



Scottish Fire and Rescue Service

Planning report to the Audit and Risk Assurance Committee
on the 2016/17 audit

22 February 2017

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Director introduction

The key messages in this report

I have pleasure in presenting our planning report to the Audit and Risk Committee for the 2016/17 audit. I would like to draw your attention to the key messages of this paper:

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.

Significant financial statement risks

- As with all public sector bodies, the Scottish Fire and Rescue Service ("SFRS") continues to face financial challenges. The overall 2016/17 forecast position as at 31 January 2017 is projecting an overspend of £0.148m at financial year end, however a number of actions are being taken to bring the budget into balance. The achievement of a breakeven position will be a key focus of our audit.
- Under Auditing Standards, there is a presumed risk that revenue may be misstated due to the improper recognition of revenue. This presumption can be rebutted if the auditor concludes that there is no risk of material misstatement due to fraud relating to revenue recognition. Having considered the risk factors set out in auditing standards and the nature of the revenue streams at SFRS, we have determined that the risk of fraud arising from revenue recognition can be rebutted. This is based on the fact that there is little incentive to manipulate revenue recognition, the majority of revenue is from the Scottish Government which can be agreed to confirmations supplied and the culture and ethical frameworks of the Service mean that all forms of fraud are seen as unacceptable.
- Other significant risks include the valuation of property assets and management override of controls.

Audit Dimensions

- The 2016 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 we will report our conclusions in our annual report to the Audit and Risk Committee in October 2017. In particular, our work will focus on:
 - **Financial sustainability** – we will monitor the Service's actions in respect of its short, 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 investment is effective.
 - **Financial management** – we will review the budget and monitoring reports to the Board during the year and liaise with internal audit in relation to their work on the key financial controls to assess whether financial management and budget setting is effective. We will also consider the capacity of the finance team in view of the prior year audit recommendations.
 - **Governance and transparency** – from our review of Board papers and attendance at Audit and Risk Assurance Committees we will assess the effectiveness of governance arrangements. We will also share best practice from elsewhere from our dedicated governance team.
 - **Value for money** – we will gain an understanding of SFRS'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.

Director introduction (continued)

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.

Other wider scope work

- We will monitor the Service's participation and progress with the National Fraud Initiative (NFI) during 2016/17 and complete an Audit Scotland audit questionnaire by 30 June 2017.
- In accordance with Audit Scotland guidance, we will be requested to provide information to support national performance audits and to inform wider analysis on the follow-up of Role of Boards report.

