

Stroud District Council

**Planning report to the Audit & Standards Committee on 2022/23 audit –
Issued on 6 July 2023 (Draft)**

Contents

01 Planning report

Audit lead introduction	3
Responsibilities of the Audit & Standards Committee	4
Your control environment	5
Our audit explained	6
Scope of work and approach	7
Continuous communication and reporting	10
Materiality	11
Significant risks	12
Other areas of audit focus	16
Value for Money	17
Purpose or our report and responsibility statement	18

02 Appendices

Fraud responsibilities and representations	20
Independence and fees	23
Revisions to auditing standards coming into effect	25
Our approach to quality	30

Audit lead introduction

The key messages in this report:

I have pleasure in presenting our planning report to the Audit & Standards Committee for the audit of the 2022/23 financial statements. 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.

Audit Plan

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

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

Significant Audit Risks

We have taken an initial view as to the significant audit risks the Council faces. These have been identified as:

- Capital expenditure; and
- Management Override of Controls

In addition, other area of audit focus is identified as the pension liability.

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.

Michelle Hopton
Audit Lead

Responsibilities of the Audit & Standards Committee

Helping you fulfil your responsibilities

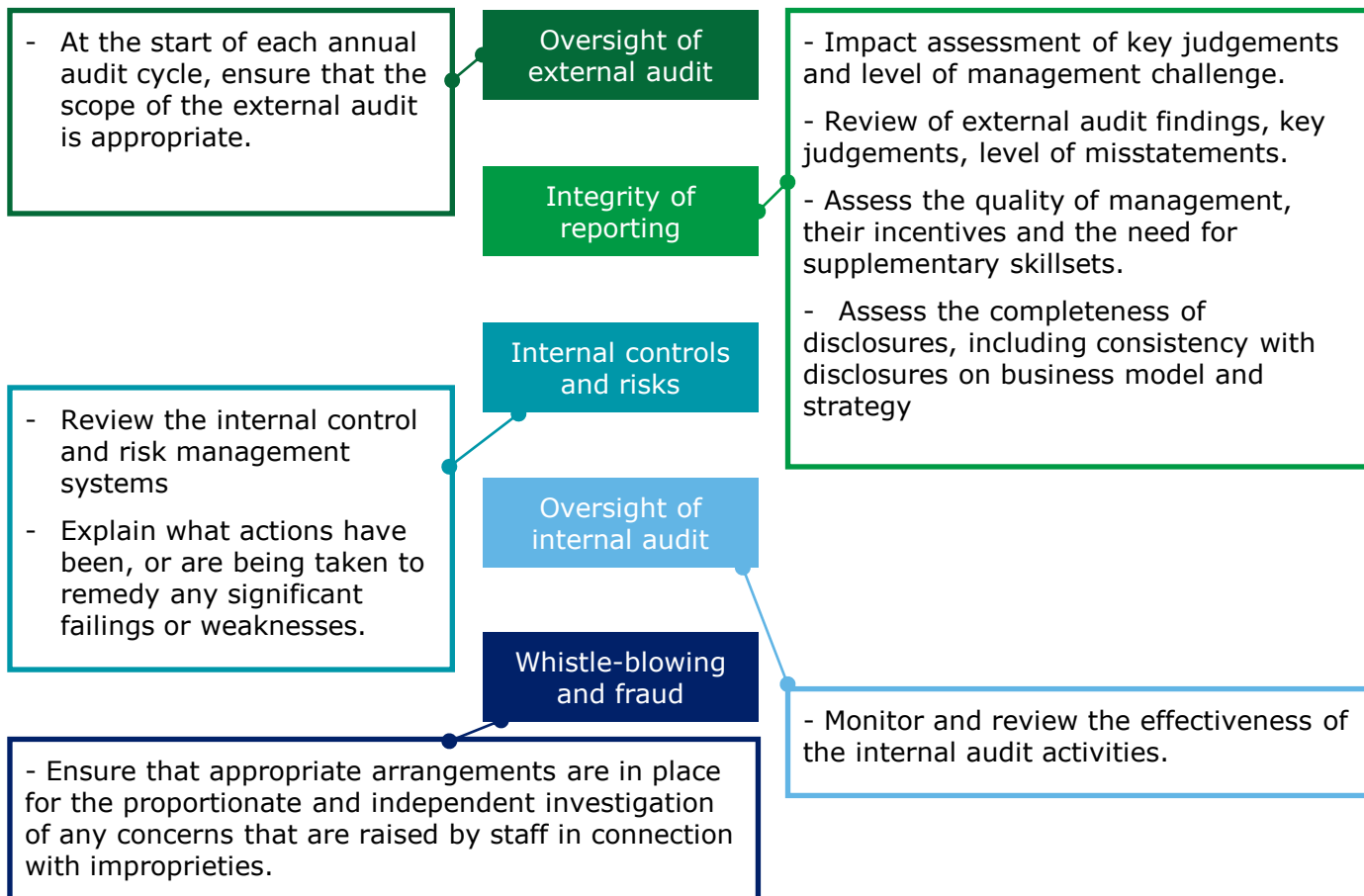
Why do we interact with the Audit & Standards Committee?

