



## **Scottish Fire and Rescue Service**

Planning report to the Audit and Risk Assurance Committee 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 planning report to the Audit and Risk Assurance Committee (ARAC) of the Scottish Fire and Rescue Service (SFRS) for the year ending 31 March 2019. We would like to draw your attention to the key messages of this audit plan:

### **Audit Plan**

We have updated our understanding of SFRS including discussion with management and review of relevant documentation.

Based on these procedures, we have developed this plan in collaboration with SFRS 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 SFRS.

### **Key Risks**

We have taken an initial view as to the significant audit risks SFRS faces. These are presented as a summary dashboard on page 14.

- In accordance with auditing standards, management override of controls has been identified as a significant audit risk.
- In the prior two years we have identified the valuation of property assets as a significant risk given the degree of judgement and complexity involved, the material impact on the financial statements, and the control weakness relating to Technology One system's fixed asset register.

- No errors were identified in the 2017/18 audit with property valuations. The methodology applied by the valuer was consistent year on year and management are in ongoing discussions with Technology One to address the control weaknesses identified. We have reduced this risk to an area of audit focus and will report to ARAC if our assessment of risk changes.
- In line with our prior year audits, having considered the risk factors set out in Auditing Standards and the nature of the revenue streams at SFRS, we have rebutted the risk of fraud arising from revenue recognition. This is based on the fact that there is little incentive to manipulate revenue recognition with the sole source of revenue being from the Scottish Government which can be agreed to third party confirmations. The key financial duty for the SFRS is to comply with the Departmental Expenditure Limit (DEL) requirement set by the Scottish Government. Due to the pressures across the whole of the public sector and the forecast overspend for the year, there is an inherent fraud risk associated with the recording of expenditure within these limits.

# 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. Our audit work will consider how SFRS is addressing these and report our conclusions in our annual report to the ARAC in October 2019. In particular, our work will focus on:
  - **Financial sustainability** – as with all public sector bodies, SFRS continues to face significant financial challenges. The overall 2018/19 forecast position as at 31 January 2019 is projecting a slight underspend of £44k, which is an improvement from the position reported to 31 December 2018 which was an overspend of £295k. SFRS is dependent on grant funded activities to operate, therefore financial sustainability remains a risk. However, given that there is a clear longer term financial strategy in place for 2017-2027 which considers different possible future funding scenarios and how to address these funding gaps, we will restrict our review of financial sustainability to a review of progress against the financial strategy.
  - **Financial management** – from our audit work in 2017/18 we found that SFRS had robust financial management procedures in place. Therefore, we will restrict our work on financial management to the review of the budget monitoring reports to the Board during the year, and the review of Board and ARAC minutes, in order to determine whether SFRS continues to have robust financial management arrangements.
- We also found in 2017/18 that SFRS has adequate systems of internal control; therefore, we will restrict our review to internal audit reports in relation to their work on the financial control environment and to the identification of any control weaknesses or gaps from our financial statements audit.
- **Governance and transparency** – from our review of Board papers and attendance at ARAC meetings we will assess the effectiveness of governance arrangements. We will also share best practice from elsewhere from our dedicated governance team. We will also review whether the change in key management personnel has an impact on governance arrangements.
- **Value for money** - we will gain an understanding of SFRS's self-evaluation arrangements to assess how it demonstrates value for money in the use of resources and the linkage between money spent and outputs and outcomes delivered, in line with the Strategic Plan 2016-19 and the long-term financial strategy.

### **Specific Risks**

Our audit work on the four audit dimensions incorporates 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.

# Introduction (continued)

## The key messages in this report (continued):

### **Regulatory Change**

New accounting standards on financial instruments and revenue will apply for 2018/19, and for leases from 2020/21. While we do not expect these standards to have a significant impact on SFRS, we recommend that the SFRS review the impact of IFRS 9 Financial Instruments and IFRS 15 Revenue from Contracts with Customers, including calculating any adjustments that will be required through the reserves as at 31 March 2018 for transition. We would suggest that the ARAC 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 in our sector updates in our separate technical update report.

