KPMG 150 years supporting the UK

Scottish National Investment Bank Plc

Report to the Audit Committee

Audit plan and strategy for the year ending 31 March 2022

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Report Date: 24 November 2021

Meeting Date: 1 December 2021

Introduction

About this report

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

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

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

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

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

Introduction (Continued)

To the Audit Committee of Scottish National Investment Bank Plc

We are pleased to have the opportunity to meet with you on 1 December 2021 to discuss our audit of the financial statements of Scottish National Investment Bank Plc ("SNIB") and its subsidiaries ("the Group") as defined on page 6, as at and for the year ended 31 March 2022.

This report outlines our risk assessment and planned audit approach. We provide this report to you in advance of the meeting to allow you sufficient time to consider the key matters and formulate your questions.

The engagement team

I am the engagement partner on the audit and am responsible for the audit opinion. I have over 22 years of experience with KPMG in the financial services industry and this will be my second year signing the audit opinion.

Other key members of the engagement team include Nina Aslibekyan (Senior Manager) with 8 years of experience.

Scope definition

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

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

We will also perform work in accordance with the wider responsibilities embodied in the Code of Audit Practice approved by the Commission and the Auditor General (see page 29).

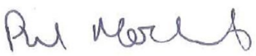
How we deliver audit quality

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

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

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

Yours sincerely,



Philip Merchant

24 November 2021

Overview of planned scope including materiality

Our materiality levels

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

Group materiality is calculated as £2,650k based on 2.5% of total assets (PY: 2.5% of total assets) of £107m per the draft trial balance as at 30 September 2021. Parent materiality is calculated as £1,855k which is the component materiality for the parent company determined by the group audit engagement team. This is lower than the materiality we would otherwise have determined with reference to parent company total assets, of which it represents 1.8%. Materiality figures will be revised when the year end position is finalised.

To respond to aggregation risk from individually immaterial misstatements, we design our procedures to detect misstatements at a lower level of materiality, £1,700k for the Group and £1,200k for the Parent.

Materiality	Group	Parent
Materiality for the financial statements as a whole	**£2,650k** (PY: £820K)	**£1,855k** (PY: £574K)
Procedures designed to detect individual errors	**£1,700k** (PY: £530K)	**£1,200k** (PY: £373K)
Misstatements reported to the Audit Committee	**£130k** (PY: £40K)	**£90k** (PY: £28K)

We will report misstatements to the Audit Committee including:

- Corrected and uncorrected audit misstatements above £130k for the Group and £90k for the Parent.
- Errors and omissions in disclosure (corrected and uncorrected).
- Other misstatements we include due to the nature of the item.

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

Control environment

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

Timing of our audit and communications

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

- Audit committee meeting on 1 December 2022 where we present our initial audit plan;
- Status meetings with management throughout the duration of our audit work;
- Audit committee meeting at the completion stage of the audit where we communicate the findings of our work, any audit misstatements and significant control deficiencies.

A timeline is included in the appendix.

Our fees

We have included a separate update on our proposed fees for 2022 audit to the directors on page 19 and will be happy to discuss the fees at the meeting.

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Significant risks and other areas of audit focus

Our risk assessment draws upon our historic knowledge of the business, the industry and the wider economic environment in which SNIB operates.

We also use our regular meetings with senior management to update our understanding.

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

Our long form audit report will include details of our findings in relation to significant financial statement audit risks and key audit matters.