To communicate audit scope

To provide timely and relevant observations

To provide additional information to help you fulfil your broader responsibilities

As a result of regulatory change in recent years, the role of the Audit & Standards Committee has significantly expanded. We set out here a summary of the core areas of Audit & Standards Committee responsibility to provide a reference in respect of these broader responsibilities.



Your control environment

What we consider when we plan the audit

Responsibilities of management

We expect management and those charged with governance to recognise the importance of a strong control environment and take proactive steps to deal with deficiencies identified on a timely basis.

Auditing standards require us to only accept or continue with an audit engagement when the preconditions for an audit are present. These preconditions include obtaining the agreement of management and those charged with governance that they acknowledge and understand their responsibilities for, amongst other things, internal control as is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

FRC guidance on good practice

The FRC, in its Review of Governance Reporting, issued November 2021, has identified good practice as including a detailed description of the process for reviewing the effectiveness of risk management and internal control systems and clarity on what the outcome of the review. This would include whether any weaknesses or inefficiencies were identified and explanations of what actions the board has taken, or will take, to remedy these.

Performance materiality



We set performance materiality as a percentage of materiality to reduce the probability that, in aggregate, uncorrected and undetected misstatements exceed materiality. We determine performance materiality, with reference to factors such as the quality of the control environment and the historical error rate. Where we are unable to rely on controls, we may use a lower level of performance materiality.

Responsibilities of the Audit & Standards Committee

As previously noted in the Responsibilities of the Audit & Standards Committee on page 4, the Audit & Standards Committee is responsible for:

- Reviewing internal financial controls and internal control and risk management systems (unless expressly addressed by a separate risk committee).
- Monitoring and reviewing the effectiveness of the internal audit function; where there isn't one, explaining the absence, how internal assurance is achieved, and how this affects the work of external audit.
- Explaining what actions have been, or are being taken to remedy any significant failings or weaknesses.

Our audit explained

We tailor our audit to your business and your strategy

Identify changes in your business and environment

We have spent time with management understanding the current year matters and prepared our risk assessment for the audit. We will continue to keep this under review throughout the audit process.

Scoping

We anticipate our scope to be in line with the Code of Audit Practice issued by the NAO.

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 materiality of £1.77m (2021/22 £1.72m). This is based on 2% of total expenditures per the Council's unaudited accounts. We will report to you any misstatements above £88k (2021/22 £85k). We will report to you misstatements below this threshold if we consider them to be material by nature.

Significant risk assessment

We have identified significant audit risks in relation to the Council. Please refer to page 13 for details.

Quality and Independence

We confirm all Deloitte network firms and engagement team members are independent of Stroud District Council. We take our independence and the quality of the audit work we perform very seriously. Audit quality is our number one priority.

Scope of work and approach

Scope: we have three key areas of responsibility under the Audit Code

Financial statements

We will conduct our audit in accordance with International Standards on Auditing (UK and Ireland) ("ISA (UK and Ireland)") as adopted by the UK Auditing Practices Board ("APB") and Code of Audit Practice issued by the National Audit Office ("NAO"). The Council will prepare its accounts under the Code of Practice on Local Authority Accounting ("the Code") issued by CIPFA and LASAAC.

We are also required to issue a separate assurance report to the NAO on the Council's separate return required for the purposes of its audit of the Whole of Government Accounts and departmental accounts.

Annual Governance Statement

We are required to consider the completeness of the disclosures in the Annual Governance Statement in meeting the relevant requirements and identify any inconsistencies between the disclosures and the information that we are aware of from our work on the financial statements and other work.

As part of our work we will review the annual report and compare with other available information to ensure there are no material inconsistencies. We will also review any reports from other relevant regulatory bodies and any related action plans developed by the Council.

Value for Money (VfM) conclusion

We are required to satisfy ourselves that the Council has made proper arrangements for securing financial resilience and economy, efficiency and effectiveness in its use of resources.

We will need to assess three areas as part of our procedures:

- Financial sustainability;
- Governance and Improving economy; and
- Efficiency and effectiveness.

This will require a minimum level of work at every local public body, with additional risk based work where relevant.

Scope of work and approach

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 their reports and meet with them to discuss their work where necessary. We will review 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, where necessary, to develop an approach that avoids inefficiencies and overlaps, therefore avoiding any unnecessary duplication of audit requirements on the Council'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 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.

We recommend the Council to complete the Code checklist during drafting of their financial statements.

We would review the existing format of the financial statements, and assess if there is any scope for simplifying or streamlining disclosures.

Obtain and refresh our understanding of the Council and its environment including identification of relevant controls

Identify risks and any 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.

Scope of work and approach

Our approach (Continued)

Value for Money and other reporting

The Updated Code of Audit Practice changes the approach of external audit work away from the auditor performing a risk assessment, and then only performing further work if a significant risk were identified, to specifying procedures that will need to be undertaken in each of three areas – Financial sustainability; Governance and Improving economy, efficiency and effectiveness.

