



Scottish Public Services Ombudsman

Planning report to the Scottish Public Services Ombudsman on the audit for the year ending 31 March 2019

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

We have pleasure in presenting our draft planning report to the Scottish Public Services Ombudsman (SPSO) for the year ending 31 March 2019 audit. We would like to draw your attention to the key messages of this draft audit plan:

Audit Plan

We have updated our understanding of the SPSO through discussion with management and review of relevant documentation.

Based on these procedures, we have developed this plan in collaboration with the Ombudsman to ensure that we provide an effective audit service that meets your expectations and focuses on the most significant areas of importance and risk to the SPSO.

Key Risks

We have taken an initial view as to the significant audit risks the SPSO faces. These are presented as a summary dashboard on page 12.

- As with other public sector bodies, the SPSO continues to face financial challenges, due to uncertainty around future funding. An underspend of £167k against budget has been reported for the period to 30 September 2018, due to the phasing of costs through the year and a reduction in budgeted professional advice. At this point in the year the SPSO is projecting a small overspend of £2k against its budget for the year, which is extremely close to the breakeven point.

- Given the pressures across the whole of the public sector, there is an inherent risk associated with the accuracy and completeness of recording of expenditure within this limit, therefore this will be a key focus of our audit.
- Our significant risk is pinpointed to invoices processed around the year-end (including associated accruals and prepayments).
- In accordance with auditing standards, management override of controls has also been identified as a significant audit risk.
- In line with our prior year audit, having considered the risk factors set out in Auditing Standards and the nature of the revenue streams at the SPSO, we have determined that the risk of fraud arising from revenue recognition can be rebutted. This is based on the fact that there is little incentive to manipulate revenue recognition with the main source of revenue being from the Scottish Parliamentary Corporate Body (SPCB) which can be agreed to third party confirmations.

Introduction (continued)

The key messages in this report (continued):

Audit Dimensions

The Code of Audit Practice sets out four audit dimensions which set a common framework for all public sector audits in Scotland. These are financial sustainability, financial management, governance and transparency and value for money. Due to the relative size and scale of the functions delivered by the SPSO, we have concluded that the full wider scope audit is not appropriate. In accordance with paragraph 53 of the Code, our work in this area will therefore be restricted to concluding on:

- The appropriateness of the disclosures in the governance statement; and
- The financial sustainability of the SPSO and the services that it delivers over the medium to longer term.

Our audit work on the audit dimensions will incorporate the specific risks highlighted by Audit Scotland, in particular, the impact of EU withdrawal, the changing landscape for public financial management, dependency on key suppliers and increased focus on openness and transparency.

Regulatory Change

New accounting standards on revenue and financial instruments will apply for 2018/19, and for leases from 2020/21. While we do not expect these standards to

have a significant impact on the SPSO, we recommend that the SPSO review the impact of IFRS 9 and 15 early in the year, including calculating any adjustments that will be required as at 31 March 2018 for transition. We would suggest that the Ombudsman receive reporting in year from management on the implementation of the new standard, and we will report specifically on the findings from our audit work in this area.

We have reported on other regulatory changes pages 23–26.

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.

