



## **Shetland Islands Council Pension Fund**

Planning report to the Audit Committee on the audit for the year ending  
31 March 2019

# Contents

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## 01 Planning report

Introduction	3
Responsibilities of the Audit Committee	5
Our audit explained	6
Materiality	7
Scope of work and approach	8
Wider scope requirements	9
Significant audit risk and areas of focus dashboard	11
Significant audit risk	12
Areas of audit focus	13
Audit quality	15
Purpose of our report and responsibility statement	16

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## 02 Appendices

Prior year audit adjustments	18
Fraud responsibilities and representations	19
Independence and fees	21
Our approach to quality	22

# 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 Audit Committee of Shetland Islands Council Pension Fund (the "Fund") for audit of the year ending 31 March 2019. We would like to draw your attention to the key messages of this draft audit plan:

<b>Fund changes</b>	<p>Following discussions with the Fund's finance team, we have not identified any significant changes to the Fund itself during the year, other than changes to sponsoring employer rates of contribution as outlined in the latest triennial valuation. We will continue to liaise with the finance team to identify any changes between the date of this report and the Fund's year end, and will update our audit plan accordingly should any occur.</p> <p>There have been no significant regulatory changes to the accounting of the Fund in the current year. The Code of Practice on Local Authority Accounting in the United Kingdom 2018/19 ("the 2018/19 Code") applies in the current year.</p>
<b>Significant audit risk</b>	<p>We have identified management override of controls as our significant audit risk. Auditing standards require us to assume that management override of controls is an audit risk for all of our audits.</p> <p>Further details of this significant risk, including our proposed testing can be found on page 12.</p>
<b>Areas of audit focus</b>	<p>The following areas of audit focus have not been identified as significant risks, but will be considered as part of the audit:</p> <ol style="list-style-type: none"><li>1. Accuracy and timeliness of contributions payable to the Fund</li><li>2. Existence of investments</li></ol> <p>Further details of the areas of audit focus, including our proposed testing, are outlined on pages 13 and 14.</p>

# Introduction (continued)

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

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### Audit dimensions

The Code of Audit Practice sets our four audit dimensions which set a common framework for all public sector audits in Scotland. Our audit work will consider how the Fund is addressing these and report our conclusions in our annual report to the Members and Controller of Audit in September 2019. In particular, our work will focus on:

- **Financial sustainability** – we will monitor the Fund’s actions in respect of its medium and longer term financial plan to assess whether short term financial balance can be achieved, whether there is a long-term financial strategy and if the investments are in line with the 2014-2027 investment strategy.
- **Financial management** – we will review the budget and monitoring reports of the Fund during the year to assess whether financial management and budget setting is in line with good practice.
- **Governance and transparency** – from our review of the Fund’s Audit Committee papers and attendance at Audit Committee meetings, we will assess the effectiveness and scrutiny of governance arrangements. We will also share best practice examples, where it is deemed appropriate.
- **Value for money** – we will gain an understanding of the Fund’s self-evaluation arrangements to assess how it demonstrated value for money in the use of resources and the linkage between money spent and outputs and outcomes delivered.

