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LANCASTER
CITY COUNCIL
Promoting City, Coast & Countryside

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

February 2019

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Partner 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.

I have pleasure in presenting our planning report to the Audit Committee for the 2019 audit. I would like to draw your attention to the key messages of this paper:

Audit Plan	• We have completed our handover with KPMG, including review of their prior year file. We understand there were no unadjusted misstatements from the 2017/18 audit. • We are developing 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.
Key risks	• We have taken an initial view as to the significant audit risks the Council faces. These are presented as a summary dashboard on page 11.
Regulatory change	• Our audit is carried out under the Code of Audit Practice issued by the National Audit Office.

Paul Hewitson
Lead audit director

Responsibilities of the Audit Committee

Helping you fulfil your responsibilities

Why do we interact with the Audit 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 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.

Oversight of external audit

- At the start of each annual audit cycle, ensure that the scope of the external audit is appropriate.
- Make recommendations as to the auditor appointment and implement a policy on the engagement of the external auditor to supply non-audit services.

Integrity of reporting

- Impact assessment of key judgements and level of management challenge.
- Review of external audit findings, key judgements, level of misstatements.
- Assess the quality of the internal team, their incentives and the need for supplementary skillsets.
- Assess and advise the Council on the appropriateness of the Annual Governance Statement, including conclusion on value for money.

Internal controls and risks

- Review the internal control and risk management systems
- Explain what actions have been, or are being taken to remedy any significant failings or weaknesses.

Oversight of internal audit

- Consider annually whether the scope of the internal audit programme is adequate.
- Monitor and review the effectiveness of the internal audit activities.

Whistle-blowing and fraud

- Ensure that appropriate arrangements are in place for the proportionate and independent investigation of any concerns that are raised by staff in connection with improprieties.

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, including key audit matters if applicable.

Determine materiality

We have determined a materiality of £2.9m. This is based on 2% of gross expenditure. We will report to you any misstatements above £145,000. 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. More detail is given on pages 10-15.

Quality and Independence

We confirm all Deloitte network firms and engagement team members are independent of Lancaster City 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

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 may be required to issue a separate assurance report to the NAO on the Authority's separate return required for the purposes of its audit of the Whole of Government Accounts and departmental accounts. We will update the Committee on this matter once NAO instructions are confirmed for the year.

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 remuneration report and 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 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.
To perform this work, we are required to:

- plan our work based on consideration of the significant risks of giving a wrong conclusion; and
- carry out as much work as is appropriate to enable us to give a safe conclusion on the arrangements to secure VFM.

Our work therefore includes a detailed risk assessment based on the risk factors identified in the course of our audits. This is followed by specific work focussed on the risks identified.

Our risk assessment in this area remains ongoing although we have not yet identified any specific risks to the delivery of value for money.

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

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

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

We would welcome early discussion on the planned format of the financial statements, and whether there is scope for simplifying or streamlining disclosures, as well as the opportunity to review a skeleton set of financial statements and an early draft of the annual report ahead of the typical reporting timetable to feedback any comments to management.

Value for Money and other reporting

The Code of Audit Practice requires us to report by exception in our audit report any matters that we identify that indicate the Council has not made proper arrangements for securing economy, efficiency and effectiveness in its use of resources.

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.

Planning	Interim	Year end fieldwork	Reporting activities
Planning meetings to inform risk assessment; and agree on key judgemental accounting issues. Update understanding of key and changes to financial reporting. Review of key Council documents including Cabinet, Council and Audit Committee minutes.	Document design and implementation of key controls and update understanding of key business cycles. Substantive testing of limited areas including fixed asset additions, expenditure, payroll, certain areas of income. Update on value for money responsibilities.	Substantive testing of all areas. Finalisation of work in support of value for money responsibilities. Detailed review of annual accounts and report, including Annual Governance Statement. Review of final internal audit reports and opinion. Completion of testing on significant audit risks	Year-end closing meetings Reporting of significant control deficiencies Signing audit reports in respect of Financial Statements Issuing Annual Audit Letter Whole of Government Accounts reporting
2019 Audit Plan	Verbal update to the Audit Committee	Final report to the Audit Committee	Any additional reporting as required
November	**March**	**June-July**	**July**