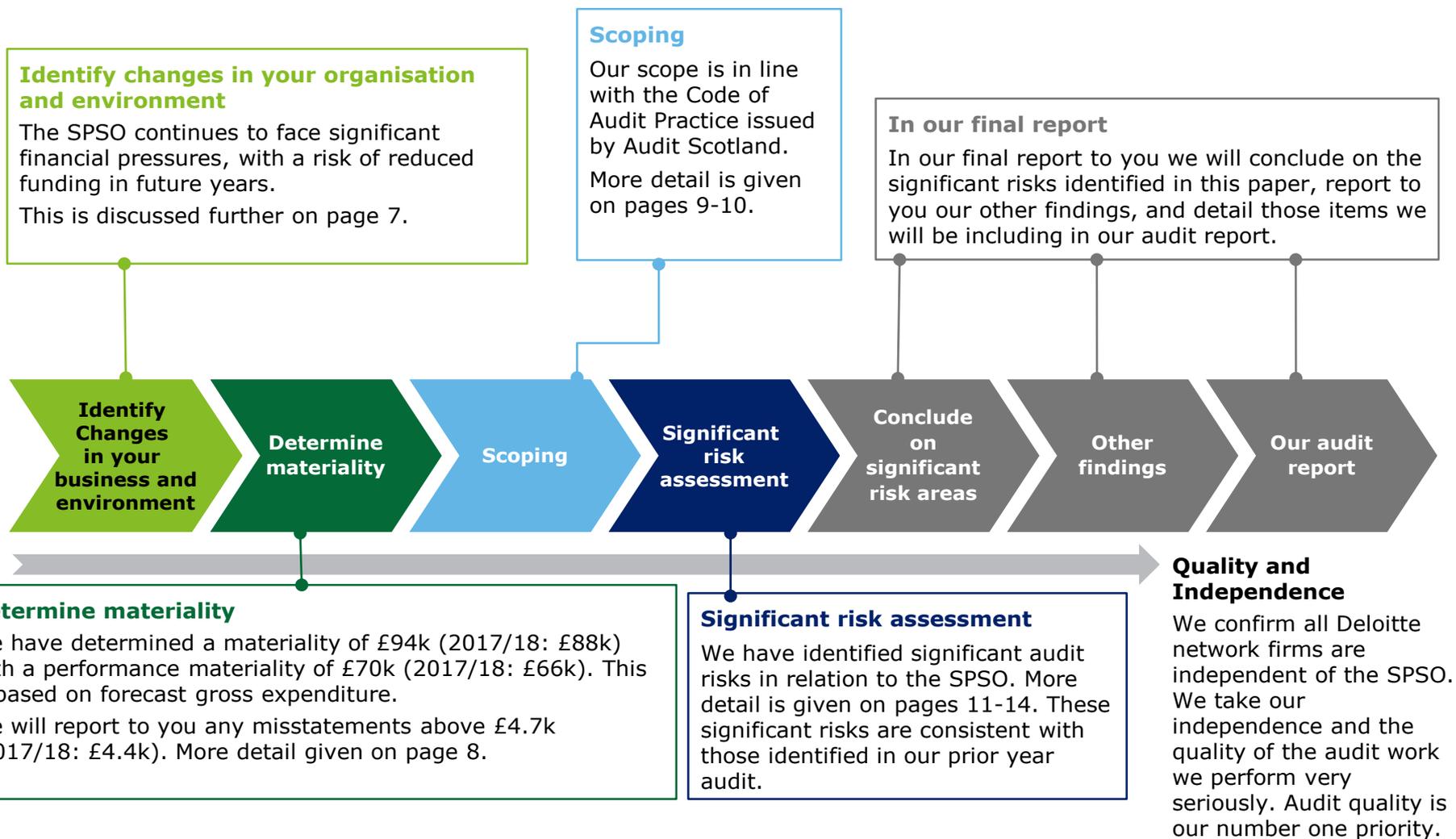
Adding value

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

Pat Kenny
Audit director

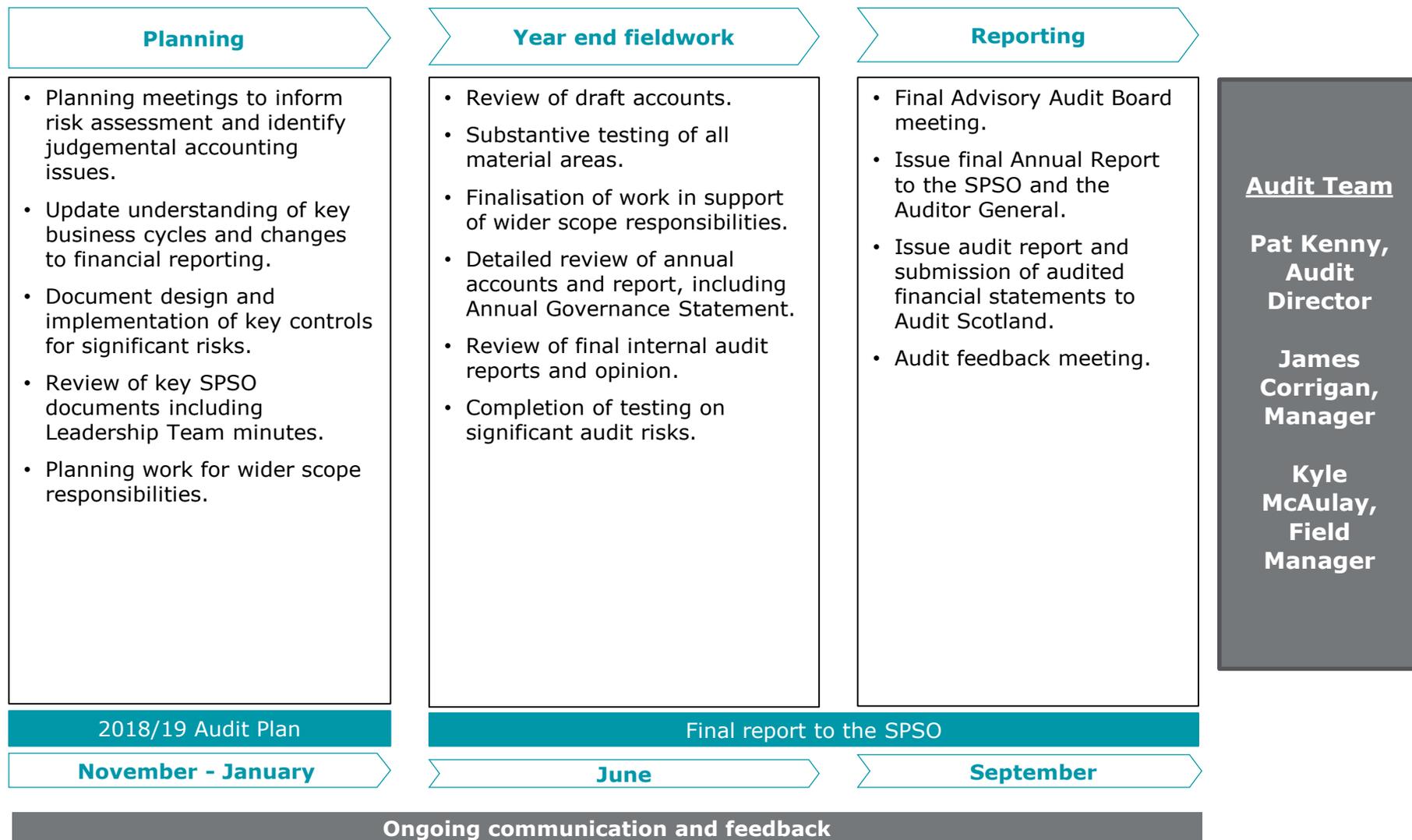
Our audit explained

We tailor our audit to your Ombudsman and your strategy



Continuous communication and reporting

Planned timing of the audit



An audit tailored to you

Focusing on your business and strategy

Impact on our audit

Performance against expenditure resource limit



There is a financial duty for the SPSO to maintain its expenditure within the budget approved by the SPCB. As at September 2018, the SPSO reported a £167k underspend against budget, primarily due to the phasing of costs through the year and a reduction in budgeted professional advice. At this point in the year the SPSO is projecting a small overspend of £2k against its budget for the year, which is extremely close to the breakeven point.

Our significant audit risk has been pinpointed to accruals and prepayments at the year end as these areas have a higher risk of management override of controls as discussed further on page 13.