### **Other Wider Scope Work**

We will continue to monitor the Boards participation and progress with the National Fraud Initiative (NFI) during 2018/19 and complete an Audit Scotland questionnaire by 30 June 2019.

In accordance with Audit Scotland guidance, we may be requested to provide information to support national performance audits on Digital progress in central government sector (see page 24).

### **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 SFRS 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 SFRS promote improved standards of governance, better management and decision making and more effective use of resources.

**Pat Kenny**  
Audit director

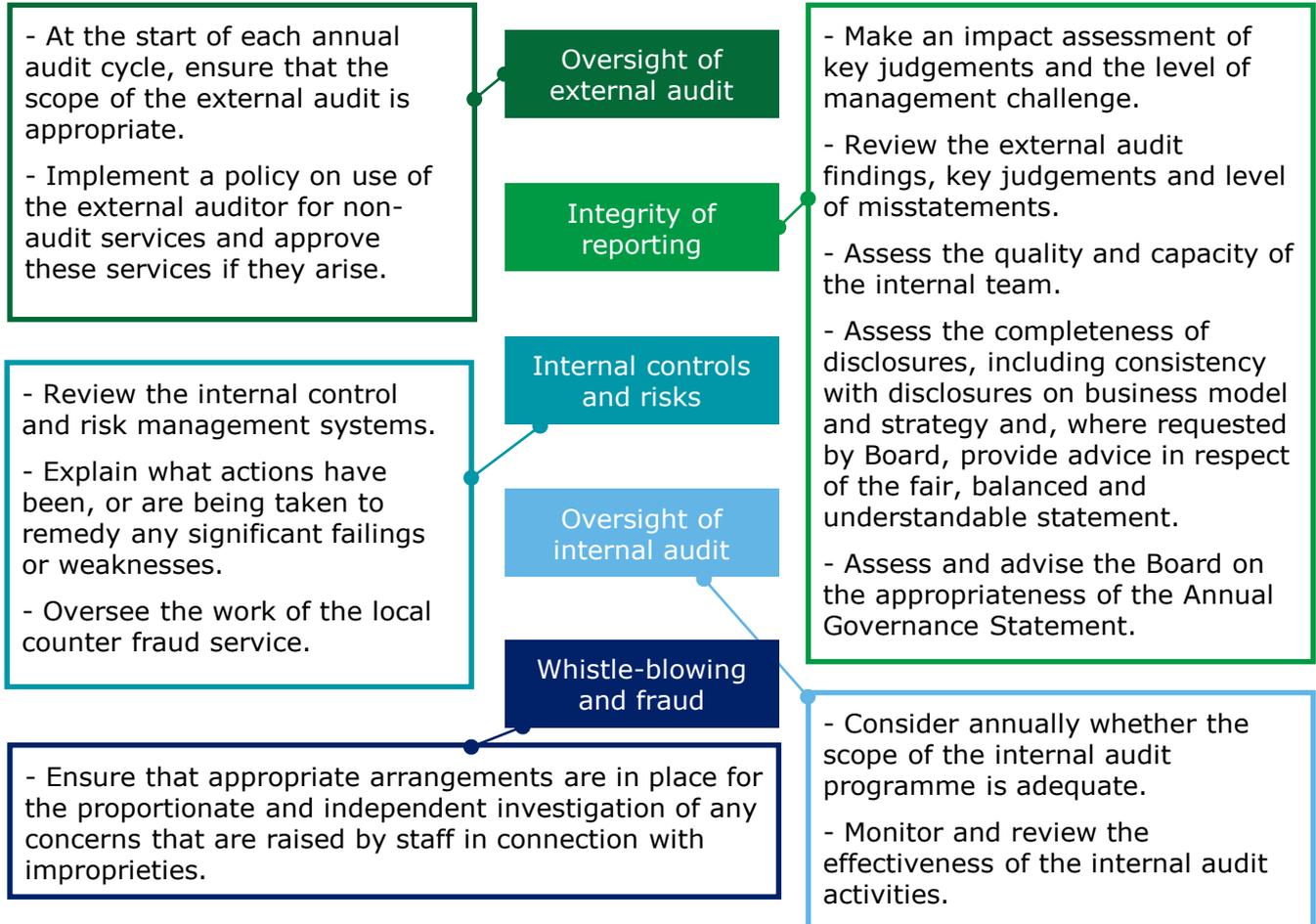
# Responsibilities of the Audit and Risk Assurance Committee