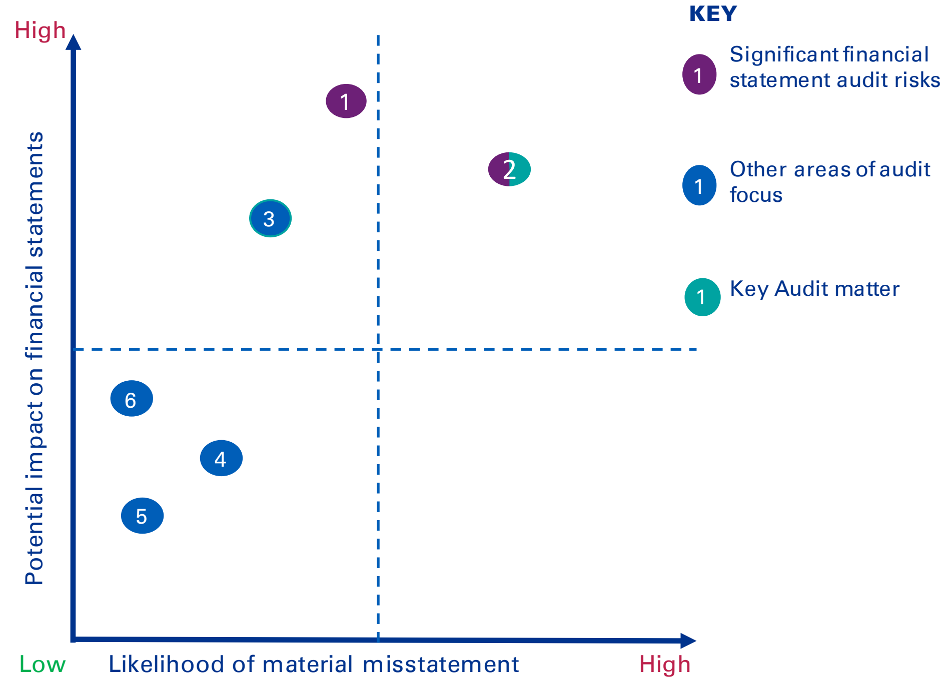
Significant risks

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

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

Going concern

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



Significant Risks	
1	Management override of controls
2	Valuation of unlisted investments (Key audit matter)
Other Areas of Audit Focus	
3	Going concern and the impact of COVID-19
4	Expenses
5	Cash
6	Financial Reporting

KPMG

Group scoping

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

	Materiality	Performance materiality	Misstatements reported to the Audit Committee
Significant Risks			
Scottish Investments Limited (SIL)	£2,640k	£1,715k	£132k
Scottish Investments Services Limited (SISL)	£284k	£184k	£14k

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

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

Audit risks and our audit approach

1 Management Override of Controls[a]

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

Significant audit risk

The risk

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

Planned response

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

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

Audit risks and our audit approach (continued)

2 Valuation of unlisted investments

Risk that the carrying value of unlisted investments is materially misstated

Significant audit risk

The risk

- The Group's portfolio of unlisted investments makes up 78% of the total assets (based on the draft trial balance as at 30 September 2021). Unlisted investments are measured at fair value, which is established in accordance with the International Private Equity and Venture Capital Valuation Guidelines by using measurements of value such as prices of recent orderly transactions, earnings multiples and net assets.
- The effect of these matters is that, as part of our risk assessment, we determined that the valuation of unlisted investments has a high degree of estimation uncertainty, with a potential range of reasonable outcomes greater than our materiality for the financial statements as a whole.

Planned response

- **Methodology choice:** In the context of observed industry best practice and the provisions of the International Private Equity and Venture Capital Valuation Guidelines, we will challenge the appropriateness of the valuation basis selected;
- **Our valuations experience:** We will challenge the directors on key judgements affecting investee company valuations, such as the choice of benchmark for earnings multiples. We will compare key underlying financial data inputs to external sources, investee company audited accounts and management information as applicable. We will challenge the assumptions around sustainability of earnings based on the plans of the investee companies and whether these are achievable. Our work will include consideration of events which occur subsequent to the year end up until the date our audit report;
- **Comparing valuations:** Where a recent transaction is used to value a holding, we will obtain an understanding of the circumstances surrounding the transaction and whether it is considered to be on an arm's length basis and suitable as an input into a valuation;
- **Assessing transparency:** We will consider the appropriateness, in accordance with relevant accounting standards, of the disclosures in respect of unlisted investments and the effect of changing one or more inputs to reasonably possible alternative valuation assumptions.