We will consider the SPSO's financial sustainability in the medium to longer term and consider whether the SPSO is planning effectively to continue to deliver its services on a sustainable basis, as discussed further on page 15. We will also assess the progress in medium term financial planning and linking resources to the outcomes delivered.



New significant risk



Continuing significant risk



Considered as part of wider scope audit requirements

Materiality

Our approach to materiality

Basis of our materiality benchmark

- The Audit Director has determined materiality as £94k (2017/18: £88k) and a performance materiality of £70k (2017/18: £66k), based on professional judgement and risk factors specific to the SPSO, the requirement of auditing standards and the financial measures most relevant to users of the financial statements.
- We have used 2.0% of forecast gross expenditure as the benchmark for determining materiality and applied 75% as performance materiality.
- This approach is consistent with our prior year materiality calculation.

Reporting to those charged with governance

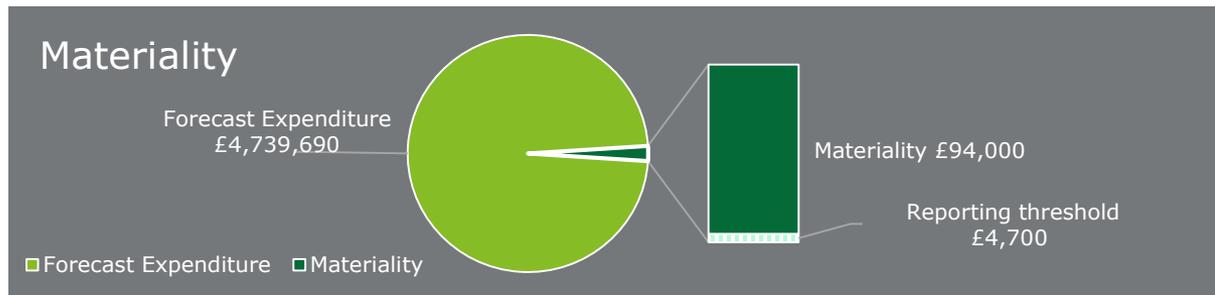
- We will report to you all misstatements found in excess of our clearly trivial threshold which is £4.7k (2017/18: £4.4k).
- We will report to you misstatements below this threshold if we consider them to be material by nature.

- Our approach to determining the materiality benchmark is consistent with Audit Scotland guidance which states that the threshold for clearly trivial above which we should accumulate misstatements for reporting and correction to audit committees must not exceed £250k.

Our annual audit report

We will:

- report the materiality benchmark applied in the audit of the SPSO;
- provide comparative data and explain any changes in materiality, compared to prior year, if appropriate; and
- explain any normalised or adjusted benchmarks we use, if appropriate.



Although materiality is the judgement of the Audit Director, the Ombudsman must be satisfied that the level of materiality chosen is appropriate for the scope of the audit.

Scope of work and approach

Our key areas of responsibility under the Code of Audit Practice

Core audit work	Planned output	Timeline
Perform an ISA (UK) compliant audit of the annual accounts	<ul style="list-style-type: none">Annual audit planIndependent auditor's report	<ul style="list-style-type: none">January 2019September 2019
Audit and report on the audit dimensions	<ul style="list-style-type: none">Annual audit planAnnual audit report	<ul style="list-style-type: none">January 2019September 2019
Share audit intelligence with Audit Scotland including highlighting potential statutory reports	<ul style="list-style-type: none">Current issues returns	<ul style="list-style-type: none">January and July 2019
Carry out preliminary enquiries into referred correspondence	<ul style="list-style-type: none">None	<ul style="list-style-type: none">N/A
Provide information on cases of fraud	<ul style="list-style-type: none">Fraud returns	<ul style="list-style-type: none">November 2018, February, May and August 2019
Provide information on cases of money laundering	<ul style="list-style-type: none">Audit Scotland to advise	<ul style="list-style-type: none">As required
Contribute to technical guidance notes	<ul style="list-style-type: none">Consultation comments on draft technical guidance notes	<ul style="list-style-type: none">As required

Scope of work and approach (continued)

Our approach

Liaison with internal audit

The Auditing Standards Board's version of ISA (UK) 610 "Using the work of internal auditors" prohibits use of internal audit to provide "direct assistance" to the audit. Our approach to the use of the work of Internal Audit has been designed to be compatible with these requirements.

We will review their reports and meet with them to discuss their work. We will discuss the work plan for internal audit, and where they have identified specific material deficiencies in the control environment we consider adjusting our testing so that the audit risk is covered by our work.

Using these discussions to inform our risk assessment, we can work together with internal audit to develop an approach that avoids inefficiencies and overlaps, therefore avoiding any unnecessary duplication of audit requirements on the SPSO's staff.

Approach to controls testing

Our risk assessment procedures will include obtaining an understanding of controls considered to be 'relevant to the audit'. This involves evaluating the design of the controls and determining whether they have been implemented ("D&I").

The results of our work in obtaining an understanding of controls and any subsequent testing of the operational effectiveness of controls will be collated and the impact on the extent of substantive audit testing required will be considered.

Promoting high quality reporting to stakeholders

We view the audit role as going beyond reactively checking compliance with requirements: we seek to provide advice on evolving good practice to promote high quality reporting.

The National Audit Office prepare a checklist each year designed to ensure that entities covered by the Government financial reporting manual (FReM) have prepared their annual accounts in the appropriate form and have complied with all disclosure requirements. We would recommend the SPSO consider this during drafting the annual accounts.

Audit Scotland has published good practice guides in relation the annual report and the Governance Statement to support the SPSO in preparing high quality drafts of the Annual Report and financial statements, which we would recommend the SPSO consider during drafting.

Obtain an understanding of the SPSO and its environment including the identification of relevant controls.

Identify risks and controls that address those risks.

Carry out "design and implementation" work on relevant controls.