## Helping you fulfil your responsibilities

The primary purpose of the auditor's interaction with the ARAC:

- Clearly communicate the planned scope of the financial statements audit
- Provide timely observations arising from the audit that are significant and relevant to the ARAC's responsibility to oversee the financial reporting process
- In addition, we seek to provide the ARAC with additional information to help fulfil your broader responsibilities

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



# Our audit explained

## We tailor our audit to your body and your strategy

### Identify changes in your body and environment

SFRS continues to face significant financial pressures with a risk of reduced funding in future years, emphasising a need for ongoing transformation of services. There have also been changes in key management personnel during the year. A summary of these considerations is set out on page 9.

### Scoping

Our scope is in line with the Code of Audit Practice issued by Audit Scotland. More detail is given on pages 11-12.

### In our final report

In our final report to you we will conclude on the significant risks identified in this paper, report to you our other findings, and detail those items we will be including in our audit report.



### Determine materiality

We have determined a preliminary planning materiality of £8,397k (2017/18: £8,197k) with a performance materiality of £6,297k (2017/18: £6,147k). This is based on forecasted gross expenditure which is in line with prior year.

We will report to you any misstatements above £250k (2017/18: £250k). More detail given on page 10.

We will revisit materiality at the year end using the draft financial statement figures and report this to the ARAC.

### Significant risk assessment

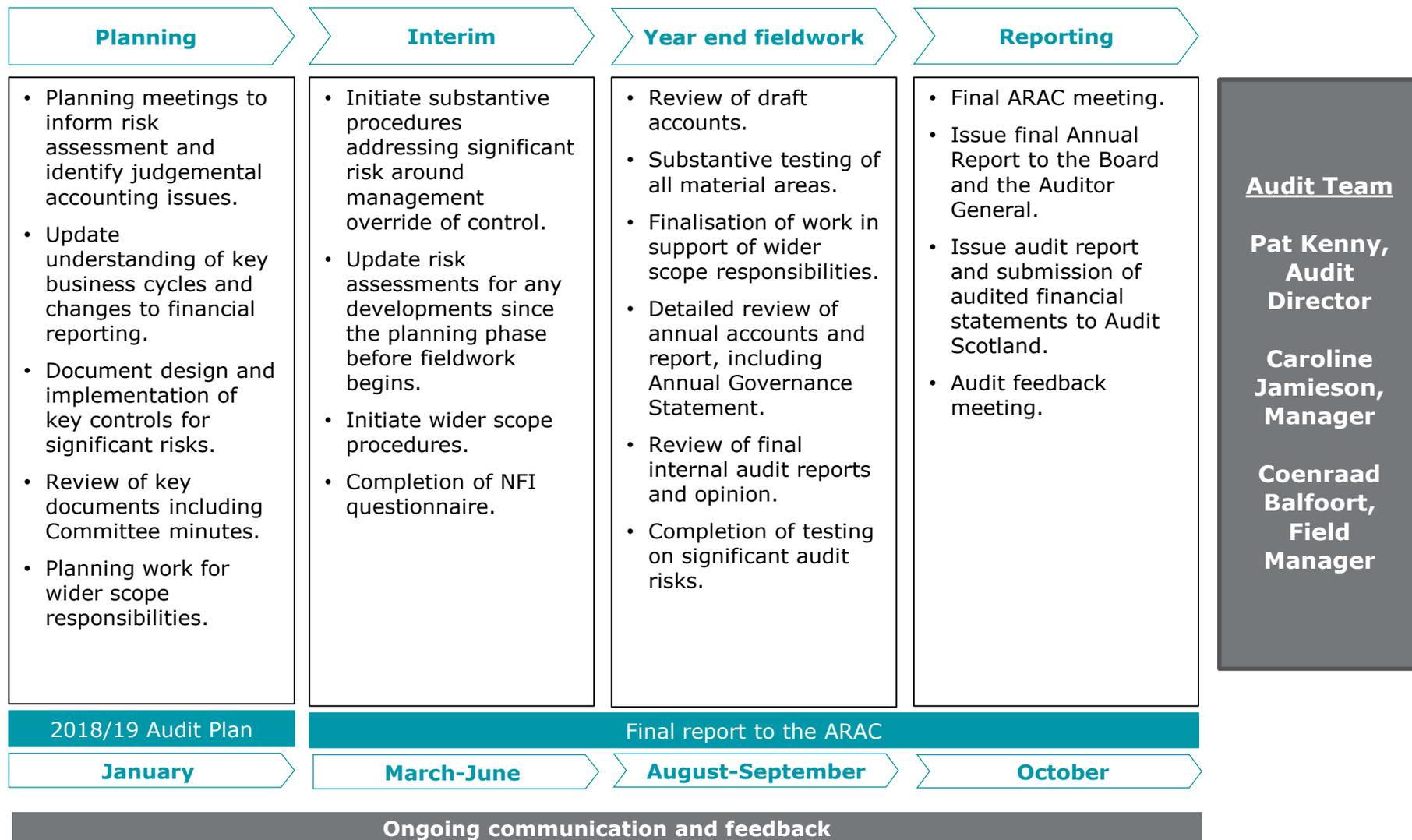
We have identified significant audit risks in relation to SFRS. More detail is given on pages 13-16. These significant risks are consistent with those identified in the prior year, except for property valuation which has been downgraded and identified as an other area of audit focus as discussed further on page 17.