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

Yours Faithfully,

**Pat Kenny**  
Audit Director

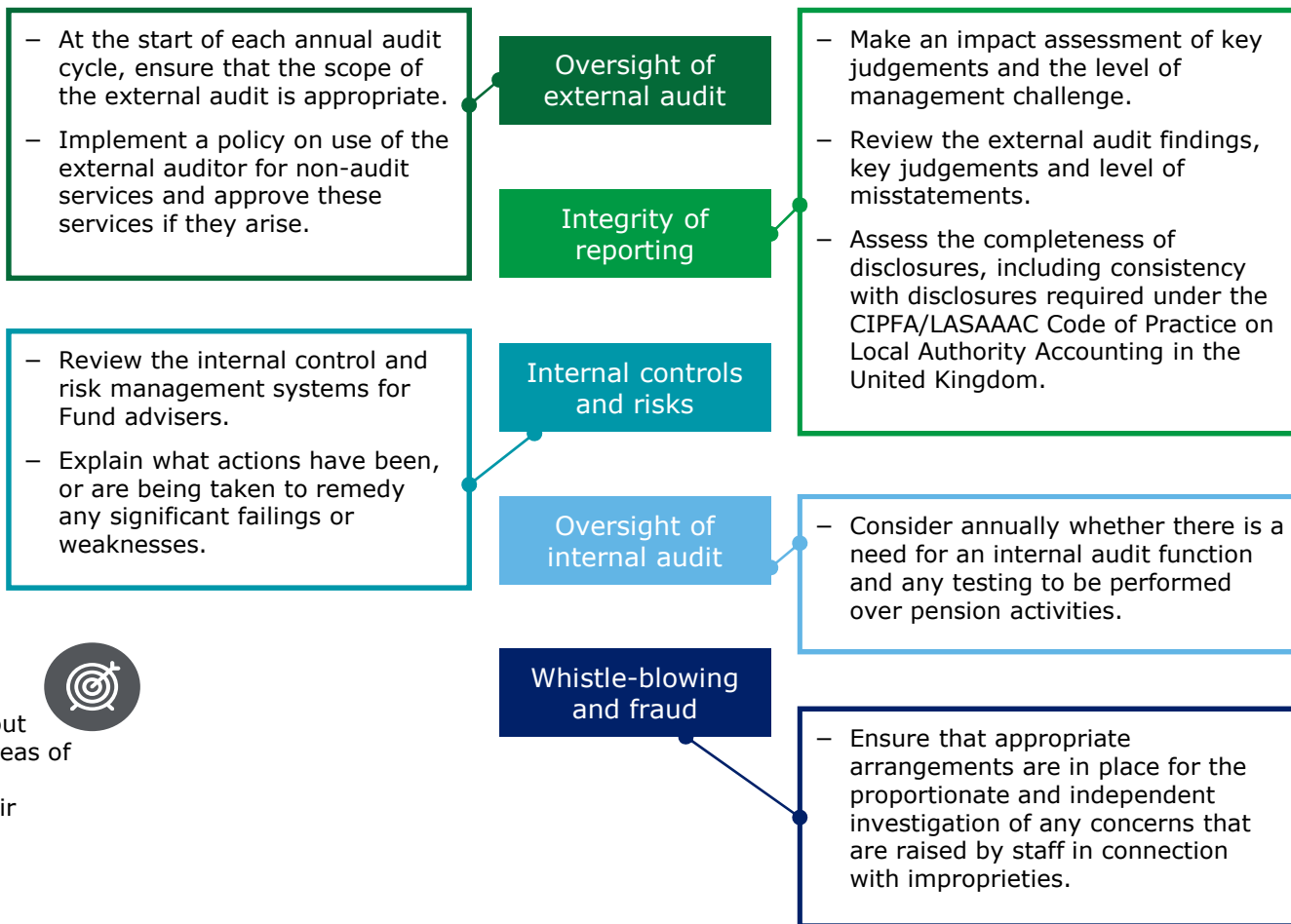
# Responsibilities of the Audit Committee

## Helping you fulfil your responsibilities

The primary purpose of the Auditor's interaction with the Audit Committee:

- Provide assurance over the financial statements;
- Provide timely observations arising from the audit that are significant and relevant to the Audit Committee's responsibility to oversee the financial reporting process; and
- In addition, we seek to provide the Audit Committee with additional information to help fulfil your broader responsibilities

