the challenges for the public sector in tackling climate change and the role audit could play in this.

In July, Audit Scotland held a roundtable to help inform its approach to auditing climate change. The roundtable was made up of the climate change leads for the Accounts Commission and key stakeholders from across Scotland. They posed some challenging questions around the opportunities and challenges of tackling climate change and what it meant for the public sector. Several **key themes and challenges** emerged which were published in an update in October 2021 [Auditing climate change: An update \(audit-scotland.gov.uk\)](https://audit-scotland.gov.uk):

- Climate ambition v plans and actions.
- Importance of adaption.
- Paying for it.
- Critical role of the public.
- Joined up working.
- Public sector leadership role.

The time is right for independent audit and scrutiny to help achieve Scotland’s climate change ambitions.

Annual Report and Accounts considerations

As part of our planning discussions with management, we have shared an illustrative framework. The potential impacts of climate change are extensive and pervasive, therefore we recommend the framework is adopted and continually reviewed. Specific areas to start considering in advance of drafting the Annual Report and Accounts include key risks, mitigating actions (for **narrative disclosure**) and impact on **judgements and estimates** made by management:

Acute physical risks, e.g. extreme weather events causing supply chain disruption or severe damage to PPE.

Chronic physical risks, e.g. rising sea levels causing damage to PPE; or increased temperatures resulting in higher heat stress to employees.

Policy and Legal transition risks, e.g. direct and indirect tax compliance as tax legislation develops.

Technology transition risks, e.g. development and use of emerging technologies such as renewable energy and battery storage.

Market transition risks, e.g. changing consumer trends resulting in services becoming obsolete.

Reputation transition risks, e.g. damage to reputation through failure to transition effectively to a lower-carbon economy.

Financing risks.

The State of the State 2021-22

Towards a new public sector normal

Background and overview

Now in its ninth year, this report brings together Deloitte and think tank Reform to provide an annual snapshot of the UK's public sector.

This year's report features an exclusive Ipsos MORI survey of more than 5,000 members of the UK public – including almost 900 Scottish adults – plus analysis of interviews with more than 50 senior figures across the UK's public sector. This blend of quantitative and qualitative research offers a unique perspective on government and public services.

What will I learn from this year's State of the State?

Since March 2020, the UK's governments and public services have led radical, exhaustive, and dynamic responses to the coronavirus pandemic. This year's State of the State finds them dealing with both the pandemic and its wider repercussions as a 'new normal' emerges.

Looking beyond the pandemic, the UK Government has set out its ambition to 'build back better' through infrastructure investment, levelling up economic outcomes across the regions and revitalising the UK's place in the world. At the same time, the policies and politics of Scotland, Northern Ireland and Wales continue to diverge from Westminster and Whitehall as well as each other. The State of the State explores all of these developments.

Next steps

A summary of the some of the key Scottish findings are provided on the next page. The full report is available at [The State of the State 2021/22 \(deloitte.com\)](https://www.deloitte.com/uk/en/sectors/public-sector/state-of-the-state-2021-22.html)



The State of the State 2021-22 (continued)

Towards a new public sector normal (continued)

Public spending

This year has seen a shift in attitudes to public spending amongst Scottish people. Historically, the keenest in the UK on a higher tax and higher spend environment, views in Scotland are now broadly the same as those in the rest of the UK; possibly driven by the cost of the pandemic on the public purse and worries over household incomes.

29% of the public want to see higher levels of spending after the pandemic.

30% want to see the same balance of tax and spending as before the pandemic began

27% would like to see tax cuts and spending cuts to match.



Social mobility

40% of Scots believe skills and employability are the most important factors when trying to get ahead in life. However, Scots feel more strongly than the UK average that wealth and region are also important indicators on getting ahead in society.



Spending priorities

The Scottish public's views were in line with the rest of the UK with public health and social care the most frequently named priorities.

Support for the growth in green industries and technologies is also high in Scotland, sitting behind housing but on a par with primary and secondary schools and reducing inequality between UK regions.

Appendices



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 Report and Accounts as a whole are free from material misstatement, whether caused by fraud or error.
- As set out in the significant risks section of this document, we have identified risks of material misstatement due to fraud in relation to operating within the expenditure resource limit, and management override of controls.
- We will explain in our audit report how we considered the audit capable of detecting irregularities, including fraud. In doing so, we will describe the procedures we performed in understanding the legal and regulatory framework and assessing compliance with relevant laws and regulations.



Fraud Characteristics:

- Misstatements in the Annual Report and 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 Report and 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 Report and 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.



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 Commissioner's Office and will reconfirm our independence and objectivity to the Commissioner's Office for the year ending 31 March 2022 in our final report to the AAB.

Fees

The audit fee for 2021/22, in line with the fee range provided by Audit Scotland is £15,784, as analysed below:

	£
Auditor remuneration	12,804
Audit Scotland fixed charges:	
Pooled costs	2,470
Contribution to AS costs	510
Total proposed fee	15,784



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 Commissioner'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 Commissioner's Office, 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

Executing high quality audits remains our number one priority. We are committed to our critical public interest role and continue to embed our culture of quality and excellence into all of our people. This includes using new technology and tools to continue to transform our audit approach.

In July 2021 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 2020/21 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.

In that context, overall FRC inspection results, showing an improvement since last year from 76% to 79% of all inspections assessed as good or needing limited improvement, reflect the progress we are making. The overall profile of our ICAEW inspections and our internal inspection programme also show a similar overall improvement since last year.

The results for the inspections of FTSE 350 entities fell short of our overall scores, reflecting specific findings on those particular audits rather than issues pervasive across other audits. Our objective continues to be for all 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 agree with and accept the FRC’s findings on the individual inspections. The FRC has recognised improvements following the actions and programmes for previous years and we welcome the good practice points raised, including in respect of impairment and revenue where individual findings continue to occur.