### Quality and Independence

We confirm all Deloitte network firms are independent of SFRS. We take our independence and the quality of the audit work we perform very seriously. Audit quality is our number one priority.

# Continuous communication and reporting

## Planned timing of the audit



# An audit tailored to you

## Focusing on your business and strategy

### Impact on our audit

Future financial strategy and sustainability



SFRS faces an extremely challenging financial environment for the foreseeable future with Audit Scotland identifying future cost pressures and likely reductions in funding. The longer term financial strategy for 2017-2027 approved by the Board in December 2017, which demonstrates a worst case scenario cumulative funding gap to 2019/20 of £25,110k; over the period to 2026/27 this worst case scenario projects a potential funding gap of £77,249k. The mid-point scenario projects a potential funding gap of £16,934k over the period to 2026/27.

The latest forecast position as at 31 January 2019 which was projecting a slight underspend of £44k; this is an improvement from the position reported as at 31 December 2018 which was an overspend of £295k.

While the above longer term funding gap scenarios do pose a challenge to the financial sustainability of SFRS, the service has been able to demonstrate robust budgetary processes and an ability to achieve balanced budgets in past years. Part of this success has been driven by a focus on transforming how the services are delivered with a greater emphasis on preventative measures. However, it is noted that while the instances of fires have been reducing year on year, that the service is experiencing greater demand from other areas, such as severe weather, e.g. flash floods, wildfires, and an ageing population.

As part of our work on financial sustainability we will look at how the SFRS is progressing against the 2017-2027 financial strategy and consider whether it is planning effectively to continue to deliver its services on a sustainable basis. This includes monitoring progress against the six key strategic priorities for the service as set out in the 2016-19 Strategic Plan: improved local outcomes; workforce development; national and community resilience; governance and social responsibility; modernising response; and transformation. We will also review how the Strategic Plan is refreshed to 2022.



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 a preliminary planning materiality as £8,397k (2017/18: £8,197k) and a performance materiality of £6,297k (2017/18: £6,147k), based on professional judgement and risk factors specific to SFRS, the requirement of auditing standards and the financial measures most relevant to users of the financial statements.
- We have used 2% of forecast gross expenditure as the benchmark for determining materiality.
- This approach is consistent with our prior year materiality calculation.
- We will revisit materiality at the year-end using the draft financial statement figures.