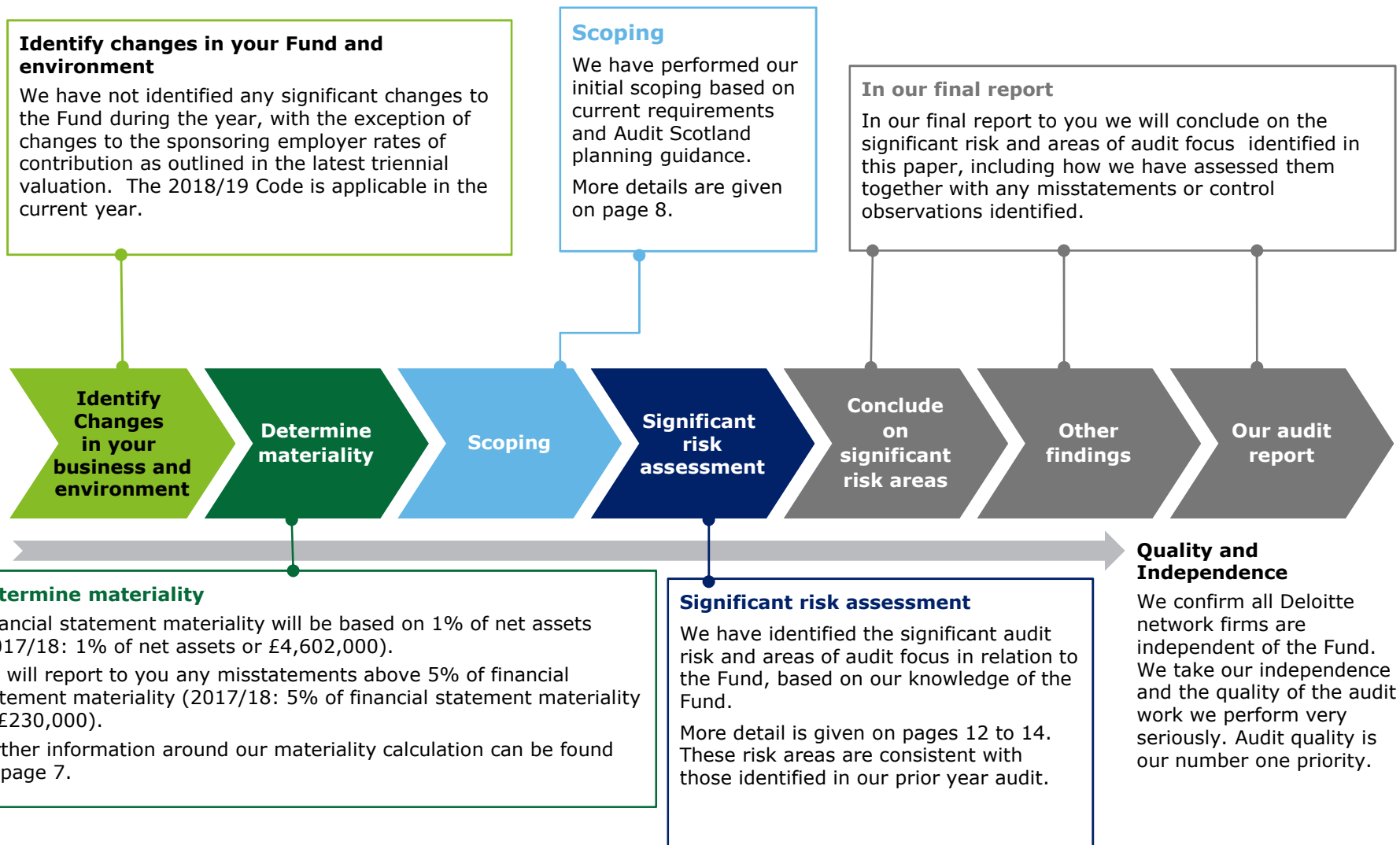
As a result of regulatory change in recent years, the role of the Audit Committee has significantly expanded. We set out here a summary of the core areas of Audit Committee responsibility to provide a reference in respect of these broader responsibilities and highlight throughout the document where there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



We use this symbol throughout this document to highlight areas of our audit where the Audit Committee need to focus their attentions.

# Our audit explained

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

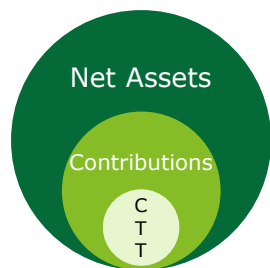


# Materiality

## Approach to materiality



### Basis of materiality - benchmark



We set materiality for our opinion on the financial statements at 1% (2017/18: 1%) of the Net Assets of the Fund and performance materiality at 90% of our materiality based on professional judgement, the requirements of auditing standards and the financial measures most relevant to the users of the financial statements.