Audit risks and our audit approach (continued)

3 Going concern

Ability of the business to continue as a going concern

Other areas of audit focus

The risk

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

Planned response

- Evaluate how management's risk assessment process identifies business risks relating to events and conditions that may cast significant doubt on the ability to continue as a going concern;
- Evaluate any models management uses in its assessment and evaluate how the information system captures events and conditions that may cast significant doubt on ability to continue as a going concern;
- Evaluate whether management's assessment has failed to identify events or conditions that may cast significant doubt on going concern and whether the method used by management is appropriate;
- Assess management's going concern assessment including the plausible but severe downside scenarios particularly whether those downside scenarios reflect plausible impacts of COVID-19 on the business;
- Evaluate whether sufficient and appropriate audit evidence has been obtained to conclude whether a material uncertainty exists and the appropriateness of management's use (or otherwise) of the going concern basis of accounting;
- Evaluate whether there is adequate support for the assumptions underlying management's assessment, whether they are realistic and achievable and consistent with the external and/or internal environment and other matters identified in the audit;
- Challenge management's plans for future actions, and verify the reliability and relevance of data used. Determine whether the outcome of these plans is likely to improve the situation and whether management's plans are feasible; and
- We will inspect letters received by the directors indicating Scottish Government's intention to provide this support and will assess the business reasons why Scottish Government may or may not choose to provide this support.

Audit risks and our audit approach (continued)

4 Expenses

Expenses may be materially misstated

Other areas of audit focus

The risk

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

Planned response

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

Audit risks and our audit approach (continued)

5 Cash

Cash balances may be materially misstated.

Other areas of audit focus

The risk

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

Planned response

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

Audit risks and our audit approach (cont.)

6 Financial reporting

Risk related to non compliance with the various regulatory and disclosure requirements

Other areas of audit focus

The risk

The Group must ensure the financial statements have been properly prepared and comply in all material respects with the disclosure requirements of:

- IFRS, where appropriate, as interpreted and adapted by the 2020/21 Government Financial Reporting Manual (the 2020/21 FReM)
- the Companies Act 2006;
- directions made under the Public Finance and Accountability (Scotland) Act 2000 by the Scottish Ministers.

The directors have decided to prepare voluntarily a Corporate Governance Statement as if the Company were required to comply with the Listing Rules and the Disclosure Guidance and Transparency Rules of the Financial Conduct Authority in relation to those matters.

Planned response

- We will evaluate the financial statements using our tailored checklists covering the requirements of the Companies Act 2006, IFRS the UK Corporate Governance Code and the FCA Disclosure, Guidance and Transparency Rules will provide comments to the management.
- Over the course of our audit, we will evaluate the appropriateness of the Group's accounting policies, accounting estimates and financial statement disclosures including those over key estimates and judgements.
- We will also read the Viability Statement, including consideration of the robust assessment of the principal risks threatening the business, how these have been mitigated and the period over which they have been considered that the Group can reasonably expect to continue in operation.
- We will review the s172 statement and assess it for compliance with corporate governance requirements.
- We will consider the disclosures surrounding COVID-19 in the context of the situation at year-end.
- We will consider the appropriateness of any ESG disclosures in the annual report, as well as the wider impact of climate-related matters on any account balances and disclosures.

Wider scope

Approach

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

Risk assessment

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

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

Identification of significant risks

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

Significance has both qualitative and quantitative aspects.

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

Concluding on wider scope

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

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

Reporting

At the planning stage we have not identified any significant risks relating to wider scope reporting. We will update our assessment throughout the year and should any issues present themselves we will report them in our Audit Highlights Memo.