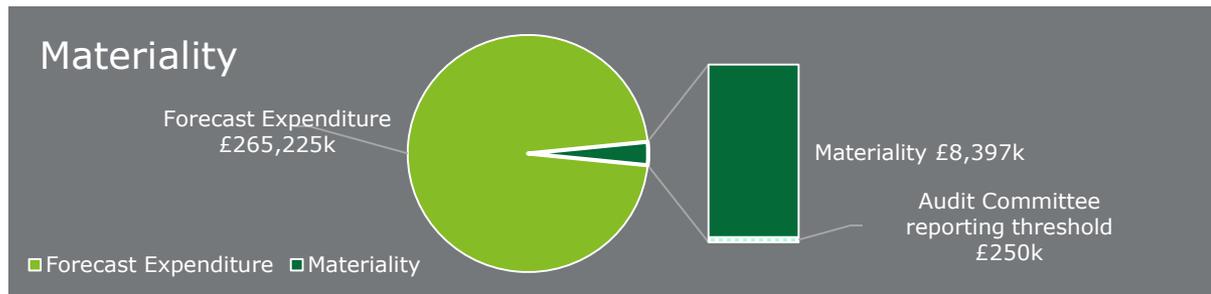
- We will report to you misstatements below this threshold if we consider them to be material by nature.
- Our approach to determining the materiality benchmark is consistent with Audit Scotland guidance which states that the threshold for clearly trivial above which we should accumulate misstatements 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 SFRS; and
- Provide comparative data and explain any changes in materiality, compared to prior year, if appropriate.

### Reporting to those charged with governance



Although materiality is the judgement of the Audit Director, the ARAC must satisfy themselves that the level of materiality chosen is appropriate for the scope of the audit.

# Scope of work and approach

## Our key areas of responsibility under the Code of Audit Practice

Core audit work	Planned output	Timeline
Perform an ISA (UK) compliant audit of the annual accounts	<ul style="list-style-type: none"> <li>Annual audit plan</li> <li>Interim report (if required)</li> <li>Independent auditor's report</li> </ul>	<ul style="list-style-type: none"> <li>March 2019</li> <li>April 2019</li> <li>October 2019</li> </ul>
Audit and report on the audit dimensions	<ul style="list-style-type: none"> <li>Annual audit plan</li> <li>Annual audit report</li> </ul>	<ul style="list-style-type: none"> <li>March 2019</li> <li>October 2019</li> </ul>
Contribute to performance audits (including performance audit reports, overview reports and impact reports)	<ul style="list-style-type: none"> <li>Data returns</li> </ul>	<ul style="list-style-type: none"> <li>As required</li> </ul>
Share audit intelligence with Audit Scotland including highlighting potential statutory reports	<ul style="list-style-type: none"> <li>Current issues returns</li> </ul>	<ul style="list-style-type: none"> <li>January and July 2019</li> </ul>
Carry out preliminary enquiries into referred correspondence	<ul style="list-style-type: none"> <li>None</li> </ul>	<ul style="list-style-type: none"> <li>N/A</li> </ul>
Provide information on cases of fraud	<ul style="list-style-type: none"> <li>Fraud returns</li> </ul>	<ul style="list-style-type: none"> <li>November 2018, February, May and August 2019</li> </ul>
Provide information on cases of money laundering	<ul style="list-style-type: none"> <li>Audit Scotland to advise</li> </ul>	<ul style="list-style-type: none"> <li>As required</li> </ul>
Contribute to the NFI report	<ul style="list-style-type: none"> <li>NFI audit questionnaire</li> <li>Reference, if necessary, in annual audit report</li> </ul>	<ul style="list-style-type: none"> <li>June 2019</li> </ul>
Contribute to technical guidance notes	<ul style="list-style-type: none"> <li>Consultation comments on draft technical guidance notes</li> </ul>	<ul style="list-style-type: none"> <li>As required</li> </ul>

# 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 SFRS'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 SFRS consider this during drafting the annual accounts.

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

Obtain an understanding of the body 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
- SFRS's actual and planned performance on financial and other governance metrics compared to its peers.