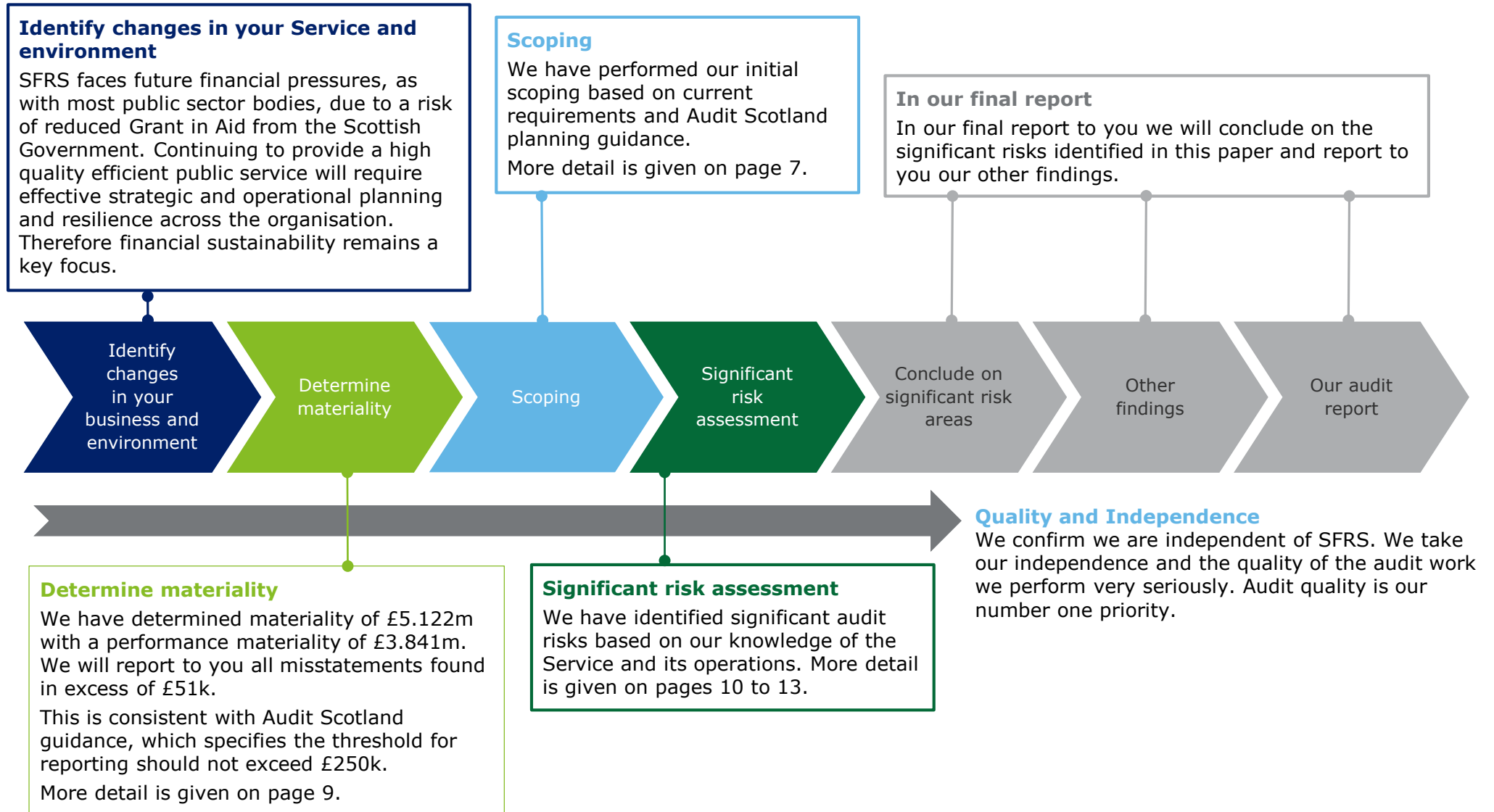
Our commitment to quality

- We are committed to providing the highest quality audit, with input from our market leading specialists, sophisticated data analytics and our wealth of experience. Further information is presented on page 25.

Pat Kenny
Audit Director

Our audit explained

We tailor our audit to your business and your strategy



An audit tailored to you

Focusing on your business and strategy



Significant risk



Normal risk



Considered as part of wider scope audit requirements

Impact on our audit

Future financial sustainability and strategy



SFRS faces an extremely challenging financial environment for the foreseeable future with Audit Scotland identifying in their May 2015 report that, due to future cost pressures and likely reductions in funding, the Service could face a potential funding gap of £47.2m by 2019/20.

The Service are developing a long term financial strategy to effectively meet these challenges and the Service must continue to look at how it can reduce costs to meet the challenge of making significant savings each year.

As part of our responsibilities in relation to the wider audit dimensions, we will consider the Service's financial sustainability in the medium to longer term and consider whether it is planning effectively to continue to deliver its services on a sustainable basis.

Performance against six key strategic priorities



As part of the Strategic Plan 2016-19, SFRS has identified six key strategic priorities for the service going forward

- Improved local outcomes
- National and community resilience
- Modernising response
- Workforce development
- Governance and social responsibility
- Transformation

Each priority is underpinned by specific strategic objectives.

We will review how the Service has begun to deliver these strategic priorities and objectives during the 2016/17 audit and assess the performance reporting arrangement for this plan. We will use this as a benchmark to monitor improvement in performance over our five year appointment period.

Corporate governance



Following the 2014/15 Review of the Effectiveness of the Board, SFRS have been developing a Code of Corporate Governance. The Service undertook a review of Governance Codes across the public sector and consulted with key individuals in Central Government. It presented a draft SFRS Code of Corporate Governance to the Board for approval in December 2016.

In tandem with this, SFRS is currently undertaking an exercise to review their committee structure to achieve cost savings of £10k per annum and free up member time. Significant consultation has occurred throughout this process and the new structure will see the number of standing committees being reduced by one.

Both the Code of Corporate Governance and the revised committee structure are intended to support the outcomes and priorities set out in the Strategic Plan 2016-19.

We will monitor the progress towards introduction of the Code of Corporate Governance and the revised committee structure during the 2016/17 audit.