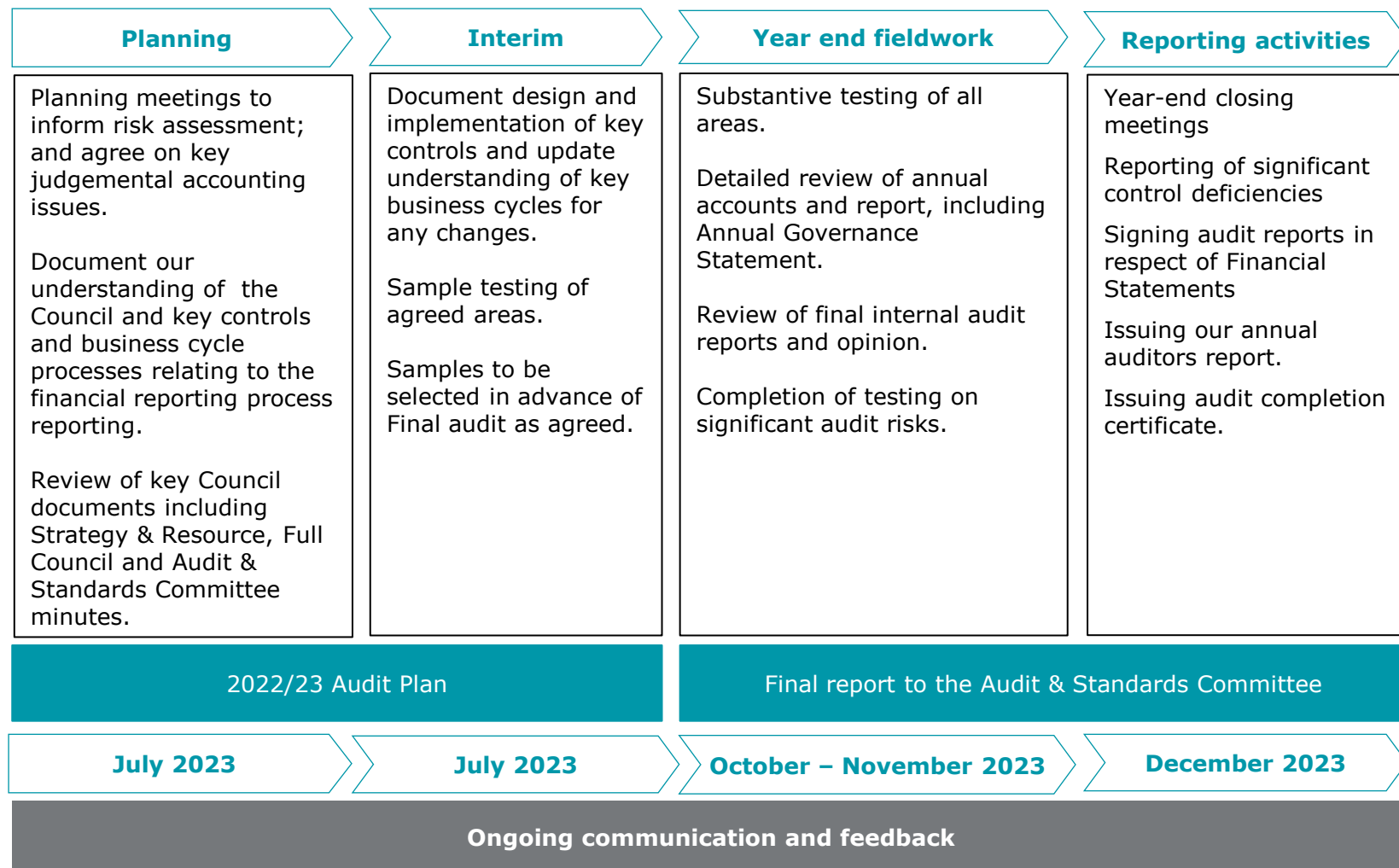
This will require a minimum level of work at every local public body, with additional risk based work where relevant. The National Audit Office (NAO) has recently issued an audit procedures scope and discussions on implementation are ongoing.

We will report by exception any matters we identify that indicate the Governance Statement does not comply with the CIPFA guidance, or is misleading or inconsistent with information of which we are aware from our audit. We are not required to consider, nor will we consider, whether the Annual Governance Statement addresses all risks and controls or that risks are satisfactorily addressed by internal controls.

Continuous communication and reporting

Planned timing of the audit

As the audit plan is executed throughout the year, the results will be analysed continuously and conclusions (preliminary and otherwise) will be drawn. The following sets out the expected timing of our reporting to and communication with you. Please note timing of the Grant work will be communicated separately.