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

Appendices

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Audit Committee 1 December

Audit Committee meeting

Valuation Committee meeting

Audit Committee meeting

AGM

SNIB Plc, SIL & SISL filing deadline

Debrief 2022

COVID-19: Audit implications

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

The table below identifies the specific areas of our audit that may be affected by the COVID-19 pandemic, and how our audit may differ from the prior year. Where required, we will engage in more frequent communications with the audit committee and management due to the increased risks of material misstatement, the potential challenges in completing our audit and the continually developing events.

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

COVID-19: Audit implications (continued)

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

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

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

Confirmation of independence

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

To the Audit Committee

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

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

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

— general procedures to safeguard independence and objectivity;

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

— independence and objectivity considerations relating to other matters.

General procedures to safeguard independence and objectivity

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

— instilling professional values;

— communications;

— internal accountability;

— risk management;

— independent reviews.

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

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

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

Application of the FRC Ethical Standard 2019

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

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

Confirmation of audit independence

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

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

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

Yours faithfully

KPMG LLP

KPMG LLP

Audit Fees

We recognise the need for competitive fees and we wish to provide value. We believe in being very open in the way we deal with audited entities and our approach to fees is no different.

Our fee proposal below is based on the level of work we expect to carry out for 2022 audits.

	2022	**2021**
Scottish National Investment Bank plc (SNIB)	70,000	70,000
Scottish Investments Limited (SIL)	43,000-87,000*	20,000
Scottish Investments Services Limited (SISL)	24,645	20,000
Total	**137,645-181,645**	**110,000**

* Estimate, subject to review of year end portfolio

The underlying principles of our fee calculation were agreed at the time of our appointment in May 2020.

The SIL fee is driven by the number of level 3 investments as at the reporting date. The fee charged per investment ranges from £2,000 to £4,000, reflects the work required to audit level 3 investments and is consistent with the fee levels for other audited entities. The audit fee for SIL will be in the range £43,000-£87,000 where the lower end of the range is an estimated fee for the audit of the portfolio as at the 30 September 2021 (8 investments) and the higher end of the range is based on the pipeline (25 investments) as at the year end. The final fee will be revised and agreed as at the year end once we receive the final portfolio.

SNIB and SISL fees are based on the level of work we perform for similar entities and takes into account actual prior year hours.

The fee schedule above does not include any CASS audit that may be required for SIL depending on the timing of permissions approval by FCA. If we are engaged to deliver this work, the fee for it will be agreed separately.

FRC's areas of focus

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

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

FRC's areas of focus (continued)

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

Mandatory communications

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

Newly effective standards

	Expected impact				Effective for years beginning on or after		
Standards	**High**	**Moderate**	**Low**	**None**	**1 January 2021**	**1 January 2022**	**1 January 2023**
Interest Rate Benchmark Reform Phase 2 (Amendments to IFRS 9, IAS 39, IFRS 7, IFRS 4 and IFRS 16)			●		✓		
Onerous Contracts – Cost of Fulfilling a Contract (Amendments to IAS 37)				○		✓	
Annual Improvements to IFRS Standards 2018-2020			●			✓	
Property, Plant and Equipment: Proceeds Before Intended Use (Amendments to IAS 16)				○		✓	
Reference to the Conceptual Framework (Amendments to IFRS 3)				○		✓	
Classification of Liabilities as Current or Non-current (Amendments to IAS 1)			●				✓
IFRS 17 Insurance contracts				○			✓
Accounting Policies, Changes in Accounting Estimates and Errors: definition (Amendments to IAS 8)			●				✓
Amendments to IAS 1 Presentation of Financial Statements and IFRS Practice Statement 2 Making Materiality Judgements			●				✓
IFRS 16 Leases (effective from 1 April 2022)			●			✓	