Scoping

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 (and any assurance statement on consolidation packs);
- providing the **annual report** on the audit addressed to the Service and the Auditor General for Scotland;
- communicating **audit plans** to those charged with governance;
- providing **reports to management**, as appropriate, in respect of the auditor's corporate governance responsibilities in the Code (including auditors' involvement in the NFI exercise);
- Preparing and submitting **fraud returns**, including nil returns, to Audit Scotland where appropriate;
- Identifying significant matters arising from the audit, alert the Auditor General for Scotland 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 body 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.

Scoping (continued)

Our approach



Liaison with internal audit

The Auditing Standards Board's version of ISA (UK and Ireland) 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 reports prepared by internal audit and meet with them to discuss their work. We will also discuss the work where they have identified specific material deficiencies in the control environment and we will consider adjusting our testing so that the audit risk is covered by our work.

Using these discussions to inform our risk assessment, we will work together with internal audit to develop an approach that avoids inefficiencies and overlaps, therefore avoiding any unnecessary duplication of audit requirements on the Service's staff. We do not plan to place any specific reliance on the work of internal audit.

Approach to controls testing

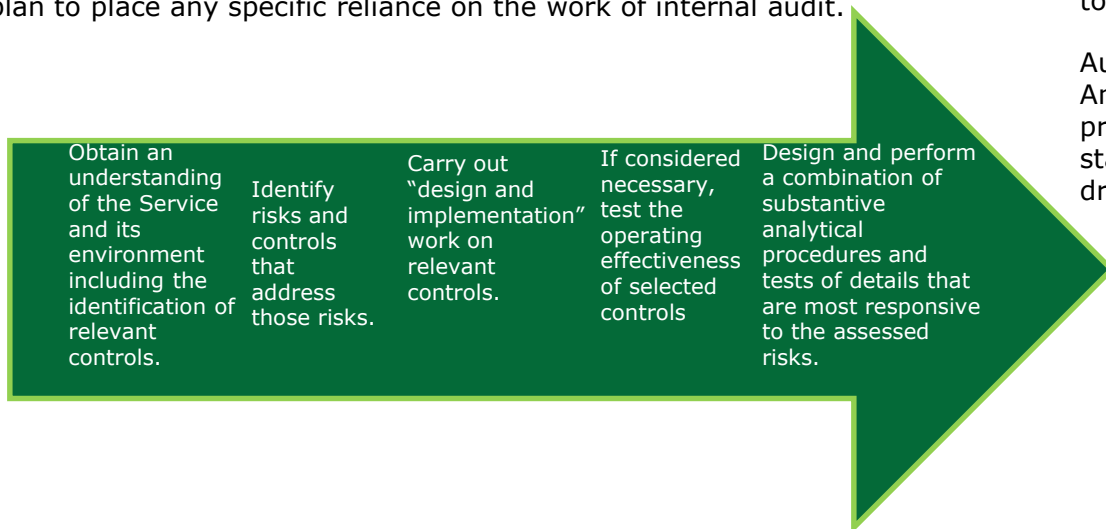
Our risk assessment procedures will include obtaining an understanding of controls considered to be 'relevant to the audit'. This involves evaluating the design of the controls and determining whether they have been implemented ("D&I").

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.

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

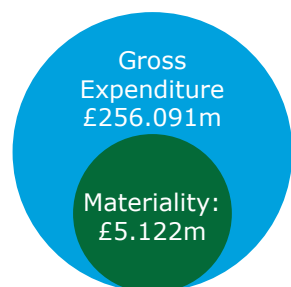


Materiality

Approach to materiality



Basis of materiality – benchmark



- The Audit Director has estimated materiality as £5.122m and a performance materiality of £3.841m, based on professional judgement, the requirements of auditing standards and the financial measures most relevant to users of the financial statements.
- We have used 2% of forecast gross expenditure for the year as the benchmark for determining materiality (based on projected expenditure as of 31 January 2017).
- Materiality calculation will be revisited at year end and calculated based on actual final figures.
- 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.

Reporting to those charged with governance

Under the current materiality level based on gross expenditure, we will report to you all misstatements found in excess of £51k.

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

Our audit report

We will:

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

Although materiality is the judgement of the audit director, the Audit and Risk Committee must satisfy themselves that the level of materiality chosen is appropriate for the scope of the audit.

Significant risks

Core Expenditure Resource Limits

Key focus for management

Nature of risk

The key financial duty for the SFRS is to comply with the Departmental Expenditure Limit (DEL) requirement set by the Scottish Government. Given the current budget position 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, including year end transactions, in an attempt to achieve a breakeven position.