Materiality

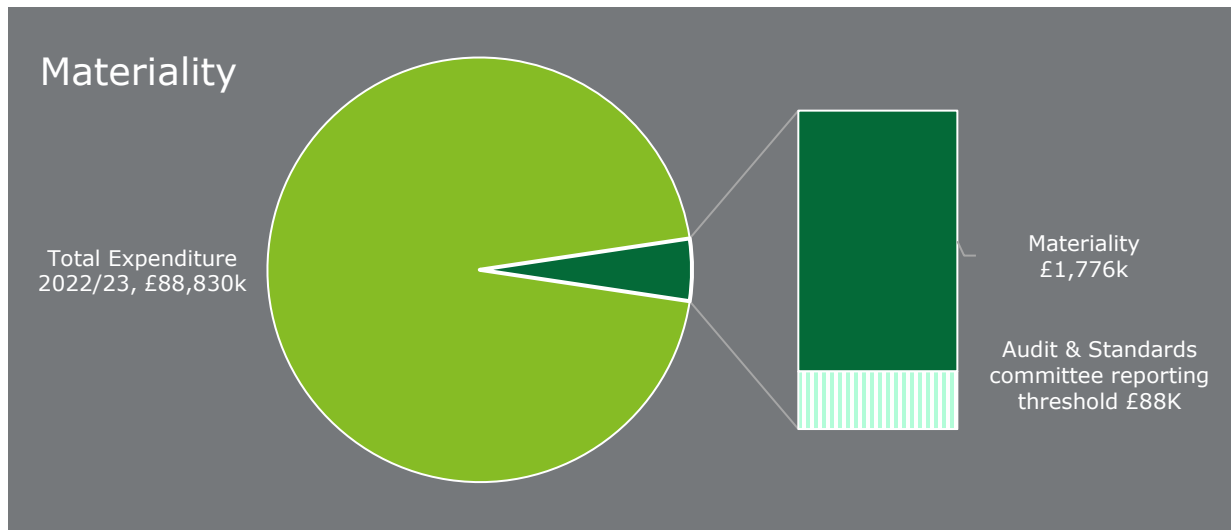
Our approach to materiality

Basis of our materiality benchmark

- The audit lead has determined materiality as £1.77m (2021/22 £1.72m), based on professional judgement, the requirement of auditing standards and the financial measures most relevant to users of the financial statements.
- We have used 2% of total expenditure based on the Council's unaudited accounts for year 2022/23 as the benchmark for determining materiality.

Reporting to those charged with governance

- We will report to you all misstatements found in excess of £88k (2021/22 £85k).
- We will report to you misstatements below this threshold if we consider them to be material by nature.



Although materiality is the judgement of the audit lead, the Audit & Standards Committee must satisfy themselves that the level of materiality chosen is appropriate for the scope of the audit.

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; and
- the changes that have occurred in the business and the environment it operates in since the last annual report and financial statements.

Expected principal risks

- Property valuations
- Impairment
- Pension Liability
- Provision for Business Rates Appeals
- Funding Settlement
- Regulatory

IAS 1 Critical accounting estimates

- Impairment
- Provisions and contingencies
- Property valuations

Changes in your business and environment

No significant changes.

Deloitte view

Management must carefully consider the principal risks, uncertainties and accounting estimates of the Council.









The next page summarises the significant risks that we will focus on during our audit.

We have rebutted this risk of fraud in revenue recognition since the Council's revenue mainly comprises council tax income, business rates and other government grants where no such complex estimates or judgements are involved.


We have downgraded the risk of car parks valuation being significant risk in prior year to normal risk in current year given that full valuations were reviewed during last year and no such significant differences were noted. We will continue to consult with our Property Valuation Specialists over the testing of property valuation balance.


Consistent with prior year, we have also not considered valuation of the pension fund liabilities as significant risk given that both the Goodwin and McCloud items were immaterial in the prior years with no expectation for their impact to differ in the coming year. We will continue to consult with our Pensions Specialists over the testing of this balance.


Significant Audit Risks Dashboard

Risk	Material	Fraud risk	Planned approach to controls	Level of management judgement	Expected to be included in our report to the Audit & Standards Committee	Slide no.
Capital expenditure			D+I			14
Management Override of Controls			D+I			15

D+I: Assessing the design and implementation of key controls

Low Level of Judgement 

Medium Level of Judgement 

High Level of Judgement 

Significant Audit Risks

Risk 1 – Capital expenditure

Risk identified Under UK auditing standards, there is a presumed risk of revenue recognition due to fraud. We have rebutted this risk, and instead believe that the fraud risk lies with the capital expenditure.

The Council's capital expenditure in 2022/23 was £12,690k (2021/22 £17,695k).

There is an element of judgement in applying the relevant capitalisation criteria for expenditure. We therefore consider that there is an incentive for revenue expenditure to be capitalised so that this expenditure does not impact the statement of comprehensive income in one year, but is instead spread over a number of years through the depreciation charges in an attempt to report a more favourable year end position.

Our response Our work in this area will include the following:

- We will assess the design and implementation of the key controls in place in relation to the determination of capitalisation expenditure
 - We will perform test of details of capital expenditures during the year 2022/23 on a sample basis to confirm that the capitalisation criteria has been met and complies with relevant accounting requirements.
 - We will identify the journals of increased audit interest within capital expenditure i.e. debit to capital expenditure and credit to revenue expenditure and other material journals in capital expenditure (greater than 50% of our performance materiality) to ensure there are no errors that may result in material misstatement. The appropriateness of these journals would then be assessed through detailed testing.
-

Significant Audit Risks

Risk 2 – Management Override of Controls

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 Council's controls for specific transactions.