### Principal risk and uncertainties

- Financial austerity
- Public service reform
- Social issues – income inequality and ageing population
- Climate change
- Wildfires

### Changes in your business and environment

- EU withdrawal
- Change in key management personnel

### IAS 1 Critical accounting estimates

- Property, plant and equipment
- Pensions liability
- Short term accumulated absences

# Significant risks Dashboard

Risk	Material	Fraud risk	Planned approach to controls testing	Level of management judgement	Slide no.
Achievement of expenditure resource limits			Design and implementation		15
Management override of controls			Design and implementation		16



Some degree of management judgement



Limited management judgement

# Significant risks (continued)

## Risk 1 – Achievement of expenditure resource limits

### A key focus for management

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**Risk identified**

ISA 240 states that when identifying and assessing the risks of material misstatement due to fraud, the auditor shall, based on a presumption that there are risks of fraud in revenue recognition, evaluate which types of revenue, revenue transactions or assertions give rise to such risks. However, given that most of SFRS's revenue comes directly from the Scottish Government as Grant in Aid (GiA) and that this is neither complex nor involves any judgement, we have determined that revenue is not a fraud risk. Instead, we have pinpointed this to expenditure.

The key financial duty for the SFRS is to comply with the DEL requirement set by the Scottish Government. Given the projected overspend for the Service and the pressures across the whole of the public sector, there is an inherent fraud risk associated with the recording of expenditure within these limits.

The risk is therefore that the Scottish Fire and Rescue Service materially misstates expenditure through the accruals balance, including year end transactions, in an attempt to achieve a breakeven position.

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**Planned audit challenge**

We will evaluate the results of our audit testing in the context of the achievement of the target set by the Scottish Government.

Our work in this area will include the following:

- Obtain an understanding of the design and implementation of the key controls in place in relation to recording of accruals including year end transactions;
  - Reviewing and challenging the assumptions made in estimating key accruals to assess completeness and accuracy of recorded expenditure;
  - Perform focused cut-off testing of invoices received and paid around the year-end; and
  - Obtain independent confirmation of the resource limits allocated to SFRS by the Scottish Government.
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# 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

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**Risk identified**

In accordance with ISA 240 (UK) management override 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 controls for specific transactions.

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

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**Planned audit challenge**

In considering the risk of management override, 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 our Spotlight data analytics tool, 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 biases 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.

# Area of audit focus

## Valuation of property assets

The valuation of property assets is inherently judgemental

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### **Risk considerations**

SFRS holds property assets at market-based evidence of fair value; where this evidence does not exist, depreciated replacement cost is used. All other buildings are held at existing use value. The valuations are by their nature significant estimates which are based on specialist and management assumptions and which can be subject to material changes in value.

The valuation of property assets was classed as a significant risk in prior years. However, in 2017/18, we found no errors with the valuations. The methodology applied by the valuer was consistent year on year and management are in ongoing discussions with Technology One to address the control weaknesses identified.

On the basis that a solution will be implemented to address Technology One's shortcomings, we have deemed this to no longer be a significant risk area, but we will monitor and update the ARAC if there are any changes to this assessment.

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### **Planned audit challenge**

SFRS held £386.6m of property assets at 31 March 2018. SFRS have a rolling programme in which 50% of the portfolio will be revalued each year, as well as any new build assets and assets with significant capital additions in the year (deemed as over £0.1m). Revaluation is undertaken by the Service's internal Royal Institute of Chartered Surveyors (RICS) qualified valuer.

Similar to the prior year approach, we will perform the following:

- Review any revaluations performed in the year, assessing whether they have been performed in a reasonable manner, on a timely basis and by suitably qualified individuals;
- Test a sample of revalued assets and re-perform the calculation assessing whether the movement has been recorded through the correct line of the accounts; and
- Consider material changes of assets not subject to full revaluation during the year.