The key judgement areas, its potential impact on the financial statements and our 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 expenditure including year end transactions;
- assessing whether expenditure is correctly classified between revenue and capital and whether it has been incurred in accordance with Scottish Government's guidance;
- performing focused cut-off testing of expenditure;
- reviewing and challenging the assumptions made in estimating key accruals to assess completeness and accuracy of recorded expenditure; and
- obtain independent confirmation of the resource limits allocated to SFRS by the Scottish Government.

Deloitte comment

The Service came into being on 1 April 2013, and, as a new organisation, has undergone significant transformation and rationalisation. Over the last 3 financial years, the Service has managed the financial position to deliver an underspend against budget each year.

SFRS was reporting a forecast year end revenue overspend position of £148k as at 31 January 2017, which equates to less than 0.01% of the overall budget. A number of actions across budget pressure areas are underway and the Service anticipates that it will achieve a break even position at year end.

We will keep the financial position under review and take the final position into consideration as part of our year end testing.

Valuation of property assets

The valuation of £521.8 million of property assets (as at 31 March 2016) is inherently judgemental

Nature of risk

SFRS holds all property assets where there is no market-based evidence of fair value at depreciated replacement cost. All other buildings are held at existing use value. The valuations are by nature significant estimates which are based on specialist and management assumptions and which can be subject to material changes in value.

The key judgement areas, its potential impact on the financial statements and our planned audit challenge

SFRS held £521.8 million of property assets at 31 March 2016. 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 (over £100K). Revaluation is undertaken by the Service's internal Royal Institute of Chartered Surveyors (RICS) qualified Valuer.

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;
- consider material changes of assets not subject to full revaluation during the year;
- consider assets classified as surplus or held for sale to assess whether these have been valued and disclosed in line with IFRS and the FReM; and
- involve the use of our internal property specialists to review and challenge the assumptions and methodology adopted by the Service's Valuer, including sample testing of inputs to the valuations.

Deloitte comment

We note that regular discussion takes place between the Finance Team and the Service's internal Valuer during the year. We will use our Property Specialists to assist in our testing of the Service's property assets.

Management override of controls

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

Nature of risk

International Standards on Auditing requires auditors to identify a presumed risk of management override of control. This presumed risk cannot be rebutted by the auditor. This recognises that management may be able to override controls that are in place to present inaccurate or even fraudulent financial reports.

The key judgement areas, its potential impact on the financial statements and our planned audit challenge

Our work will focus on:

- the testing of journals, using data analytics to focus our testing on higher risk journals;
- significant accounting estimates. In addition to the estimates discussed above in respect of property valuations, we will also consider any other provisions and accruals; and
- any unusual transactions or one-off transactions, including those with related parties.

Our wider response to the risk of fraud is set out in the Appendix of this report.

In considering the risk of management override, we will:

- assess the overall position taken in respect of key judgements and estimates;
- consider the sensitivity of the financial statements with respect to achieving financial performance targets, including Departmental Expenditure Limit thresholds;
- consider remuneration plans and linkage with key management judgements; and
- consider our view on the overall control environment and 'tone at the top'.

Deloitte comment

No testing has been performed to date as we will complete the above as part of our year-end visit.