As a reference our materiality and performance materiality for the 2017/18 Annual Report and Accounts was determined as £4,602,000 and £4,141,800 respectively.

We will update our materiality assessment following receipt of the draft 2018/19 financial statements and will communicate this to the Audit Committee in our final report.

### Reporting to the Audit Committee

We report to the Audit Committee any unadjusted misstatements greater than 5% of materiality (“reporting threshold”) and other adjustments we consider to be qualitatively material. Based on the 2017/18 Annual Report and Accounts, we determined reporting threshold (“RT”) to be £230,000.

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 £250,000.

We will report to you misstatements below this threshold if we consider them to be material in nature.

### Our audit report

The extent of our procedures is not based on materiality alone but also on the quality of systems and controls in preventing material misstatement in the financial statements, and the level at which known and likely misstatements are tolerated by you in the preparation of the financial statements.



Although materiality is the judgement of the Audit Director, the Audit Committee 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

Our core audit work as defined by Audit Scotland comprises:

- Providing the **Independent Auditor's Report** on the annual accounts;
- Providing the **annual report** on the audit addressed to the Pension Fund Audit Committee;
- Communicating **audit plans** to the Audit Committee;
- Providing **reports to management**, as appropriate, in respect of the auditor's responsibilities in the Code;
- Identifying **significant matters arising from the audit**, alert the Controller of Audit and support Audit Scotland in producing statutory reports as required; and
- Undertaking work requested by Audit Scotland or local performance audit work.

### Wider scope requirements

The Code of Audit Practice sets out four audit dimensions which set a common framework for all public sector audits in Scotland:

- **Financial sustainability** – looking forward to the medium and longer term to consider whether the Fund is planning effectively to continue to deliver its services or the way in which they should be delivered.
- **Financial management** – financial capacity, sound budgetary processes and whether the control environment and internal controls are operating effectively.
- **Governance and transparency** – the effectiveness of scrutiny and governance arrangements, leadership and decision making, and transparent reporting of financial and performance information.
- **Value for money** – using resources effectively and continually improving services.



# 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 the Fund addresses 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 Fund 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> </ul>	<p>We will review arrangements and financial planning systems in place by the Fund regarding investments to ensure that its services can continue to be delivered. This will include a review of the latest actuarial valuation of the Fund and the plans in place to reduce the deficit over the shorter and medium term. In addition, we will review the funding policy as set out in the Shetland Islands Council Pension Fund Investment Strategy 2014-2027, which aims to secure the long term solvency of the Fund, so that there are sufficient funds available to meet all benefits as they fall due.</p> <p><b>Audit Risk:</b> The Fund's investment strategy is inconsistent with the long term solvency of the Fund.</p>
<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 will review the budget and monitoring reporting by the Fund during the year to assess whether financial management and budget setting is in line with good practice.</p> <p>In addition, we will also review whether there is a proper officer and fund manager who have sufficient status to be able to deliver good financial management, that monitoring reports contain information linked to performance as well as financial data, and that members have the opportunity to provide a sufficient level of challenge around variances and under-performance.</p> <p><b>Audit Risk:</b> The underlying financial performance of the Fund is not transparently reported.</p> <p>Our fraud responsibilities and representations are detailed on pages 19 and 20.</p>

# Wider Scope Requirements (continued)










## Audit Dimensions (continued)

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 the Fund addresses 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>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 will review the Fund's papers and use our attendance at Audit Committee meetings to assess the effectiveness and scrutiny of governance arrangements.</p> <p>We will also review other aspects of governance around the Fund including Codes of Conduct for officers and members, fraud and corruption arrangements for reporting regulatory breaches to the Pensions Regulator.</p> <p>In addition, we will review the Annual Governance Statement and Governance Compliance Statement to confirm the governance arrangements observe the guidance issues by Scottish Ministers.</p> <p><b>Audit Risk:</b> The Fund's approach is not keeping pace with 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 and pace of improvement.</li> </ul>	<p>We will gain an understanding of the Fund'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.</p> <p>We will also review the scrutiny that is in place to challenge the Fund's investment managers on fees and performance.</p> <p><b>Audit Risk:</b> The Fund does not have sufficient scrutiny over the expenditure of the Fund.</p>

# Significant audit risk and areas of focus dashboard

We welcome the Audit Committee's input into this risk assessment to ensure that any new or emerging risks or focus areas are considered for inclusion as a significant audit risk or area of audit focus.