# 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. We will consider how SFRS in addressing these areas, including any risks to their achievement, as part of our audit work as follows:

Audit dimension	Areas to be considered	Impact on the 2018/19 Audit
<p><b>Financial sustainability</b> 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"><li>• The financial planning systems in place across the shorter and longer terms</li><li>• The arrangements to address any identified funding gaps</li><li>• The affordability and effectiveness of funding and investment decisions made</li><li>• Workforce planning</li></ul>	<p>SFRS continues to face significant financial challenges with the majority of its funding coming from GiA from the Scottish Government. We concluded in 2017/18 that SFRS had made good progress with developing the longer term financial strategy for 2017-2027, which highlights a worst case scenario funding gap to 2019/20 of £25,110k.</p> <p>In view of the Scottish Government’s Medium Term Financial Strategy (MTFS) (discussed further on page 22) we will consider the extent to which SFRS 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><b>Audit Risk:</b> SFRS’s long-term financial planning is inconsistent with the Scottish Government’s five-year plan.</p>

# Wider scope requirements (continued)

## Audit dimensions (continued)

Audit dimension	Areas to be considered	Impact on the 2018/19 Audit
<p><b>Financial management</b> is concerned with financial capacity, sound budgetary processes and whether the control environment and internal controls are operating effectively</p>	<ul style="list-style-type: none"> <li>• Systems of internal control</li> <li>• Budgetary control system</li> <li>• Financial capacity and skills</li> <li>• Arrangements for the prevention and detection of fraud</li> </ul>	<p>We concluded in 2017/18 that SFRS has robust financial monitoring arrangements in place, sufficient financial capacity, and adequate arrangements in place for the prevention and detection of fraud. Furthermore, SFRS are on track to achieve a balanced budget by the year-end, with a slight forecast underspend of £44k (0.02% of budget) for the year per the latest financial report to 31 January 2019. Therefore we will restrict our work in 2018/19 to attendance at the ARAC, review of Board and ARAC minutes, and a review of budget monitoring reports to monitor whether SFRS achieves financial balance by the year-end.</p> <p><b>Audit Risk:</b> SFRS fails to achieve a balanced budget for the year resulting in brokerage from Scottish Government.</p> <p>In view of the Scottish Government’s new budget process (discussed further on page 22) we will confirm that underlying financial performance, including any in-year changes to funding agreed with the Scottish Government, is transparently presented.</p> <p><b>Audit Risk:</b> The underlying financial performance of SFRS is not transparently reported.</p> <p>Our fraud responsibilities and representations are detailed on pages 29 and 30.</p>

# Wider scope requirements (continued)

## Audit dimensions (continued)

Audit dimension	Areas to be considered	Impact on the 2018/19 Audit
<p><b>Governance and transparency</b> is concerned with the effectiveness of scrutiny and governance arrangements, leadership and decision making, and transparent reporting of financial and performance information.</p>	<ul style="list-style-type: none"> <li>• Governance arrangements</li> <li>• Scrutiny, challenge and transparency on decision making and financial and performance reports</li> <li>• Quality and timeliness of financial and performance reporting</li> </ul>	<p>We concluded in 2017/18 that SFRS has effective scrutiny, challenge and transparency on decision making, and we noted no issues with the quality and timeliness of financial and performance reporting up to the Board during the period. Therefore, we will restrict our work in 2018/19 to the review of Board and ARAC minutes.</p> <p><b>Audit Risk:</b> lack of timely reporting results in inadequate action being taken to remedy poor performance.</p> <p>In view of the increased focus on how public money is used and what is achieved (as discussed further on page 23), we will consider how SFRS has reviewed its approach to openness and transparency.</p> <p><b>Audit Risk:</b> SFRS’s approach is not keeping pace with public expectation and good practice.</p>
<p><b>Value for money</b> is concerned with using resources effectively and continually improving services.</p>	<ul style="list-style-type: none"> <li>• Value for money in the use of resources</li> <li>• Link between money spent and outputs and the outcomes delivered</li> <li>• Improvement of outcomes</li> <li>• Focus on and pace of improvement</li> </ul>	<p>We concluded in 2017/18 that SFRS has a clear framework in place to ensure that performance is monitored and reported. No issues were identified.</p> <p>In view of the Scottish Government’s new budget process (discussed further on page 22) we will consider the extent to which SFRS’s performance report provides an accessible account of SFRS’s overall performance and impact of its public spending.</p> <p><b>Audit Risk:</b> SFRS does not clearly report on its contribution towards the national outcomes.</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 SFRS 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	
<b>EU withdrawal</b>	<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 weeks up to March 2019. EU withdrawal has been recognised as a high risk in SFRS's risk register in the context of EU withdrawal having an impact on service provision and the supply of goods. 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"><li>• <b>Workforce</b> – 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.</li><li>• <b>Funding</b> – 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.</li><li>• <b>Regulation</b> – 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.</li></ul> <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 SFRS has prepared for EU withdrawal and how it continues to respond to any emerging risk after March 2019. Some suggested key questions for the ARAC are included in our separate Sector Update paper.</p> <p>In addition, in accordance with the FRC guidance, SFRS should consider the <b><i>disclosure within its annual report</i></b>, which distinguishes between the specific and direct challenges that it faces from the broader economic uncertainties. In some circumstances this may mean <b><i>recognising or re-measuring</i></b> certain items in the Balance Sheet. A comprehensive <b><i>post balance sheet events review</i></b> must be reflected in accounts and disclosures.</p>