KPMG's Audit quality framework

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

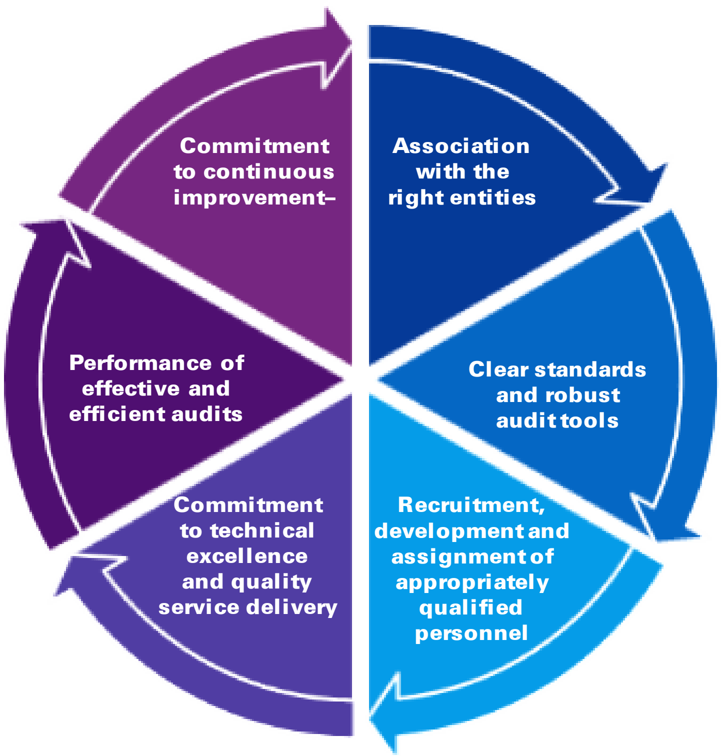
To ensure that every partner and employee concentrates on the fundamental skills and behaviours required to deliver an appropriate and independent opinion, we have developed our global Audit Quality Framework.

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

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

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

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



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

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

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

Investing in Audit Quality

The figure below identifies the performance of KPMG over FY21 to date in respect of key measures of audit quality and factors that aid the firm in the pursuit of audit quality.

01 Engaging with our stakeholders

103 ▲ 75%
Number of individual contact points with institutional investors and investor associations

£10tn >FTSE350 market cap
Value of assets under management of institutional investors attending our events

2,900 ▲ 4%
Members of our UK Audit Committee Institute

79% ▲ 9%
FTSE 100 companies who attend our Audit Committee Institute events

24% ▲ 1%
Market share of the FTSE350 (YTD FY21)

31% ▼ 44%
FTSE350 audit bids won (YTD FY21)

Audit Committee Institute survey on audit quality:

89% Audit committees believe they receive high quality audits

82% More evidence of auditors demonstrably challenging management

Based on responses from 80 FTSE350 audit committee chairs and refer to the profession overall (June 2020).

02 Investing in our audit business

810 ▲ 20%
Audit professionals working in transformation, data and analytics, information risk management and new technology

£184m
Cumulatively invested by KPMG in audit quality over the last 3 years

387 ▶ 0%
Partners and Directors

88% ▼ 2%
Top talent retention

45% ▶ 0%
Quality through diversity: Women

35% ▲ 5%
Quality through diversity: BAME

Upskilling our people

Average number of hours of mandatory training[1]

59 hours **FY20**

82 hours **FY19**

1,211k ▲ 11%
Training hours completed by audit professionals

516 ▶ 0%
Colleagues completing a professional qualification (e.g. ICAEW, ICAS)

[1] We note that the FY20 mandatory training phasing was impacted by Covid-19, this was remediated during Q1 of FY21

03 Measuring our progress

External monitoring

Audit engagements rated 'good or limited improvement required' by the FRC's AQR in 2021

75% ▲ 17% **FTSE350**

59% ▼ 2% **All reviews**

Audit engagements rated 'good or limited improvement required' by the ICAEW's QAD in 2021

100% ▲ 10% **Corporate**

100% ▲ 0% **Public Sector**

Unsatisfactory rating in internal Quality Performance Reviews of audit engagements

14% **2020**

15% **2019**

27% **2018**

Favourable employees responses in our Global People Survey to:

88% ▲ 4%
KPMG's commitment to quality is apparent in what we do on a day-to-day basis

48% ▼ 33%
I have access to the tools and resources I need to do my job effectively[2]

73% ▼ 4%
I am satisfied with the learning and development available to improve my knowledge and skills

[2] Access to tools and resources was impacted by Covid-19, this survey was issued prior to the provision of home working kits to our people

Restoring Trust in Audit and Corporate Governance

Overview

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

The consultation period has now closed.