If considered necessary, test the operating effectiveness of selected controls.

Design and perform a combination of substantive analytical procedures and tests of details that are most responsive to the assessed risks.

Significant risks

Our risk assessment process

We consider a number of factors when deciding on the significant audit risks. These factors include:

- the significant risks and uncertainties previously reported in the annual report and financial statements;
- the IAS 1 critical accounting estimates previously reported in the annual report and financial statements;
- our assessment of materiality;
- the changes that have occurred in the business and the environment it operates in since the last annual report and financial statements; and

Principal risk and uncertainties

- Adequacy of resources
- Cyber security

IAS 1 Critical accounting estimates

- Valuation of tangible and intangible assets

Changes in your business and environment

- New Chair of Advisory Audit Board
- New member of Advisory Audit Board
- New business premises

The next page summarises the significant risks that we will focus on during our audit. All the risks mentioned in the prior year report are included as significant risks in this year's audit plan.



Significant risks Dashboard

Risk	Material?	Fraud risk identified?	Planned approach to controls testing	Level of management judgement	Page no.
Achievement of expenditure resource limits			Design and implementation		13
Management override of controls			Design and implementation		14



Some degree of management judgement



Limited management judgement

Significant risks (continued)

Risk 1 – Achievement of expenditure resource limits

Risk identified

The key financial duty for the SPSO is to comply with the Departmental Expenditure Limit (DEL) allocated by the SPCB to cover cash expenditure and non-cash costs such as depreciation and amortisation. Given the pressures across the whole of the public sector, there is an inherent risk associated with the accuracy and completeness of recording of expenditure as there is an incentive for management to either over or under accrue expenditure at the year-end, depending on the forecast position, in order to meet the allocation.

Our response

We will evaluate the results of our audit testing in the context of the achievement of the targets set by the SPCB.

Our work in this area will include the following:

- evaluate the design and implementation of the controls around the monthly monitoring of financial performance and journal entry postings;
 - obtain independent confirmation of the resource limits allocated to the SPSO by the SPCB;
 - compare in-year budget monitoring to final year-end position to identify any specific areas where the final results are out of line with expectations;
 - performing focussed cut-off testing of accruals and prepayments made at the year-end; and
 - perform focussed cut-off testing of invoices received and paid around the year-end.
-

Significant risks (continued)

Risk 2 – Management override of controls

We will use computer assisted audit techniques to support our work on the risk of management override of controls

Risk identified

In accordance with ISA 240 (UK) management override of controls is a significant risk. This risk area includes the potential for management to use their judgement to influence the financial statements as well as the potential to override the SPSO's controls for specific transactions.

The key judgements in the financial statements are those which we have selected to be the significant audit risks around expenditure recognition. This is inherently the areas in which management has the potential to use their judgment to influence the financial statements.

Planned audit challenge

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

Journal testing

- We will test the design and implementation of controls over journal entry processing.
- Using data analytics tools, we will risk assess journals and select items for detailed follow up testing. The journal entries will be selected using computer-assisted profiling based on areas which we consider to be of increased interest.
- We will test the appropriateness of journal entries recorded in the general ledger, and other adjustments made in the preparation of financial reporting.

Accounting estimates

- We will test the design and implementation of controls over key accounting estimates and judgements.
- We will review accounting estimates for bias that could result in material misstatements due to fraud. This will include both a retrospective review of 31 March 2018 estimates and a review of the corresponding estimates as at 31 March 2019.

Significant and unusual transactions

- We will obtain an understanding of the business rationale of significant transactions that we become aware of that are outside of the normal course of business for the entity, or that otherwise appear to be unusual, given our understanding of the entity and its environment.
-

Wider scope requirements

Audit dimensions

The Code of Audit Practice sets out four audit dimensions which set a common framework for all public sector audits in Scotland. These are financial sustainability, financial management, governance and transparency and value for money. Due to the relative size and scale of the functions delivered by the SPSO, we have concluded that the full wider scope audit is not appropriate. In accordance with paragraph 53 of the Code, our work in this area will therefore be restricted to concluding on the following:

Audit dimension	Areas to be considered	Impact on the 2018/19 Audit
<p>The appropriateness of the disclosures in the governance statement.</p>	<ul style="list-style-type: none"> The completeness of the disclosures in meeting the requirements of the essential features, as specified in the Scottish Public Finance Manual (SPFM). Inconsistencies between the disclosures or information that is materially incorrect and audit knowledge. 	<p>We will review the draft governance statement and assess whether there are any inconsistencies or omissions based on other audit evidence obtained throughout the audit. We did not note any issues from our work performed in the 2017/18 audit.</p> <p>Audit Risk: The governance statement is not consistent with the wider disclosures in the accounts or compliant with the SPFM.</p>
<p>Financial sustainability looks forward to the medium and longer term to consider whether the body is planning effectively to continue to deliver its services or the way in which they should be delivered.</p>	<ul style="list-style-type: none"> The financial planning systems in place across the shorter and longer terms. The arrangements to address any identified funding gaps. The affordability and effectiveness of funding and investment decisions made. Workforce planning. 	<p>We will continue to monitor the SPSO's actions in respect of its short, medium and longer term financial plans, including progress towards outcome based planning/ budgeting.</p> <p>Audit Risk: A lack of forward financial planning, leading to the SPSO's projects being delayed or cancelled.</p> <p>In view of the Scottish Government's Medium Term Financial Strategy (MTFS) (discussed further on page 17) we will consider the extent to which the SPSO has reviewed the potential implications of the MTFS for its own financial planning and whether it is taking these into account in its arrangement for financial management and financial sustainability.</p> <p>Audit Risk: The SPSO's long-term financial planning is inconsistent with the Scottish Governments five-year plan.</p>

Wider scope requirements (continued)

Specific risks

As part of the 2018/19 planning guidance, Audit Scotland have identified the following areas as significant risks faced by the public sector. Any specific risks in relation to these areas for the SPSO have been included in our audit risk under the audit dimensions, discussed on the previous pages. We will continue to monitor these areas as part of our audit work.