Wider scope requirements

Audit dimensions

The Code of Audit Practice sets our four audit dimensions which set a common framework for all public sector audits in Scotland. We will consider how SFRS 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 2017 Audit
<p>Financial sustainability looks forward to the medium and longer term to consider whether the body is planning effectively to continue to deliver its services or the way in which they should be delivered.</p>	<ul style="list-style-type: none"> • The financial planning systems in place across the shorter and longer terms • The arrangements to address any identified funding gaps • The affordability and effectiveness of funding and investment decisions made 	<p>We will monitor SFRS's actions in respect of its short, medium and longer term financial plans to assess whether short term financial balance can be achieved, whether there is a long-term (5-10 years) financial strategy and if investment is effective. We will also assess the effectiveness of the SFRS approach to transformational change and benefits realisation.</p>
<p>Financial management 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"> • Systems of internal control • Budgetary control system • Financial capacity and skills • Arrangements for the prevention and detection of fraud 	<p>As noted on page 8, we will liaise with Internal Audit in relation to their work on the key financial controls. We will also provide management with feedback on their review of the internal audit function and share benchmarking information from similar organisations.</p> <p>We will review the budget and monitoring reporting to the Board during the year to assess whether financial management and budget setting is effective.</p> <p>We have invited SFRS to take part in the Deloitte benchmarking survey to assess the level of financial capacity and skills within the Service. Our fraud responsibilities and representations are detailed on pages 20 and 21.</p>
<p>Governance and transparency 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"> • Governance arrangements • Scrutiny, challenge and transparency on decision making and financial and performance reports • Quality and timeliness of financial and performance reporting 	<p>We will review how the governance arrangements are developing during 2016/17 as the new committee structure is implemented.</p> <p>We will review the financial and performance reporting to the Board during the year as well as minutes of all Board meetings to assess the effectiveness of the governance arrangements. Our attending at Audit and Risk Assurance Committees will also inform our work in this area.</p> <p>We will also review the Risk Management Policy and Strategy documents and provide feedback based on our knowledge and experience from the wider sector.</p>
<p>Value for money is concerned with using resources effectively and continually improving services.</p>	<ul style="list-style-type: none"> • Value for money in the use of resources • Link between money spent and outputs and the outcomes delivered • Improvement of outcomes • Focus on and pace of improvement. 	<p>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.</p>

Wider scope requirements (continued)

NFI and Performance audits

National Fraud Initiative (NFI)

The NFI is a data matching exercise which matches electronic data within and between participating bodies to prevent and detect fraud and is run every two years. All data was submitted in October 2016 and the Service received matches for investigation in January 2017.

In the SFRS 2015/16 annual report, Grant Thornton raised no concerns in relation to SFRS's participation in the 2014/15 exercise.

In accordance with Audit Scotland planning guidance, we are required to monitor the Service's participation and progress during 2016/17 and complete an NFI audit questionnaire by 30 June 2017. The information contained in this questionnaire will be used for Audit Scotland's NFI report to be published in June 2018.

Performance audits

In accordance with Audit Scotland planning guidance, we will be requested to provide information to support performance audits and to inform wider analysis on the following subject during the year:

Purpose	Date
Contribute to follow up Role of Boards	30 June 2017

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 the material issues and significant judgements identified, by using our expertise in the sector and elsewhere to provide robust challenge to management;
- We will obtain a deep understanding of your organisation, its environment and of your processes in key areas – such as payroll expenditure, and capital expenditure - enabling us to develop a risk-focused approach tailored to the Services;
- Our engagement team is selected to ensure that we have the right subject matter expertise and industry knowledge. We will involve IT and Estates specialists to support the audit team in our work, leading to high quality understanding and challenge; and
- In order to deliver a quality audit to you, each member of the core audit team has received tailored training to develop their expertise in audit skills which includes local Engagement Team Based Learning. This is a partner led programme encouraging teams from across our practice to engage and discuss current sector and audit issues, sharing best practice and expertise.

Engagement Quality Control Review

We have developed a tailored Engagement Quality Control approach. Our dedicated Professional Standards Review (PSR) function will provide a 'hot' review before any audit or other opinion is signed. PSR is operationally independent of the audit team, and supports our high standards of professional scepticism and audit quality by providing a rigorous independent challenge.

Purpose of our report and responsibility statement

Our report is designed to help you meet your governance duties

What we report

Our report is designed to establish our respective responsibilities in relation to the financial statements audit, to agree our audit plan and to take the opportunity to ask you questions at the planning stage of our audit. Our report includes:

- Our audit plan, including key audit judgements and the planned scope;
- Key regulatory and corporate governance updates, relevant to you.

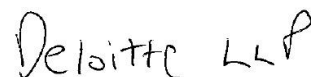
What we don't report

- As you will be aware, our audit is not designed to identify all matters that may be relevant to the Audit and Risk Assurance Committee.
- 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

- This report should be read alongside the supplementary "Briefing on audit matters" circulated separately on 18 January 2017
- We will update you if there are any significant changes to the audit plan.

We welcome the opportunity to discuss our report with you and receive your feedback.



Deloitte LLP

Chartered Accountants

Glasgow

22 February 2017

This report has been prepared for the Audit and Risk 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.

Appendices

Uncorrected misstatements and disclosure deficiencies

Prior year



There were no uncorrected misstatements identified by the previous auditors during the course of the prior year audit.

There were no disclosure deficiencies noted by the previous auditors during the prior year audit.