Overall, we are pleased that there have been no significant findings over our firm wide processes and controls over the last three inspection cycles in the areas subject to rotational review by the FRC. However, we are continually enhancing our processes and controls across our business and such changes will directly or indirectly affect audit quality.

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 2020/21 Audit Quality Inspection Report on Deloitte LLP

"We reviewed 19 individual audits this year and assessed 15 (79%) as requiring no more than limited improvements. Of the 11 FTSE 350 audits we reviewed this year, we assessed eight (73%) as achieving this standard".

"Our key findings related primarily to the need to:

- Improve the evaluation and challenge of management's key assumptions of impairment assessments of goodwill and other assets.
- Enhance the consistency of group audit teams' oversight of component audit teams.
- Strengthen the effectiveness and consistency of the testing of revenue."

"The firm has taken steps to address the key findings in our 2019/20 public report, with actions that included increasing the extent of consultations, and enhanced learning, coaching and support programmes.

We have identified improvements, for example, in the extent of challenge of management by audit teams in respect of the estimates used for model testing. This was identified as a key finding last year.

We also identified good practice in a number of areas of the audits we reviewed (including robust procedures relating to going concern and evidence to support the challenge of management in areas of key judgement) and in the firm-wide procedures (including establishing a centre of excellence focused on credit for banking audits to encourage the consistent application of the firm's methodology and guidance)."



Our approach to audit quality (continued)

Quality of public audit in Scotland – Annual Report 2020/21

Audit Scotland published its annual assessment of audit quality carried out on the audit work delivered by Audit Scotland and appointed firms. A copy of the full report is available: [Quality of public audit in Scotland annual report 2020/21 | Audit Scotland \(audit-scotland.gov.uk\)](https://www.audit-scotland.gov.uk/quality-of-public-audit-in-scotland-annual-report-2020-21)

The **public audit model in Scotland** is fundamentally different to the private sector audit regime and is well placed to meet the challenges arising from the reviews of the auditing profession.

The audit profession remains under scrutiny after high-profile corporate collapses in the private sector. The Brydon review, alongside the Kingman review, the Competition and Markets Authority market study of the audit services market and the Business, Energy and Industrial Strategy Committee's report on the Future of Audit all placed a strong focus on the need for independence of auditors from the bodies they audit.

Public audit in Scotland is well placed to meet the challenges arising from the reviews of the auditing profession. It already operates many of the proposed features to reduce threats to auditor independence including:

- independent appointment of auditors by the Auditor General for Scotland and Accounts Commission
- rotation of auditors every five years (current appointments extended to six years due to Covid-19)
- independent fee-setting arrangements and limits on non-audit services
- a comprehensive Audit Quality Framework.

Environment

The global pandemic has changed and challenged most aspects of our lives. Public bodies have been at the forefront of managing the effects of the COVID-19 pandemic. Public bodies have focused on supporting those most affected. Many bodies had new obstacles to overcome as they prepared financial statements and responded to auditors.

The Scottish Government delayed the accounting and auditing deadlines for NHS and local government bodies to help accommodate these competing pressures. The Auditor General for Scotland and Accounts Commission revised their work programme and prepared COVID-19 specific briefing papers to support public bodies and auditors to respond to the pandemic.

The Auditor General for Scotland and Accounts Commission recognised that the safety and wellbeing of audit staff and staff in public bodies was paramount and that auditors would need to take a pragmatic and flexible approach to their work in 2020/21. They were clear that audit quality should not be compromised.

Our approach to audit quality (continued)

Quality of public audit in Scotland – Annual Report 2020/21 (continued)

Key messages

1. The application of the Audit Quality Framework (AQF) continues to identify improvement areas and good practice in audit quality. Across the range of evidence used to assess audit quality the conclusion is that the quality of audit work is good in Performance audit and Best Value audit and accountancy firms, with improvement required and planned in Audit Scotland's Audit Services Group where the financial audit quality results do not meet the expected standards.

2. Areas of Good Practice

- ICAS have reviewed compliance with International Standard on Quality Control 1 for all auditors and did not note any issues or matters for further consideration. [\(One Deloitte file reviewed in 2020/21\)](#)
- All 2019/20 annual audit opinions were signed off by 9 March 2021. [\(All Deloitte opinions signed by 31 October 2020\)](#)
- Two financial audits reviewed were awarded the highest scores available by the Institute of Chartered Accountants of Scotland (ICAS) with no areas for improvement identified. [\(One Deloitte file reviewed – awarded score of 2A – limited improvement required\)](#)
- All of the Performance audit and Best Value audits reviewed achieved expected quality standards with limited concerns identified. All audit providers have confirmed that there continued to be a strong culture of support for performing high-quality audit during the pandemic. [\(One Deloitte Best Value file reviewed – awarded score of 2A – limited improvement required\)](#)
- Stakeholder feedback shows further improvement in the level of satisfaction with external audit services provided, the usefulness of the annual audit report and shows that audit work has had impact.

3. Areas for improvement

- Seven of the eleven (64 per cent) 2019/20 Audit Services Group financial audits reviewed did not meet the expected standard. [\(Not applicable to Deloitte audits\)](#)
- For two audits, auditors need to investigate the risk of material misstatement in the financial statements and ensure that any such misstatement is resolved appropriately. [\(Not applicable to Deloitte audits\)](#)
- An area that continues to be an issue for most audit providers is on audit staff views of having sufficient time and resources to deliver high quality audit. [\(An area continually monitored in planning all audits\)](#)



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