Risk	
EU withdrawal	<p>There are uncertainties surrounding the terms of the UK's withdrawal from the European Union in March 2019. Some arrangements have been provisionally agreed, such as a transition period to the end of 2020, although they are dependent on a final deal being reached between the UK Government and the remaining EU countries. The outcome of negotiations should become clearer in the months up to March 2019.</p> <p>Whatever the outcome, EU withdrawal will inevitably have implications for devolved government in Scotland and for audited bodies. Audit Scotland has identified three areas where EU withdrawal may have the most significant impact as summarised below:</p> <ul style="list-style-type: none">• Workforce – Many public services are dependent on workers from EU countries, including health, social care and education. A decline in migration from the EU could potentially result in vacancies and skills gaps in some areas of the public sector. There is a risk that this could impact on some public bodies' ability to deliver 'business as usual' particularly given existing workforce and service pressures.• Funding – Funding from the EU makes an important contribution to the Scottish public sector. The main sources of funding provide support to farmers and rural businesses, projects to encourage economic growth and support for research and education. The UK Government has made guarantees to meet some funding commitments to the end of existing programmes, but there are uncertainties about what any replacement funding may look like.• Regulation – The EU Withdrawal Bill will transpose existing EU law into UK law immediately after the UK leaves the EU. Legislation in many devolved areas will transfer to the Scottish Parliament. The UK government has identified 24 devolved policy areas where it seeks to retain temporary control until UK-wide common legislative frameworks are developed. This is currently an area of contention between the Scottish and UK Governments and is under consideration by the Supreme Court. <p>In addition, some public bodies may be affected directly by changes to trade and customs rules, which could impact on supply chains and the procurement of goods or services from EU countries. This could influence the availability and cost of supplies and services (e.g. specialist medical equipment or drugs) with potential implications for public bodies' finances and their ability to deliver specific services.</p> <p>While there are considerable uncertainties about the detailed implications of EU withdrawal, at a minimum by the end of 2018/19, we would expect public bodies to have assessed the potential impact of EU withdrawal on their operations and identified any specific risks and how they will respond to them. We will assess how the SPSO has prepared for EU withdrawal and how it continues to respond to any emerging risk after March 2019.</p> <p>In addition, in accordance with the FRC guidance, the SPSO should consider the <i>disclosure within its annual report</i>, distinguish the specific and direct challenges that it faces from the broader economic uncertainties. In some circumstances this many mean <i>recognising or re-measuring</i> certain items in the Balance Sheet. A comprehensive <i>post balance sheet events review</i> must be reflected in accounts and disclosures.</p>

Wider scope requirements (continued)

Specific risks (continued)

Risk	
Changing landscape for public financial management	<p>Scottish public finances are fundamentally changing, with significant tax-raising powers, new powers over borrowing and reserves, and responsibility for 11 social security benefits worth over £3 billion a year. This provides the Scottish Parliament with more policy choices but also means that the Scottish budget is subject to greater volatility, uncertainty and complexity.</p> <p>Parliamentary scrutiny of the public finances is increasingly important in this changing landscape. A new Scottish budget process has been introduced, which is based on a year-round continuous cycle of budget setting, scrutiny and evaluation. This involves parliamentary committees looking back to explore what public spending has achieved, looking forward to longer-term objectives and challenges, and considering what this should mean for future budgets.</p> <p>As part of the new budget process, the Scottish Government published an initial five-year MTFS in May 2018. This five-year outlook for the Scottish budget provides useful context for audited bodies' financial planning. As part of our wider scope audit work on financial sustainability (discussed further on page 15), we will consider how the SPSO has reviewed the potential implications of the MTFS for its own finances, including longer-term financial planning.</p> <p>The new budget process places greater emphasis on assessing outcomes and the impact of spending. There is an expectation that the Scottish Government and public bodies will report on their contributions towards the national outcomes in their published plans and performance reports, including their annual reports. Increased complexity and volatility is also likely to mean that the Scottish Government will be increasingly active in managing its overall budget position in-year, engaging with public bodies closely on their anticipated funding requirements. As part of our wider scope audit work on financial sustainability (discussed further on page 15) we will consider the extent to which the SPSO's performance report provides an accessible account of the body's overall performance and impact of its public spending. We will also confirm that underlying financial performance, including any in-year changes to funding agreed with the Scottish Government, is transparently presented.</p>

Wider scope requirements (continued)

Specific risks (continued)

Risk	
<p>Dependency on key suppliers</p>	<p>It has become clear that the collapse of Carillion has had a significant impact across the public sector. This has brought into focus the risk of key supplier failure and the risk of underperformance in suppliers that are experiencing difficult trading conditions. The risk exists on two levels:</p> <ul style="list-style-type: none"> • Individual public sector bodies are dependent on key suppliers; and • The Scottish public sector as a whole is subject to significant systematic risk. <p>We will determine as part of our detailed risk assessment the extent to which the SPSO is dependent on key supplier relationships. Where dependency is significant, we will consider this as part of our audit work and report back to the SPSO.</p> <p>We will also be requested to complete a short questionnaire to establish the extent, value and nature of key supplier dependencies that can inform the national position.</p>
<p>Openness and transparency</p>	<p>There is an increasing focus on how public money is used and what is achieved. In that regard, openness and transparency supports understanding and scrutiny. We will consider this as part of our wider scope work on governance (discussed further on page 15).</p> <p>We would expect to see public bodies reviewing their approach to openness and transparency to ensure they are keeping pace with public expectations and good practice. Evidence of progress might include:</p> <ul style="list-style-type: none"> • increased public availability of board papers; • more insight into why some business is conducted in private; and • development of the form and content of annual reports.