The key judgments in the financial statements are those which we have selected to be the significant audit risks: capital expenditure, management override of controls. These are inherently the areas in which management has the potential to use their judgment to influence the financial statements.

Our response

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

Journals

- We will test the design and implementation of controls in relation to journals.
- We will make inquiries 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 use computer-assisted profiling of all journals posted during the year to identify journals of increased audit interest. The appropriateness of these journals will then be assessed through detailed testing.

Significant transactions

- We will identify any significant transactions outside the normal course of business or any transactions where the business rationale was not clear.

Accounting estimates

- We will perform design and implementation testing of the controls over key accounting estimates.
 - We will review accounting estimates for biases including capital expenditure, that could result in material misstatements due to fraud.
 - We will review the accuracy of prior year estimates.
 - We will assess the design and implementation of controls relating to significant management estimates, in accordance with ISA540.
-

Other Areas of Audit Focus

Pensions Liability Valuation

Risk identified

The Council are part of the Local Government Pension Scheme operated by Gloucestershire County Council. The Council recognised a combined pensions liability of £39.6m at 31 March 2022 which has been moved from liability to surplus of £1.2m as at 31 March 2023 (shown as other long term assets on balance sheet). The Code requires that their year end carrying value should reflect the appropriate fair value at that date.

Hymans Robertson act as the Council's expert actuary, who produce a report outlining the liability and disclosures required.

The pensions valuation is an area of audit interest due to the material values attached to the valuations and disclosures in the financial statements. This has not been classified as a significant risk as both the Goodwin and McCloud items were immaterial in the prior years with no expectation for their impact to differ in the coming year, and we understand that the assumptions and methodologies used are mainly consistent with those in the previous years.

Our response

We carry out a separate, detailed risk assessment of each of the individual components of the calculation (for example market assumptions, membership data, assets and liabilities) using a developed methodology which takes into account factors such as an assessment of the actuary. We scope our work, including the nature and extent of our actuarial specialists involvement, in a way which responds to this detailed risk assessment. Should our risk assessment change our overall audit approach in respect of testing pensions, we will notify the Audit & Standards Committee.

We will confirm the disclosure of the pension figures in the statement of accounts agree with those provided by the scheme actuary.

We will request an IAS19 letter from the pension fund auditors.

Value for money

We are required to consider the Council's arrangements for securing economy, efficiency and effectiveness in the use of resources. In accordance with Code of Audit Practice 2020 and related Auditor Guidance Note 03, we are required to:

- Perform work to understand the Council's arrangements to secure economy, efficiency and effectiveness in the use of resources against each of the three reporting criteria (financial sustainability, governance, and improving economy, efficiency and effectiveness);
- Undertake a risk assessment to identify whether there are any risks of significant weaknesses in arrangements;
- If any risks of significant weaknesses are identified, perform procedures to determine whether there is in fact a significant weakness in arrangements, and if so to make recommendations for improvement;
- Issue a narrative commentary in the Auditor's Annual Report, setting out the work undertaken in respect of the reporting criteria and our findings, including any explanation needed in respect of judgements or local context for findings. If significant weaknesses are identified, the weaknesses and recommendations will be included in the reporting, together with follow-up of previous recommendations and whether they have been implemented. Where relevant, we may include reporting on any other matters arising we consider relevant to VFM arrangements, which might include emerging risks or issues.
- Where significant weaknesses are identified, report this by exception within our financial statement audit opinion.

AGN03 requires auditors to set out the results of their risk assessment, and we will report to a Audit & Standards Committee on any matters arising from this work.

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.

Use of this report

This report has been prepared for the Council, 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.

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 Council.

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.

Deloitte LLP

Bristol | 6 July 2023

Appendices



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 risks of material misstatement due to fraud in capital expenditure, and management override of controls.
- We will explain in our audit report how we considered the audit capable of detecting irregularities, including fraud. In doing so, we will describe the procedures we performed in understanding the legal and regulatory framework and assessing compliance with relevant laws and regulations.
- We will communicate to you any other matters related to fraud that are, in our judgment, relevant to your responsibilities. In doing so, we shall consider the matters, if any, regarding management's process for identifying and responding to the risks of fraud and our assessment of the risks of material misstatement due to fraud.



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.

Fraud responsibilities and representations

Representations

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

- 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

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.
- We plan to involve management from outside the finance function in our inquiries.



Internal audit

- Whether internal audit has knowledge of any actual, suspected or alleged fraud affecting the entity, and to obtain its 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 Stroud District Council and will reconfirm our independence and objectivity to the Audit & Standards Committee for the year ending 31 March 2023 in our final report to the Audit & Standards Committee.
Fees	Details of the fees proposed for the period have been presented separately on the page 24. There are no non-audit fees.
Non-audit services	In our opinion there are no inconsistencies between the FRC's Ethical Standard and the Council's approach for the supply of non-audit services, and we do not supply non audit service to the council. 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 not other relationships with the Council, its directors, senior managers and affiliates, and have not supplied any services to other known connected parties.