Risk	Material?	Fraud risk identified?	Planned approach to controls testing	Level of management judgement	Page no.
<b>Significant audit risk</b>					
<b>Management override of controls</b>			Design and implementation		12
<b>Areas of audit focus</b>					
Accuracy and timeliness of contributions payable to the Fund			Design and implementation		13
Existence of investments			Operating effectiveness		14



Moderate management judgement



Low management judgement

# Significant audit risk

## Management override of controls



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### **Risk identified**

In accordance with ISA 240 (UK) management override of controls is always a significant risk for financial statement audits. The primary risk areas surrounding the management override of internal controls are over the processing of journal entries and the key assumptions and estimates made by management.

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### **Deloitte response**

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

#### **Journal testing**

- We will make enquiries of individuals involved in the financial reporting process about inappropriate or unusual activity relating to the processing of journal entries and other adjustments;
- We will test the design and implementation of controls surrounding the financial reporting process and the controls over journal entries and other adjustments posted in the preparation of the financial statements;
- We will test the appropriateness of journal entries recorded in the general ledger, and other adjustments made in the preparation of the financial statements. As part of our work in this area, we will perform an analysis of the journal entries, which will enable us to focus on journals meeting specific pre-determined parameters determined during our audit planning;
- We will test the design and implementation of controls surrounding the segregation of duties over processing journal entries to the financial statements throughout the year.

#### **Accounting estimates**

- We will test the design and implementation of controls over key accounting estimates and judgements.
- We will review the financial statements for any accounting estimates which could contain management bias, and assess the judgements taken against supporting evidence.

#### **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 the Fund's operations, or that otherwise appear to be unusual, given our understanding of the Fund and its environment.
- We will make enquiries of management in relation to the identification of related parties.

# Areas of audit focus

## Accuracy and timeliness of contributions



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### **Risk identified**

The correct deduction and timely payment of contributions depends on system-based processing of membership data and salary details, together with a robust internal controls framework. Errors in processing contributions can lead to issues such as non-compliance with the Local Government Pension Scheme Regulations 2014 (“LGPS Regulations”) and the recommendations of the actuary. Deducting incorrect amounts from the active members’ payroll can be costly to rectify and cause reputational damage.

In addition, while no opinion is issued on the timely payment of contributions, it remains an area of focus, as LGPS Regulations stipulate due dates for payment. Late payments could cause reputational damage.

Due to the changes in employer primary contribution rates in the current year, there is a risk that contributions are not paid to the Fund accurately or in a timely manner.

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### **Deloitte response**

In order to address this area of audit focus, we will perform the following audit procedures:

- Review the design and implementation of key controls over the contribution process;
- Perform an analytical review of the employer and employee normal contributions received in the year, basing our expectation on the prior year audited balance, adjusted for the movement in active member numbers, contribution rate changes and any average pay rise awarded in the year;
- For a sample of active members, we will recalculate individual contribution deductions to ensure these are being calculated in accordance with the rates stipulated in the LGPS Regulations for employee contributions and the recommendations of the actuary for employer contributions;
- Test that the correct definition of pensionable salary is being used per the LGPS Regulations to calculate contribution deductions;
- Test the reconciliation of the total number of active members between the membership records and the employer payroll records; and
- For a sample of monthly contributions paid, check that they have been paid within the due dates per the LGPS Regulations.

# Areas of audit focus (continued)

## Valuation and existence of investments



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**Risk identified**

There is a risk that investments do not exist or are not valued accurately in the Fund's financial statements due to the potential levels of judgement involved in pricing such investments.

The Fund holds investments primarily in pooled funds, pooled property unit trusts and fixed income unit trusts with a range of investment managers.