Wider scope requirements (continued)

Other responsibilities (continued)

Performance Audits

In accordance with Audit Scotland planning guidance, we will be requested to provide information to support performance audits that Audit Scotland intends to publish during 2018/19 and 2019/20, as summarised below:

Title and planned publication date	Local auditor input
Digital progress in central government – Spring/ Summer 2019	We will be asked to inform the performance audit team of any significant ICT and digital developments within their audited body.

Impact reports

We will also be requested to provide information to support assessing the impact of previously published performance audit reports. There are no specific impact reports which directly relate to the SPSO. We will provide an update to the SPSO if there are any changes to this plan.

Anti-money laundering

The Money Laundering, Terrorist Financing and Transfer of Funds (Information on the Payer) Regulations 2017 came into force on 26 June 2017 and replace the Money Laundering Regulations 2007. The regulations impose an obligation of the Auditor General to inform the National Crime Agency if she knows or suspects that any person has engaged in money laundering or terrorist financing. As part of our audit work, we will ensure we are informed of any instances of money laundering at the SPSO so that we can advise the Auditor General.

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 identified, 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 expenditure recognition enabling us to develop a risk-focused approach tailored to the SPSO.
- Our engagement team is selected to ensure that we have the right subject matter expertise and industry knowledge. We will involve specialists to support the audit team in our work.

In order to deliver a quality audit to you, each member of the core audit team will receive tailored learning to develop their expertise in audit skills, delivered by Pat Kenny 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.

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 financial statements 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;
- Key regulatory and corporate governance updates, relevant to you.

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 SPSO.

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 financial statements 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.

This report has been prepared for the SPSO, 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.



Pat Kenny, CPFA

for and on behalf of Deloitte LLP
Glasgow
January 2019

Sector developments



The State of the State

Government beyond Brexit

Overview

Now in its seventh year, **The State of the State** has once again brought together Deloitte LLP and Reform to reflect on the most pressing public sector issues along with new, exclusive research. Central to the report is our citizen survey, which provides a platform for the most important voices of all in the public sector: that of the public. Also exclusive to the report is our research with the people who know the public sector's challenges best: the people who run it.

This year, we interviewed fifty senior figures including civil servants, police leaders, NHS directors and Council Chief Executives, producing the most extensive qualitative research of its kind in the sector.

This year's The State of the State finds the UK government amid the complex and politically-charged challenge of leaving the EU. But while Brexit may dominate daily headlines, our report finds a wider set of challenges – and opportunities – for government and the public services as they gear up for a Spending Review.

Key findings	
Scotland's government has now been led by the Scottish National Party for three consecutive terms in office	- In those eleven years, the administration has taken forward the possibilities of devolution to shape a Scottish public sector landscape that now differs substantially from the rest of the UK – in its public finances, its policy priorities and its ethos.
Austerity has flipped public attitudes to tax and spending -	As austerity began in 2010, more than half of the public backed spending cuts to restore the public finances. In 2018, as the Prime Minister calls a formal end to the austerity years, our exclusive citizen survey finds that support has dwindled to less than one fifth of the public.
People are increasingly concerned about public services and their future provision	- Our survey finds that the public is increasingly concerned about public services. It suggests that the past four years have seen a decline in the number of people who think that public bodies understand their needs, listen to their preferences and involve them in decisions – perhaps driven by perceptions of austerity. Looking to the future, the number of people who are worried that the state will provide too little support for them in the years ahead has risen from fifty per cent in 2010 to seventy per cent this year.
Citizen views differ significantly across the UK's four countries	- Recent years have seen an acceleration in the public policy differences between the devolved administrations, and our survey finds that citizen attitudes also differ. For example, people in Scotland are more likely to believe that taxes should be higher to pay for more public services, people in Northern Ireland are less likely to say they have felt the effects of austerity, and people in Wales are the most likely to say that public services listen to their needs. These differing views underscore the diverging political and policy landscapes across the UK.
The public back penalty fines for wasting public sector time	- Our citizen survey explored the circumstances in which the public would find charges reasonable, and found that the most acceptable would be penalty fines for wasting public sector time, like missing NHS appointments or wrongly calling out the emergency services.

Next steps

The report is available at <https://www2.deloitte.com/content/campaigns/uk/the-state-of-the-state/the-state-of-the-state/the-state-of-the-state.html>

UK exit from the EU

Navigating uncertainty – key questions for the Advisory Audit Board

Whilst nobody can predict the outcome of negotiations, we can be sure that Brexit will require all organisations to take some big decisions. As we have seen, some will require lengthy and complicated preparations, and we advise keeping track of the negotiations and thinking what this means for the SPSO sooner rather than later.



Is the SPSO set up to navigate the change?

Have you assessed the impact of potential changes and identified key decision points?

Does your assessment include how Brexit could impact on your customers, supply chain and people?

Have you defined the options there are to respond? E.g. scenario or contingency planning?

Are you monitoring developments and are you ready to act proportionately at the right time?

Are all the right people involved? Does this include discussion with key stakeholders?

Are channels of communication clear, both internally and externally, and have company spokespeople been fully briefed?



Impact on internal planning, forecasting and strategy

Is management using forward-looking indicators such as forward bookings, contact conversion rates and supplier forward pricing?

Have opportunities as well as risks been considered?



Impact on internal and external audit

Should the scope and plan for internal audit be amended to include contingency planning, or testing key risk indicators?

Should internal audit be asked to perform work on longer term viability?

Is there an impact on critical accounting judgments and areas of estimation uncertainty that need to be discussed with the external auditor?



Impact on external reporting

Will disclosures on principal risks and uncertainties need to be revisited now Article 50 has been triggered and the draft Withdrawal Treaty has been published.