# Wider scope requirements (continued)

## Specific risks (continued)

Risk	
<b>Changing landscape for public financial management</b>	<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 Medium Term Financial Strategy (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 management and financial sustainability (discussed further on pages 18-19), we will consider how SFRS 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 and value for money (discussed further on pages 18 and 20 respectively) we will consider the extent to which SFRS's performance report provides an accessible account of the body's overall performance and impact of its public spending. We will also assess whether 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	
<b>Dependency on key suppliers</b>	<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"><li>• Individual public sector bodies are dependent on key suppliers; and</li><li>• The Scottish public sector as a whole is subject to significant systematic risk.</li></ul> <p>We will determine as part of our detailed risk assessment the extent to which SFRS 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 ARAC.</p> <p>We will also be requested by Audit Scotland to complete a short questionnaire to establish the extent, value and nature of key supplier dependencies that can inform the national position.</p>
<b>Openness and transparency</b>	<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 20).</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"><li>• increased public availability of board papers;</li><li>• more insight into why some business is conducted in private; and</li><li>• development of the form and content of annual reports.</li></ul>

# 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 the performance audit that Audit Scotland intends to publish during 2018/19 and 2019/20. The area we may have to provide information on is:

#### Title and planned publication date

Digital progress in central government –  
Spring/ Summer 2019

#### Local auditor input

We may be asked to inform the performance audit team of any significant ICT and digital developments within SFRS.

### 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 SFRS. We will provide an update to the ARAC 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 SFRS so that we can advise the Auditor General.

### National Fraud Initiative (NFI)

A number of central government bodies, including SFRS, are participating in the NFI 2018/19. All data was required to be submitted in October 2018 and bodies received matches for investigation in January 2019. Audit Scotland expects bodies to investigate all recommended matches based on findings and the risk of error or fraud. Match investigation work should be largely completed by 30 September 2019 and the results recorded on the NFI system.

We will monitor SFRS's participation and progress during 2018/19 and into 2019/20 and, where appropriate, include references to the NFI in our annual audit reports for both years. We will also complete an NFI audit questionnaire and submit to Audit Scotland by 30 June 2019.

# 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 local government sector and elsewhere to provide robust challenge to management.
- We have obtained a deep understanding of your business, its environment and of your processes in expenditure recognition, payroll expenditure and capital expenditure enabling us to develop a risk-focused approach tailored to SFRS.
- 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 SFRS.

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 ARAC, 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  
March 2019

# Appendices



# Prior year audit adjustments

## Uncorrected and disclosure misstatements

### **Uncorrected misstatements**

There were no uncorrected misstatements above our clearly trivial threshold and no uncorrected material disclosure deficiencies.

# 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 SFRS:**

- 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 SFRS'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 SFRS and will reconfirm our independence and objectivity to the ARAC for the year ending 31 March 2019 in our final report to the ARAC.

## Fees

The audit fee for 2018/19, in line with the fee range provided by Audit Scotland, is £102,160 as analysed below:

	£
Auditor remuneration	78,550
Audit Scotland fixed charges:	
Pooled costs	18,900
Contribution to Audit Scotland costs	4,710
<b>Total proposed fee</b>	<b>102,160</b>

This represents a 2.33% increase on the 2017/18 fee based on Audit Scotland scale uplift. 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 SFRS'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 SFRS, 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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