Independence and fees

The professional fees expected to be charged by Deloitte LLP in the period from 1 April 2021 to 31 March 2022 are as follows:

	Current year £ (excluding VAT)	Prior year £ (excluding VAT)
Stroud District Council Financial Statements		
Financial statement audit including Whole of Government Accounts and procedures in respect of Value for Money assessment	42,102	40,021
Additional work on Value for Money Requirements	11,000	11,000
ISA540 scope change	4,100	4,100
Use of specialists	4,950	4,950
ISA315 and ISA240 revised	TBC	-
Audit Overruns*	TBC	57,500
Total fees	62,152	117,571

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

Deloitte fees and planned timescales for completion of the audit are based on the following assumptions:

- the financial statements are provided in accordance with the agreed timescales, to the quality expected and have been subject to a robust quality assurance review;
- information provided to support the financial statements is in accordance with the agreed audit deliverables document;
- appropriate accommodation and facilities are provided to enable the audit team to deliver the audit in an efficient manner;
- all appropriate officials will be available during the audit;
- you have all the necessary controls and checks in place to enable the Responsible Financial Officer to provide all the assurances that are required in the Letter of Representation addressed to the engagement lead; and
- Internal Audit's planned programme of work is complete and management has responded to issues that may have affected the financial statements.

Revisions to auditing standards coming into effect

ISA (UK) 315 – Identifying and Assessing the Risks of Material Misstatement

The International Auditing and Assurance Standards Board (IAASB) issued a revised risk assessment standard in December 2019, that takes effect for periods commencing on or after 15 December 2021. For most entities, this will be December 2022 year ends and later. The FRC has adopted the standard in the UK with minimal additions.

The revision was made to respond to challenges and issues with the current standard and requires a more robust risk identification and assessment. We had already incorporated many of the changes into our methodology in advance of the standard being introduced, but we summarise on the next few slides some of the areas where this may impact our audit.

"The IAASB recognizes the importance, and also the complexity, of the auditor's risk assessment process"

IAASB's basis for conclusions, ISA 315

Area of change	Impact on our audit	Impact on the entity
New requirement to evaluate the 4 entity-level components of internal control	Whilst we have always been required to gain an understanding of the entity and its environment, including its internal controls, the new standard is more prescriptive on the need to go further and evaluate the 4 entity level controls components: the entity's control environment, risk assessment process, monitoring of internal control, and information system. This could lead to an increase in the number of relevant controls.	You will need to consider the adequacy of your entity-level controls, and documentation thereof. You should also expect more granular inquiries regarding the control environment.
Enhanced consideration of the types of relevant controls	Overall we expect to identify an increased number of relevant controls, particularly for controls designed to address risks at the higher end of the spectrum of inherent risk and controls over reconciliations. Where new relevant controls are identified, we may also identify control deficiencies and need to consider the effect of these.	You should expect more challenge of controls, particularly over complex accounting estimates, financial reporting and complex or highly automated business processes.

Revisions to auditing standards coming into effect

ISA (UK) 315 – Identifying and Assessing the Risks of Material Misstatement

Area of change	Impact on our audit	Impact on the entity
Enhanced understanding of IT and General IT controls	<p>As we identify more relevant controls, it is likely there will be more relevant IT controls (e.g. automated controls) which themselves rely on underlying General IT Controls (GITCs).</p> <p>We may need more IT specialist involvement to gain an enhanced understanding of IT controls and GITCs, particularly where there are a high volume of automated transactions in the entity. Similarly, where new IT systems come into scope, the likelihood is that there will be an increase in the number of deficiencies identified and action will be needed to determine the appropriate response.</p>	You should expect more challenge over the effectiveness of your GITCs, including how these are monitored.
New approach to scoping account balances, classes of transactions and disclosures	We may now identify some account balances as “material but not significant” where we do not identify a risk of material misstatement, but where we are required to perform some substantive testing.	We may need to perform more substantive testing, where previously there was no separate category of material but not significant.
Revised definition of a significant risk, focused on risks at the upper end of a spectrum of inherent risk	We do not anticipate there being a significant increase in the number of significant risks identified, but where there are more material judgements or estimates being made and a significant risk has not been identified previously, we may conclude there is a significant risk.	You should expect more challenge on audits where before there were no significant risks beyond management override of controls.
Stand back requirement and increased focus on professional scepticism	Our audit approach already acknowledges that risk assessment is an iterative process as well as emphasising the importance of professional scepticism. We will use this as an opportunity to challenge ourselves on the evidence that professional scepticism has been applied through the risk assessment processes, including as part of the stand back assessment.	You should expect more challenge of the evidence provided in respect of our risk assessment, including revisiting this towards the concluding stage of the audit.

Revisions to auditing standards coming into effect

ISA (UK) 240 – The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements

The Financial Reporting Council (FRC) issued a revised fraud standard in May 2021, that takes effect for periods commencing on or after 15 December 2021 (i.e. December 2022 year ends).