Have you developed a plan for appropriately detailed disclosure in management commentary?

"We encourage companies to provide disclosure which distinguishes between the specific and direct challenges to their business model and operations from the broader economic uncertainties which may still attach to the UK's position when they report. Where there are particular threats, for example the possible effect of changes in import/export taxes or delays to their supply chain, we expect these to be clearly identified and for management to describe any actions they are taking, or have taken, to manage the potential impact. In some circumstances this may mean recognising or remeasuring certain items in the balance sheet.

The broad uncertainties that may still attach to Brexit when companies report will require disclosure of sufficient information to help users understand the degree of sensitivity of assets and liabilities to changes in management's assumptions."

(FRC Letter to CFOs and Audit Committee Chairs, October 2018)

Appendix: New Accounting Standards

IFRS 9 *Financial Instruments*

In a nutshell

- In July 2014, the IASB published a final version of IFRS 9. This version supersedes all previous versions.
- IFRS 9 *Financial Instruments* will replace IAS 39 *Financial Instruments: Recognition and Measurement*, and has three main impacts
 - *Classification and measurement* - introduces new approach for the classification of financial assets driven by cash flow characteristics and the business model in which an asset is held. This classification determines how financial assets are accounted for in financial statements and, in particular, how they are measured on an ongoing basis.
 - *Amortised cost and impairment of financial assets* – introduces an “expected losses” impairment model where entities are required to account for expected credit losses from when financial instruments are first recognised.
 - *Hedge accounting* - introduces new general hedge accounting model that aligns the accounting treatment with risk management activities and allows for better reflection of the hedging activities in the financial statements.
- HM Treasury has adopted IFRS 9 from 2018/19 onward, with a number of interpretations and adaptations for the public sector, generally simplifying the requirements.
- The key practical change in IFRS 9 for most central government bodies is the introduction of a new approach to recognising impairments of debtors and other financial instruments.
 - The key change to IFRS 9 affecting the SPSO will be the movement from an incurred losses model for receivables to an expected credit losses (ECL) model. The move is intended to reflect that there is always a risk of late/ non-payment when granting credit and that this should be reflected in the value of receivables upon recognition.
 - If the debt is later repaid in full, the ECL creditor can be reversed. ECL creditors should be set up on a portfolio rather than arrangement-by-arrangement basis.
 - A further change from IAS 39 to IFRS 9 will be that all financial assets are recognised as Fair Value through Profit or Loss, unless where there are specific business cases to designate alternative treatment.

Effective date

The Standard has a mandatory effective date for annual periods beginning on or after 1 January 2018, with earlier application permitted.

HM Treasury have decided that on transition there will be no restatement of comparatives, and any impact of transition will be recognised as a reserves movement in 2018/19.



Find out more on our UK Accounting Plus website www.iasplus.com/en-gb by following the links to Standards -> IFRS 9

Potential impact on the SPSO

IFRS 9 is expected to have relatively limited impact on the SPSO but will affect the process of assessing impairment of debtors and other financial assets as noted above. As part of the process of adoption, the SPSO will need to consider the impact on policies, processes, systems and people. This may include reviewing how entries are posted for impairment of assets, given the requirement to provide on initial recognition for lifetime expected credit losses. We would recommend that the SPSO review the impact of IFRS 9 early in the year, including calculating any adjustments that will be required as at 31 March 2018 for transition.

Appendix: New Accounting Standards

IFRS 16 *Leases*

In a nutshell

- The new Standard supersedes IAS 17 *Leases* and its associated interpretative guidance.
- For lessees the distinction between operating and finance leases disappears.
- A lease conveys the right to control an identified asset for a period of time in exchange for consideration.
- The accounting for all leases is similar to finance lease accounting in IAS 17, which means all leases are recognised on the balance sheet (with some exceptions).
- The lease liability is measured at the present value of the future lease payments, using a lease term that includes periods covered by extension options if exercise is reasonably certain. Variable lease payments are only included in the liability if based on an index or rate.
- That right-of-use asset is initially measured at the amount of the lease liability, plus initial direct costs and adjustments for lease incentives, payments at or prior to commencement and dilapidations provisions.
- The right-of-use asset is subsequently accounted for by applying IAS 16 *Property, Plant and Equipment*, at cost less depreciation and impairment (unless it is an investment property that is fair valued or it belongs to a class of property, plant and equipment that is revalued).
- A lessee can elect to keep the following leases off-balance sheet and typically straight line the expense:
 - leases with a lease term of 12 months or less and containing no purchase option – this election is made by class of underlying asset; and
 - leases where the underlying asset has a low value when new, such as personal computers or small office furniture – this election is made on a lease-by-lease basis.
- Operating lease expenses, typically straight line, will be replaced with interest on the liability and depreciation of the asset, producing a front-loaded expense profile.
- Although any individual lease will have a front-loaded expense, portfolios of leases containing both new and mature leases may produce an overall expense profile similar to straight line expensing.
- HM Treasury has consulted across government and is considering specific interpretations and adaptations for consistency across the public sector, but which will follow the overall principles of IFRS 16

Effective date

Periods commencing on or after 1 January 2019. HMT has delayed the implementation of IFRS 16 and is planning to adopt for 2020/21 in the public sector.



Find out more on our UK Accounting Plus website www.iasplus.com/en-gb by following the links to Standards -> IFRS 16

Potential impact on the SPSO

We would recommend that the SPSO review the impact of IFRS 16 during 2018/19, so that the impact on 2020/21 can be understood and reflected in budgeting for next year.

We would suggest that the Ombudsman receive reporting in year from management on expected impact of the new standard, to support the disclosure in the financial statement on accounting standards not yet effective. We will report to the Advisory Audit Board on any observations on the SPSO's approach in 2018/19, and on findings from our audit work in 2020/21.