Fraud responsibilities and representations

Responsibilities explained



Your responsibilities

- The primary responsibility for the prevention and detection of fraud rests with management and those charged with governance, including establishing and maintaining internal controls over the reliability of financial reporting, effectiveness and efficiency of operations and compliance with applicable laws and regulations.

Our responsibilities

- We are required to obtain representations from your management regarding internal controls, assessment of risk and any known or suspected fraud or misstatement.
- As auditors, we obtain reasonable, but not absolute, assurance that the financial statements as a whole are free from material misstatement, whether caused by fraud or error.
- As set out in the significant risks section of this document, we have identified the fraud risk of management override of controls as a key audit risk for your organisation.

Fraud characteristics

- Misstatements in the financial statements can arise from either fraud or error. The distinguishing factor between fraud and error is whether the underlying action that results in the misstatement of the financial statements is intentional or unintentional.
- Two types of intentional misstatements are relevant to us as auditors – misstatements resulting from fraudulent financial reporting and misstatements resulting from misappropriation of assets.

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

- 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 / We have disclosed to you all information in relation to fraud or suspected fraud that we are aware of and that affects the entity or group 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 (continued)



We will make the following inquiries regarding fraud:

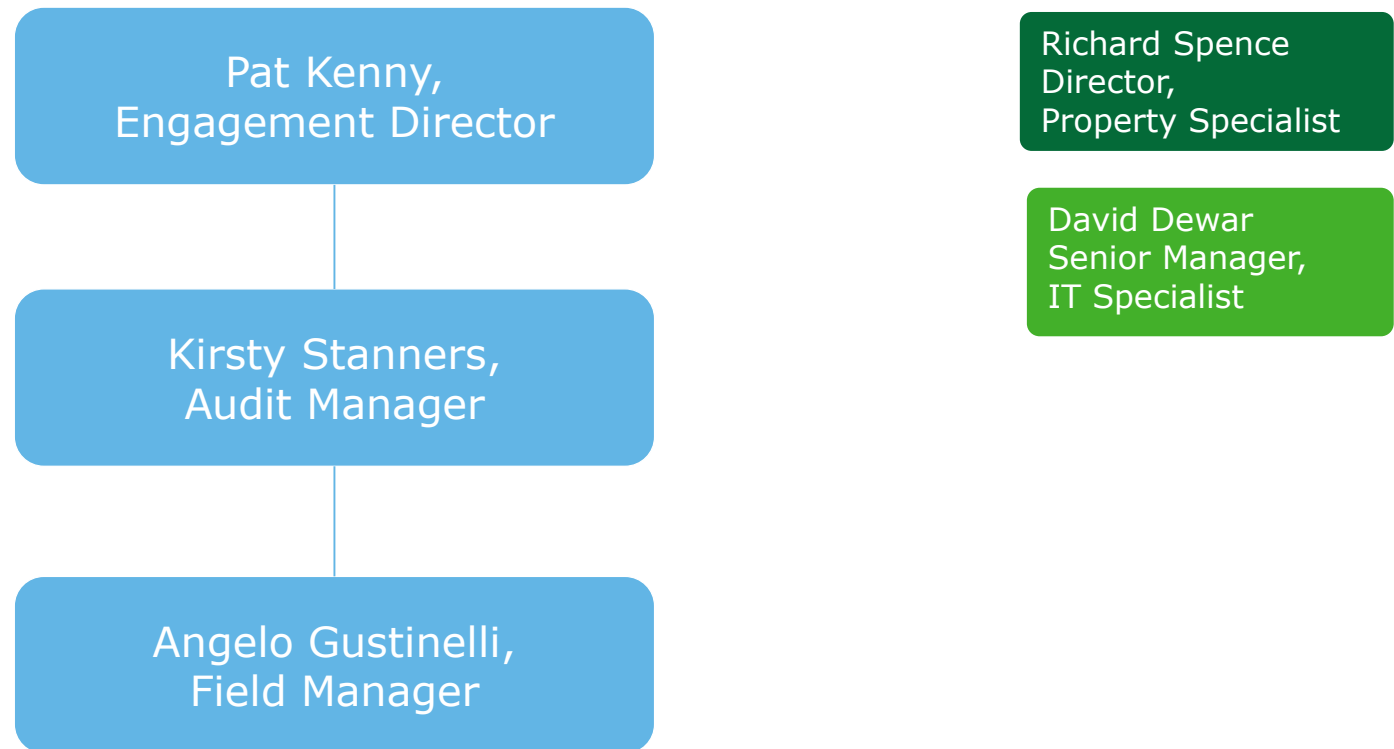
Management	Internal Audit & Local Counter Fraud Specialist	Those charged with governance
<p>Management's assessment of the risk that the financial statements may be materially misstated due to fraud, including the nature, extent and frequency of such assessments.</p> <p>Management's process for identifying and responding to the risks of fraud in the entity.</p> <p>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.</p> <p>Management's communication, if any, to employees regarding its views on business practices and ethical behaviour.</p> <p>Whether management has knowledge of any actual, suspected or alleged fraud affecting the entity.</p> <p>We plan to involve management from outside the finance function in our inquiries.</p>	<p>Whether internal audit and the Local Counter Fraud Specialist has knowledge of any actual, suspected or alleged fraud affecting the entity, and to obtain its views about the risks of fraud.</p>	<p>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.</p> <p>Whether those charged with governance have knowledge of any actual, suspected or alleged fraud affecting the entity.</p> <p>The views of those charged with governance on the most significant fraud risk factors affecting the entity.</p>