Many of the revisions provide increased clarity as to the auditor's obligations and codify existing expectations or best practice. The updates to the ISA do not include any changes relating to proposals in the Government's White Paper regarding auditor reporting on a statement by directors on the steps they have taken to prevent and detect material fraud.

We summarise on the next few slides how this will impact our audit.

Area of change	Impact on our audit	Impact on the entity
Fraud inquiries	<p>In addition to the pre-existing required enquiries, we are now explicitly required to make inquiries of management or others at the entity who handle whistleblowing.</p> <p>We also required to discuss the risks of fraud with those charged with the governance, including those risks specific to the entity's business sector.</p>	You should expect further challenge in relation to who we speak to in relation to fraud at the entity, including more focus on entity/sector specific risks.
Engagement team discussions	<p>The revised ISA (UK) emphasises that the pre-existing audit team fraud discussion should explicitly include an exchange of ideas about fraud, incentives to commit fraud, and how management could perpetrate and conceal fraud.</p> <p>There is also an explicit requirement for the engagement partner to consider whether further fraud discussions should be held at later stages of the audit.</p>	You should expect increased challenge of the controls and processes in relation to the entity's own fraud risk assessment and the documentation of that assessment.

Revisions to auditing standards coming into effect

ISA (UK) 240 – The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements

Area of change	Impact on our audit	Impact on the entity
Identified or suspected fraud by a key member of management	The revised ISA (UK) clarifies that if we identify or suspect fraud by a key member of management this may be qualitatively material.	Further challenge in relation to identified or suspected fraud by a key member of management.
Involvement of specialists	<p>We are explicitly required to determine whether the engagement team needs specialised skills and knowledge:</p> <ul style="list-style-type: none">• To perform the fraud risk assessment procedures, to identify and assess the risk of material misstatement due to fraud, to design and perform audit procedures to respond to those risks or to evaluate the audit evidence obtained; or• Where a misstatement due to fraud or suspected fraud is identified.	There is likely to be more interaction with fraud specialists as part of our planning procedures.
Journal entry testing	<p>We were already required to test the appropriateness of journal entries and other adjustments made in the preparation of the financial statements and make inquiries of personnel.</p> <p>The revised ISA (UK) clarifies that our selection process should consider specifically both automated and manual journals, consolidation adjustments (in the preparation of group financial statements), and post-closing entries.</p> <p>The standard also emphasises that when making inquiries about inappropriate or unusual activity relating to the processing of journal entries and other adjustments, we should make inquiries of individuals with different levels of responsibility in the financial reporting process.</p>	<p>You should expect more challenge on GITCs over the identification and classification of automated and manual controls, especially where there are IT deficiencies.</p> <p>There will also be more inquiries with people at different levels of responsibility at the entity.</p>

Revisions to auditing standards coming into effect

ISA (UK) 240 – The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements

Area of change	Impact on our audit	Impact on the entity
Representations from those charged with governance	We will request an additional representations from those charged with governance regarding their responsibilities for the prevention and detection of fraud.	You should expect representations from those charged with governance that they believe they have appropriately fulfilled their responsibilities to design, implement and maintain internal control to prevent and detect fraud.

Our approach to quality

FRC Audit Quality Inspection and Supervision report

We are proud of our people's commitment to delivering high quality audits and we continue to have an uncompromising focus on audit quality. Audit quality is and will remain our number one priority and is the foundation of our recruitment, learning and development, promotion and reward structures.

In July 2022 the Financial Reporting Council ("FRC") issued individual reports on each of the seven largest firms, including Deloitte, on Audit Quality Inspections providing a summary of the findings of its Audit Quality Review ("AQR") team for the 2021/22 cycle of reviews.

We greatly value the FRC reviews of our audit engagements and firm wide quality control systems, a key aspect of evaluating our audit quality.

In that context, we are pleased that both the overall and FTSE 350 inspection results for our audits selected by the FRC as part of the 2021/22 inspection cycle show an improvement. 82% of all inspections in the current cycle were assessed as good or needing limited improvement, compared to 79% last year. Of the FTSE 350 audits reviewed, 91% achieved this standard (2020/21: 73%). This reflects our ongoing focus on audit quality, and we will maintain our emphasis on continuous improvement as we seek to further enhance quality.

We welcome the breadth and depth of good practice points identified by the FRC particularly those in respect of the effective challenge of management and group audit oversight, where the FRC also reports findings.

We are also pleased that previous recurring findings relating to goodwill impairment and revenue were not identified as key finding in the current FRC inspection cycle, reflecting the positive impact of actions taken in previous years. We nevertheless remain committed to sustained focus and investment in these areas and more broadly to achieve consistently high quality audits.

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 2021/22 Audit Quality Inspection and Supervision Report on Deloitte LLP

"In the 2021/22 public report, we concluded that the firm had made progress on actions to address our previous findings and made improvements in relation to its audit execution and firm-wide procedures. The firm has continued to show improvement, with an increase in the number of audits we assessed as requiring no more than limited improvements to 82% compared with 79% in the previous year and 80% on average over the past five years. It is also encouraging that none of the audits we inspected were found to require significant improvements.