What is KPMG view?

We support the broad direction of the reforms. It's essential that the UK's regulatory framework retains and builds on its world-leading position so that we continue to be an attractive destination: for business and investment and as a magnet for talent.

Audit has a role but, critically, others do too. We're pleased that the BEIS consultation recognises both the importance of auditors' work and that all parties within the corporate reporting ecosystem have a role to play for this reform to be successful.

Sequencing, prioritisation and careful implementation will be key. Collectively, the consultation proposes a large number of individual reforms and this in itself presents a challenge. It's important that sufficient time is given for effective implementation of some of these proposals, particularly given the complex legal framework considerations and other interdependencies which need to be taken into account.

Recommendations which will move the dial in our view are:

- The creation of ARGA with appropriate powers to regulate across the boardroom
- A new UK Internal Controls framework (provided it is accompanied by independent assurance)
- The resilience statement

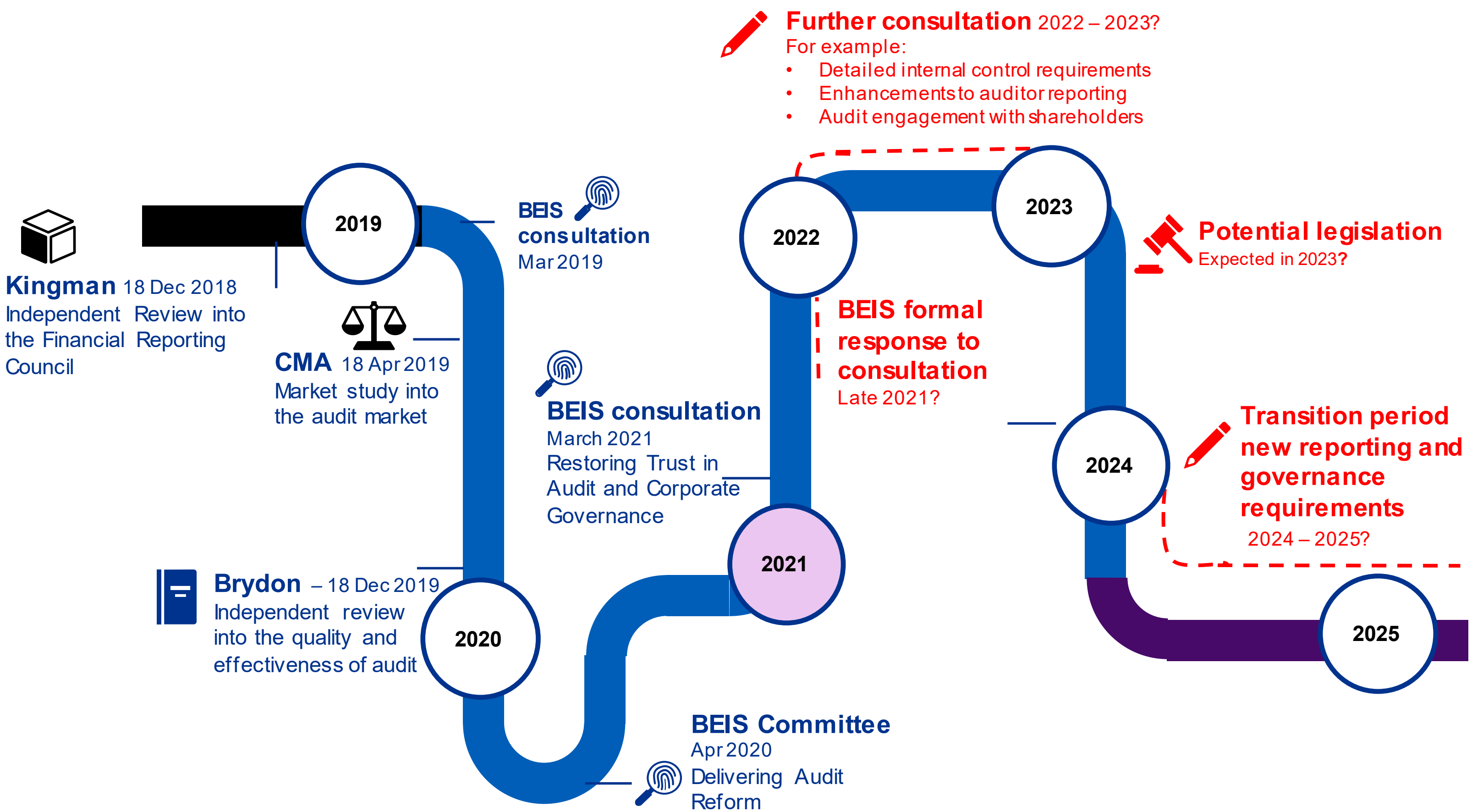
Factors essential to success, which need to be considered are:

- Market capacity and capability
- Attractiveness of the profession (both auditors and directors)
- Attractiveness of the UK in a global setting
- Proportionate costs and benefits aligned to clear aims
- Giving sufficient time for new measures to take effect

Audit and corporate governance reform - next steps

We expect further consultations to determine the precise details of how the recommendations will be taken forward.

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



KPMG view of key recommendations

Topic	KPMG View
Public Interest Entity (PIE) definition	We believe the new reporting requirements should be applied to existing PIEs before extending the definition. The definition of 'public interest' should be clarified to assess which entities should be covered.
Internal controls	We are in favour of a new internal controls framework with mandatory assurance based on benefits observed in the US following implementation of Sarbanes Oxley (SOx). We support a regime closely aligned to SOx.
Dividends and capital maintenance	Supportive of a solvency statement but there needs to be alignment of time periods covered with the Resilience Statement and further details required as to how this will operate in practice. We support narrative disclosure of a group's future dividend paying capacity.
Resilience statement	Supportive - there are some considerations to factor in: ▪ Common list of risks must not become boilerplate ▪ Alignment of time periods (particularly with the Solvency Statement) need to be considered.
Audit and assurance policy (AAP)	Support in principle - shareholder engagement is critical to the success of this recommendation. We have suggested an alternative that the regulator determine a mandatory scope of broader assurance based on engagement with investors (eg controls, KPIs impacted remuneration), which will improve comparability.
Fraud	Supportive and have recommended this is also covered by the proposed new internal controls reporting.
Audit Committee oversight	Supportive of minimum standards and have recommended these standards cover all aspects of the role, not just appointment and monitoring of auditors.

Topic	KPMG View
Strengthened regulator	Supportive of ARGA becoming a statutory regulatory however: ▪ Reference to becoming an improvement regulator should be included ▪ There needs to be an appeals processes and appropriate checks and balances We are not supportive of ARGA having concurrent competition powers with CMA, as this would be duplicative.
New regulatory regime	Supportive of ARGA having powers to hold PIE directors to account in the same way as auditors and have recommended: ▪ Enforcement must be transparent and proportionate ▪ Measures must not deter people from becoming directors ▪ Must avoid duplication with other regulators / bodies ▪ Clear guidance from ARGA needed to ensure rules applied proportionately, transparently and consistently.
Managed shared audits	Supportive of greater choice within the market, but there are operational challenges, including identifying a significant UK portion of a FTSE 350 group, capacity within the challenger firms, duplication of work, cost and liability implications.
Operational separation	While supportive of current voluntary measures, we do not support full legal separation or separate profit pools, as it could risk damaging audit quality and reduce the scope to invest and maintain current audit operations.
Publication of un-anonymised AQR reports	We are supportive of transparency and publication of anonymised AQR reports. Un-anonymised reports could impact the capital markets, as well as the impact on the attractiveness of the profession and therefore we are not supportive of this.
Corporate reporting review (CRR)	Support ARGA having powers to direct changes to the annual report and accounts, but an appeals process and appropriate checks and balances are required, as well as consideration of legal challenges. We are not supportive of the publication of all correspondence during a CRR, as we believe transparency can be achieved without this.