We will also perform procedures in relation to the National Fraud Initiative as set out on page 15.

Your audit team and timetable

We have a highly experienced audit team

We set out below our audit engagement team. We manage our audit on a basis that it draws on the expertise of our public sector group.



Your audit team and timetable (continued)

Set out below is the approximate expected timing of our reporting and communication with SFRS and Audit Scotland.



Independence and fees



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

Independence confirmation

We confirm we are independent of the Service and will reconfirm our independence and objectivity to the Audit and Risk Assurance Committee for the year ending 31 March 2017 in our final report to this Committee.

Fees

A fee range for the 2016/17 audit was provided by Audit Scotland in late December 2016. Our proposed fee for SFRS, subject to Committee approval, is £98,650 (inclusive of Audit Scotland fixed charges), which is in line with the fee level suggested by Audit Scotland, and which is analysed below:

	£
Auditor remuneration	76,000
Audit Scotland fixed charges:	
Pooled costs	18,680
Audit support costs	3,970
Total proposed fee	98,650

Details of all non-audit services fees for the period will be presented in our final report.

Non-audit services

In our opinion there are no inconsistencies between APB Ethical Standards for Auditors and the company'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.

Our approach to quality

AQR team report and findings

Audit quality and regulation

We pride ourselves on our commitment to quality and our quality control procedures. We have an unyielding pursuit of quality in order to deliver consistent, objective and insightful assurance.

In May 2016 the Financial Reporting Council ("FRC") issued individual reports on each of the six largest firms, including Deloitte, on Audit Quality Inspections which provides a summary of the findings of its Audit Quality Review ("AQR") team for the year ended 31 March 2016. We adopt an open and communicative approach with the regulator and their report is an accurate reflection of our efforts to improve audit quality across our practice over a number of years.

The review performed by the AQR forms an important part of our overall inspection process. We perform causal factor analysis on each significant finding arising from both our own internal quality review and those of our regulators to identify the underlying cause. This then drives our careful consideration of each of the FRC's comments and recommendations, as well as findings arising from our own reviews to provide further impetus to our quality agenda.

18 of the audits reviewed by the AQR were performed to a good standard with limited improvements required and four audits required improvements. No audits were assessed as requiring significant improvements. We have already taken action to respond to the key themes of the report and will continue to undertake further inputs to our audit quality improvement programmes to embed the changes into our practice.

The AQR's conclusion on Deloitte

"We reviewed selected aspects of 22 individual audits in 2015/16. In selecting which aspects of an audit to inspect, we take account of those areas identified to be of higher risk by the auditors and Audit Committees, our knowledge and experience of audits of similar entities and the significance of an area in the context of the audited financial statements.

In response to our last inspection report, the firm has made a number of improvements to its policies and procedures:

- The firm's guidance regarding the testing of journals has been enhanced.
- Additional sector-specific training was provided for individuals involved in financial services audits, together with additional training on internal controls for all audit staff.
- The firm has made a number of improvements to its internal monitoring process, including the development of a moderation process in order to increase consistency.

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

- Improve the extent of challenge of management in relation to areas of judgment, in particular for impairment reviews and judgmental valuations.
- Improve aspects of its audit approach in the areas of revenue and inventory.
- Ensure high quality reporting to Audit Committees is achieved on a consistent basis.
- Strengthen its audit approach in relation to defined benefit pension scheme balances and disclosures.
- Strengthen its policies and procedures regarding the engagement quality control review process."