The area which contributed most to the audits requiring improvement was the audit of estimates of certain provisions. There were also key findings in relation to group audits, the review and challenge by the Engagement Quality Control Review (EQCR) partner and the application of the FRC Ethical Standard."

Our approach to quality

FRC Audit Quality Inspection and Supervision report

Improve the audit of estimates in relation to certain provisions

How we have addressed this area as a firm

To address this finding, we have done, or plan to do, the following:

- Our main annual technical training includes specific training in relation to the audit of complex estimates and provisions and includes scenario examples for auditing management estimates. Our Engagement Team Based Learning (“TechEx Teams”) will also include a follow-on session focusing on accounting estimates.
- We plan to develop a checklist, similar to that in place for our banking audits, for auditing Expected Credit Loss (‘ECL’) models for corporate audit teams to use where there are complex models being deployed by the companies we audit.
- Additional coaching will be provided to improve experience and skills when performing corporate audits which have ECL provisions.
- We continue to hold monthly workshops with our partners and directors to brief them on areas of regulatory focus, including the root cause of issues identified, and raise awareness of the importance of the review process.

Our approach to quality

FRC Audit Quality Inspection and Supervision report

Further enhance the consistency of the evaluation by the group audit team of the component auditors' work

How we have addressed this area as a firm

To address this finding, we have done, or plan to do, the following:

- We established a Group Audit coaching programme to support engagement teams in key areas relating to group audits, primarily through sharing of good practice and highlighting common pitfalls. This programme will be expanded for FY22/23 to increase the number of coaches and engagements to be coached ahead of December 2022 year-ends.
- We included a mandatory training module within our main annual training ("TechEx") on Group Audits which focused on effective direction, supervision and review of component auditors. Our Engagement Team Based Learning ("TechEx Teams") will also include a follow-on session focusing on Group Audits.
- We are performing a refresh of our Group Audit practice aid in light of inspection findings to develop a reference point for good practice examples. We also intend to share templates that audit teams can use to evidence the communications held throughout the audit process with component audit teams.
- Monthly workshops are held with partners and directors to brief them on the areas of regulatory focus. We also regularly communicate the FRC findings, including those on group audits to the wider audit practice during the inspection cycle through our Weekly technical email update to ensure that audit teams who might be affected by the findings are fully briefed.

Our approach to quality

FRC Audit Quality Inspection and Supervision report

Strengthen the evidence of review and challenge by the Engagement Quality Control Review partner

How we have addressed this area as a firm

To address this finding, we have done, or plan to do, the following:

- We commenced an EQCR transformation programme in the second half of 2021 designed to build on our existing EQCR practices to further enhance the effectiveness of our EQCR process and improve the evidence retained to demonstrate the EQCR challenge.
- We have made enhancements to our EQCR allocation process and refreshed the onboarding of new EQCR partners, with a new onboarding pack that emphasises the expectations and accountability of the EQCR role.
- Our evidence of EQCR review and challenge template has been refreshed and updated.
- We have delivered additional guidance on expectations for the EQCR reviewers and also shared good practice examples across the audit practice.
- We have included reminders of the EQCR requirements with respect to the need to hold discussions with Key Audit Partners of material subsidiaries in our EQCR briefings which are delivered to all EQCR reviewers.
- We included reminders within our 'Group Audit' and 'Direction, Supervision & Review' training modules in our main annual training ("TechEx") on EQCR which focused on EQCR review requirements and policies.

Our approach to quality

FRC Audit Quality Inspection and Supervision report

Appropriately apply the FRC Ethical Standard, particularly in relation to the approval of non-audit services

How we have addressed this area as a firm

To address this finding, we have done, or plan to do, the following:

- We have updated our templates and guidance in respect of the Objective, Reasonable and Informed Third Party ('ORITP') test for non-audit services.
- We have updated our breach management policies, as well as introduced additional training and guidance on the revised FRC Ethical Standard.
- We continue to develop further guidance and to monitor all areas of the application of the FRC Ethical Standard to manage the risk of recurrence.
- We plan to run further workshops and training for all Partners and Directors in Autumn 2022 to communicate FRC findings, re-iterate latest guidance, share examples and common pitfalls with a specific focus on the ORITP test.



This document is confidential and it is not to be copied or made available to any other party. Deloitte LLP does not accept any liability for use of or reliance on the contents of this document by any person save by the intended recipient(s) to the extent agreed in a Deloitte LLP engagement contract.

Deloitte LLP is a limited liability partnership registered in England and Wales with registered number OC303675 and its registered office at 1 New Street Square, London, EC4A 3HQ, United Kingdom.

Deloitte LLP is the United Kingdom affiliate of Deloitte NSE LLP, a member firm of Deloitte Touche Tohmatsu Limited, a UK private company limited by guarantee ("DTTL"). DTTL and each of its member firms are legally separate and independent entities. DTTL and Deloitte NSE LLP do not provide services to clients. Please see www.deloitte.com/about to learn more about our global network of member firms.

© 2023 Deloitte LLP. All rights reserved.