Audit Scotland Code of Audit Practice

The Code of Audit Practice sets the framework for public audit in Scotland. It outlines the responsibilities of external auditors appointed by the Auditor General for Scotland and the Accounts Commission, and describes the scope of public audit in Scotland.

Responsibilities of management

Financial Statements

Audited bodies must prepare an annual report and accounts containing financial statements and other related reports. They have responsibility for:

- preparing financial statements which give a true and fair view of their financial position and their expenditure and income, in accordance with the applicable financial reporting framework and relevant legislation;
- maintaining accounting records and working papers that have been prepared to an acceptable professional standard and that support their financial statements and related reports disclosures;
- ensuring the regularity of transactions, by putting in place systems of internal control to ensure that they are in accordance with the appropriate Council;
- maintaining proper accounting records; and
- preparing and publishing, along with their financial statements, an annual governance statement, management commentary (or equivalent) and a remuneration report that are consistent with the disclosures made in the financial statements. Management commentary should be fair, balanced and understandable and also clearly address the longer- term financial sustainability of the body.

Further, it is the responsibility of management of an audited body, with the oversight of those charged with governance, to communicate relevant information to users about the entity and its financial performance, including providing adequate disclosures in accordance with the applicable financial reporting framework. The relevant information should be communicated clearly and concisely.

Audited bodies are responsible for developing and implementing effective systems of internal control as well as financial, operational and compliance controls. These systems should support the achievement of their objectives and safeguard and secure value for money from the public funds at their disposal. They are also responsible for establishing effective and appropriate internal audit and risk-management functions.

Audited bodies are responsible for providing the auditor with access to all information relevant to the preparation of the financial statements, additional information requested and unrestricted access to persons within the entity.

Audit Scotland Code of Audit Practice (continued)

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

Audit Scotland Code of Audit Practice (continued)

Responsibilities of auditors

Appointed auditor responsibilities

Auditor responsibilities are derived from statute, this Code, ISAs, professional requirements and best practice and cover their responsibilities when auditing financial statements and when discharging their wider scope responsibilities. These are to:

- undertake statutory duties, and comply with professional engagement and ethical standards;
- provide an opinion on audited bodies' financial statements and, where appropriate, the regularity of transactions;
- review and report on, as appropriate, other information such as annual governance statements, management commentaries, remuneration reports, grant claims and whole of government returns;
- notify the Auditor General when circumstances indicate that a statutory report may be required;
- participate in arrangements to cooperate and coordinate with other scrutiny bodies (local government sector only);
- demonstrate compliance with the wider public audit scope by reviewing and providing judgements and conclusions on the audited bodies:
  - effectiveness of performance management arrangements in driving economy, efficiency and effectiveness in the use of public money and assets;
  - suitability and effectiveness of corporate governance arrangements; and
  - financial position and arrangements for securing financial sustainability.

Weaknesses or risks identified by auditors are only those which have come to their attention during their normal audit work in accordance with the Code, and may not be all that exist. Communication by auditors of matters arising from the audit of the financial statements or of risks or weaknesses does not absolve management from its responsibility to address the issues raised and to maintain an adequate system of control.

This report communicates how we plan to identify, assess and obtain sufficient appropriate evidence regarding the risks of material misstatement of the financial statements due to fraud and to implement appropriate responses to fraud or suspected fraud identified during the audit.

Audit Scotland Code of Audit Practice (continued)

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

Audit Scotland Code of Audit Practice (continued)

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