Ongoing communication and feedback

Materiality

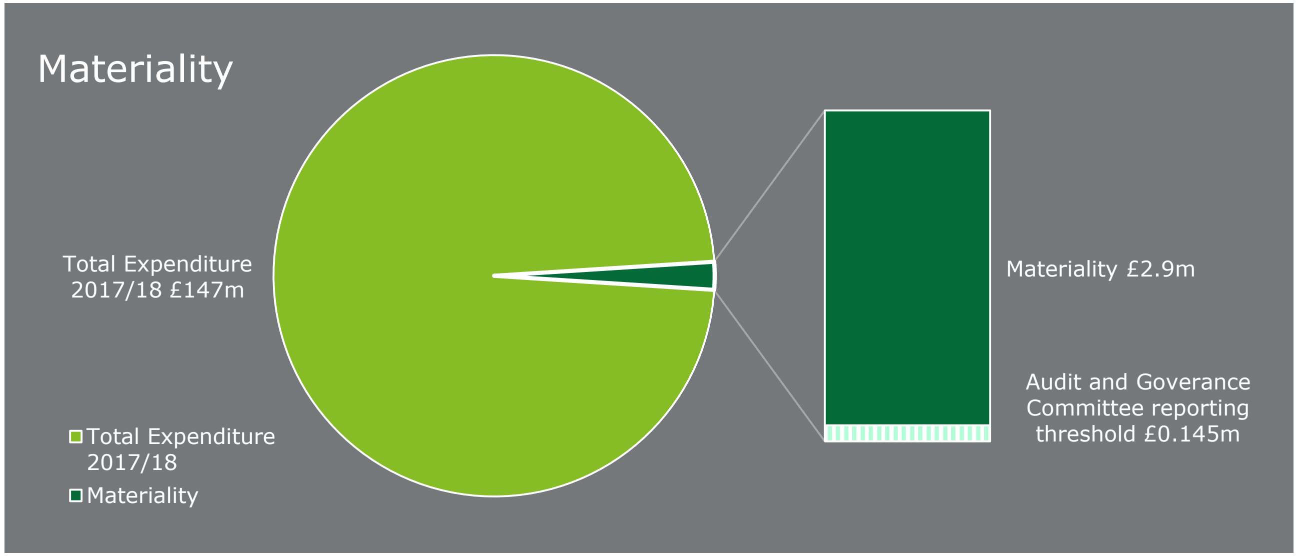
Our approach to materiality

Basis of our materiality benchmark

- The audit partner has determined materiality as £2.9m, 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 2017/18 audited accounts as the benchmark for determining materiality.
- We will re-visit the determined materiality based on completion of interim audit procedures.

Reporting to those charged with governance

- We will report to you all misstatements found in excess of £0.145m.
- 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 partner, the Audit 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.

Principal risk and uncertainties

- Business planning
- Performance management
- Risk management
- Information governance
- Staffing capacity
- Decision making arrangements

IAS 1 Critical accounting estimates

- Property Valuations
- Pension Liabilities
- Fair Value Measurement
- Provision for NNDR Appeals
- Provision for debtors

Changes in your business and environment

- Management restructure
- Change of Chief Executive & S151 officer
- Bailrigg Garden Village

NAO – Auditor Guidance Note 06

The National Audit Office has identified going concern, new accounting standards (IFRS15 and IFRS 9) and the guaranteed minimum pension as key issues for 2018-19. Whilst we do not consider these to represent significant risks we will carefully review the approach being taken by the Council to address these issues.

The next page summarises the significant risks that we will focus on during our audit. All the risks mentioned in the prior year Audit Committee report are included as significant risks in this year's audit plan. We have also included expenditure as a new significant risk.