2015/16 Audit Quality Inspection Report on Deloitte LLP

Our approach to quality (continued)

AQR team report and findings (continued)

Review of individual audits

The following chart provides a summary of the AQR's assessment of the quality of our individual audits inspected in 2015/16, with comparatives for the previous 4 years. The chart also shows the 5 year average of Deloitte and the 5 year average of the 6 largest firms inspected by the AQR (which comprises Deloitte LLP, Ernst & Young LLP, KPMG LLP, PricewaterhouseCoopers LLP, BDO LLP and Grant Thornton UK LLP).

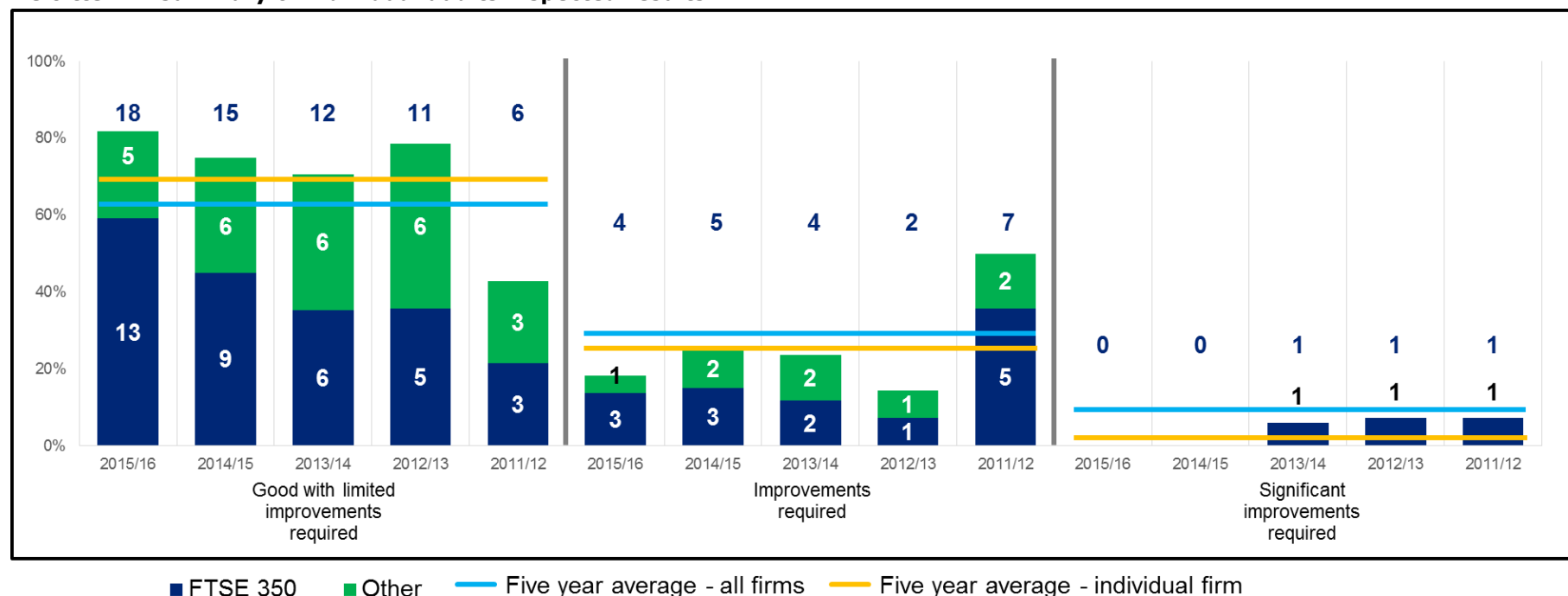
The AQR categorises audits as either:

- Good with limited improvements required
- Improvements required
- Significant improvements required

Changes to the proportion of audits reviewed falling within each grade from year to year reflect a wide range of factors, which may include the size, complexity and risk of the individual audits selected for review and the scope of the individual reviews. For this reason, and given the sample sizes involved, changes in gradings from one year to the next are not necessarily indicative of any overall change in audit quality at the firm.

All the AQR public reports on individual firms are available on its website <https://www.frc.org.uk/Our-Work/Conduct/Audit-Quality-Review/Audit-firm-specific-reports.aspx>

Deloitte LLP summary of individual audits inspected results





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