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**Deloitte response**

In order to address this area of audit focus, we will perform the following audit procedures:

- Review the design and implementation and operating effectiveness of key controls over the valuation of investments by obtaining the investment manager internal controls reports and evaluating the implications for our audit of any exceptions noted;
- Independently request confirmations from all investment managers for balances held per the financial statements;
- Agree year end valuations, sales proceeds and purchases in the financial statements to the reports received directly from the investment managers;
- Perform a full unit reconciliation of investments held during the year;
- Agree a sample of investment sales and purchases to cash movements and/or transfers between funds where possible.
- Perform valuation testing by using a range of techniques depending on the type of investment:
  - Where the investment held is directly quoted on an exchange, we will obtain an independent price of the investment asset using our own internal pricing systems e.g. Bloomberg.
  - Where the investment is not directly quoted on an exchange, we will confirm if it is registered on the Financial Conduct Authority website and obtain an independent price, or use sales transactions close to the year end as an estimate of the price.
  - Where the investment is a unit linked insurance policy, we will confirm that the investment is held under the form of a unit linked insurance policy, that the insurance provider is authorised to provide insurance services and obtain confirmation that the provider would be willing to transact at the unit price stated on the confirmation received.
  - Where none of these options are available we will obtain audited financial statements and assess the year end price against the audited accounts, and benchmark movements where the date of the audited financial statements is not coterminous with the Fund's financial year.

# Audit quality

## Our commitment to audit quality

We set out below a summary of our commitments to both the Audit Committee and Fund management in key areas and we will actively seek feedback on how we have performed against them.



### AUDIT QUALITY PROMISE

The quality and distinctiveness of our audit delivery is of great importance to us.

#### Key aspects of this delivery are:

- how we ensure that the team is delivering the best quality audit at every level;
- how we continue to be insightful; and
- how we use technology to improve the quality of our audit and the insight we bring to you.



### INSIGHT

We will continue to use specialists in the audit of areas of audit interest. Our audit procedures and use of technology are designed to provide the Audit Committee with an insightful audit.

We will report our insights and results of the testing performed to the Audit Committee in our final paper following the completion of the audit.



### CULTURAL FIT

#### We commit to:

- giving you the best team with the right mix of industry knowledge and experience - the audit team consists of pension audit specialists, led by Pat Kenny (audit Director) and Graeme McCrum (Pensions accredited Director) with over 20 years of experience in the pensions industry;
- Pat is committed to meeting with the Audit Committee on a regular basis; and
- embedding Specialists into the audit team in order to provide you with the best advice in a timely manner and constructive audit challenge.



### PROFESSIONAL STANDARDS REVIEW

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 Fund.

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 Audit Committee, 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

8 February 2019



# Appendices



# Prior year audit adjustments

## Uncorrected and disclosure misstatements

We identified the following uncorrected and disclosure misstatements from our prior year audit work.

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	Debit/ (credit) in Fund Account £'000	Debit/ (credit) in net assets £'000	If applicable, control deficiency identified
<b>Uncorrected misstatements</b>			
None			
<b>Corrected misstatements</b>			
None			
<b>Total</b>			

### Disclosure misstatements

[1] The Schroder Liquidity Fund was disclosed under Cash income due in note 11a of the financial statements. As this is a Pooled Investment Vehicle, it should have been disclosed under that heading. The result of the current classification is that £973,000 of sales were not presented in note 11a.

# 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 management override of controls as a key audit risk for your Fund.



### **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 Fund:**

- 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 Fund 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 Fund'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:

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## 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 Fund and will reconfirm our independence and objectivity to the Audit Committee for the year ending 31 March 2019 in our final report to the Audit Committee.

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## Fees

The fee for the 2018/19 audit has been agreed as £29,100 (2017/18: £29,486).

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

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## Non-audit services

In our opinion there are no inconsistencies between the FRC's Ethical Standard and the Fund'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.

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## Relationships

We have no other relationships with the Fund, the Audit Committee, or management, and have not supplied any services to other known connected parties.

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# 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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