Appendices



Prior year audit adjustments

Uncorrected and disclosure misstatements

Prior year uncorrected misstatements

There were no uncorrected misstatements identified during the course of our prior year audit.

Prior year disclosure misstatements

There were no uncorrected disclosure misstatements identified during the course of our prior year audit.

Fraud responsibilities and representations

Responsibilities explained



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 financial statements 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 the risk of fraud in the achievement of expenditure resource limits and management override of controls as a key audit risk for your organisation.



Fraud characteristics:

- Misstatements in the financial statements 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 financial statements 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.

We will request the following to be stated in the representation letter signed on behalf of the SPSO:

- We acknowledge our responsibilities for the design, implementation and maintenance of internal control to prevent and detect fraud and error.
- We have disclosed to you the results of our assessment of the risk that the financial statements may be materially misstated as a result of fraud.
- We are not aware of any fraud or suspected fraud that affects the entity and involves:
 - (i) management;
 - (ii) employees who have significant roles in internal control; or
 - (iii) others where the fraud could have a material effect on the financial statements.
- We have disclosed to you all information in relation to allegations of fraud, or suspected fraud, affecting the entity's financial statements communicated by employees, former employees, analysts, regulators or others.

Fraud responsibilities and representations

Inquiries

We will make the following inquiries regarding fraud:



Management

- Management's assessment of the risk that the financial statements may be materially misstated due to fraud, including the nature, extent and frequency of such assessments.
- Management's process for identifying and responding to the risks of fraud in the entity.
- Management's communication, if any, to those charged with governance regarding its processes for identifying and responding to the risks of fraud in the entity.
- 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.

Internal audit and local counter fraud specialist

- Whether internal audit and the SPSO's local counter fraud specialist has knowledge of any actual, suspected or alleged fraud affecting the entity, and to obtain their views about the risks of fraud.



Those charged with governance

- How those charged with governance exercise oversight of management's processes for identifying and responding to the risks of fraud in the entity and the internal control that management has established to mitigate these risks.
- Whether those charged with governance have knowledge of any actual, suspected or alleged fraud affecting the entity.
- The views of those charged with governance on the most significant fraud risk factors affecting the entity.



Independence and fees

As part of our obligations under International Standards on Auditing (UK), we are required to report to you on the matters listed below:

Independence confirmation We confirm the audit engagement team, and others in the firm as appropriate, Deloitte LLP and, where applicable, all Deloitte network firms are independent of the SPSO and will reconfirm our independence and objectivity to the SPSO for the year ending 31 March 2019 in our final report to the SPSO.

Fees The audit fee for 2018/19, in line with the fee range provided by Audit Scotland, is £17,870 as analysed below:

	£
Auditor remuneration	13,740
Audit Scotland fixed charges:	
Pooled costs	3,310
Audit support costs	820
Total proposed fee	17,870

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 SPSO'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 SPSO, 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

We maintain a relentless focus on quality and our quality control procedures and continue to invest in and enhance our overall firm Audit Quality Monitoring and Measuring programme.

In June 2018 the Financial Reporting Council ("FRC") issued individual reports on each of the eight largest firms, including Deloitte, on Audit Quality Inspections which provides a summary of the findings of its Audit Quality Review ("AQR") team for the 2017/18 cycle of reviews.

We take the findings of the AQR seriously and we listen carefully to the views of the AQR and other external audit inspectors. We remediate every finding regardless of its significance and seek to take immediate and effective actions, not just on the individual audits selected but across our entire audit portfolio. We are committed to continuously improving all aspects of audit quality in order to provide consistently high quality audits that underpin the stability of our capital markets.

We have improved the speed by which we communicate potential audit findings, arising from the AQR inspections and our own internal reviews to a wider population, however, we need to do more to ensure these actions are embedded. In order to achieve this we have launched a more detailed risk identification process and our InFlight review programme. This programme is aimed at having a greater impact on the quality of the audit before the audit report is signed. Consistent achievement of quality improvements is our aim as we move towards the AQR's 90% benchmark.

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

The AQR's 2017/18 Audit Quality Inspection Report on Deloitte LLP

"The overall results of our reviews of the firm's audits show that 76% were assessed as requiring no more than limited improvements, compared with 78% in 2016/17. Of the FTSE 350 audits we reviewed this year, we assessed 79% as achieving this standard compared with 82% in 2016/17. We are concerned at the lack of improvement in inspection results. The FRC's target is that at least 90% of these audits should meet this standard by 2018/19."

"Where we identified concerns in our inspections, they related principally to aspects of group audit work, audit work on estimates and financial models, and audit work on provisions and contingencies. During the year, the firm has continued to develop the use of "centres of excellence", increasing the involvement of the firm's specialists in key areas of the audit. We have no significant issues to report this year in most of the areas we reported on last year."

"The firm has revised its policies and procedures in response to the revised Ethical and Auditing Standards. We have identified some examples of good practice, as well as certain areas for improvement."

The firm has enhanced its policies and procedures in the following areas:

- Increased use of centres of excellence ("CoE") involving the firm's specialists, including new CoEs focusing on goodwill impairment (established in response to previous inspection findings) and corporate reporting, to address increasing complexity of financial reporting.
- Further methodology updates and additional guidance issued to the audit practice including the audit approach to pension balances, internal controls, data analytics, group audits and taxation.
- A new staff performance and development system was implemented with additional focus on regular timely feedback on performance, including audit quality.
- Further improvements to the depth and timeliness of root cause analysis on internal and external inspection findings.

Our key findings in the current year requiring action by the firm:

- Improve the group audit team's oversight and challenge of component auditors.
- Improve the extent of challenge of management's forecasts and the testing of the integrity of financial models supporting key valuations and estimates.
- Strengthen the firm's audit of provisions and contingencies.

Review of firm-wide procedures. The firm should:

- Enhance certain aspects of its independence systems and procedures.



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