Significant risks

Significant risk dashboard

Risk	Material	Fraud risk	Planned approach to controls	Level of management judgement	Management paper expected	Slide no.
Completeness and Cut off of service line expenditure	✓	✓	D+I	⚠	✓	12
Property Valuations	✓	✗	D+I	⚠	✓	13
Management Override of Controls	✓	✓	D+I	⚠	✗	14

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

⚠ Low level of management judgement ⚠ Moderate level of management judgement ⚠ High level of management judgement

Significant risks

Risk 1 – Completeness and cut-off of service line 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 a fraud risk lies with the completeness and cut-off of service line expenditure. We identify this as expenditure excluding payroll costs, depreciation and amortisation and expenditure which is grant backed (such as Housing Benefit expenditure). There is an inherent fraud risk associated with the recording of expenditure in order for the Council to report a more favourable year-end position. There is a risk that the Council may materially misstate expenditure through manipulating the year end position in order to report a more favourable outturn.
Our response	Our work in this area will include the following: We will obtain an understanding of the design and implementation of the key controls in place in relation to recording completeness and cut-off of service line expenditure (excluding payroll, depreciation and amortisation, and expenditure which is grant backed); We will perform focused testing in relation to the completeness and cut-off of service line expenditure (excluding the areas set out above); and, We will review and challenge the assumptions made in relation to year-end estimates and judgements to assess completeness and accuracy of recorded service line expenditure.

Significant risks

Risk 2 – Property Valuation

Risk identified	The council held £236m of property assets at 31 March 2017 which increased to £241m as at 31 March 2018. The increase was in part due to additions of £13.6m offset by £1.6m of disposals, and depreciation of £7.8m. The Code requires that where assets are subject to revaluation, their year end carrying value should reflect the appropriate fair value at that date. The Council has adopted a rolling revaluation model which sees all land and buildings revalued over a five year cycle. As a result of this, however, individual assets may not be revalued for four years. Furthermore the Council completed the valuation as at the 1 April 2018. Any changes to factors used in the valuation process could materially affect the value of the Council's assets as at year end. There is therefore a risk that that the value of property assets materially differ from the year end fair value.
Our response	We will test the design and implementation of key controls in place around the property valuation, and how the Council assures itself that there are no material impairments or changes in value for the assets not covered by the annual valuation; We will 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; We will review the approach used by the Authority to assess the risk that assets not subject to revaluation are materially misstated. We will use our valuation specialists, Deloitte Real Estate, to support our review and challenge the appropriateness of the Council's assumptions on its assets values between April 2018 and Year end. We will 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.

Significant risks

Risk 3 – Management override of controls

Risk identified	In accordance with ISA 240 (UK and Ireland) management override of controls is a significant risk for all entities. 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 judgements in the financial statements include those which we have selected to be the significant audit risks, (completeness and cut-off of service line expenditure and the Council's property valuations) and any one off and unusual transactions where management could show bias. 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: We will test the design and implementation of key controls in place around journal entries and key management estimates; We will risk assess journals and select items for detailed testing. The journal entries will be selected using computer-assisted profiling based on areas which we consider to be of increased interest; We will review accounting estimates for biases that could result in material misstatements due to fraud; and, We will obtain an understanding of the business rationale of significant transactions that we become aware of that are outside of the normal course of business for the Council, or that otherwise appear to be unusual, given our understanding of the entity and its environment.

Value for Money

Risk Management

Context for Risk Management

As noted in the Authority's Risk Management Strategy, "A sense of proportion" (April 2014),

> *Risk management is both a statutory requirement and an indispensable element of good management. As such, its implementation is crucial to the Council and its ability to discharge its various functions as a deliverer of public services, a custodian of public funds and a significant employer.*

This is further emphasised in the guidance to auditors concerning the formulation of the Value For Money opinion which sets out an expectation that Authorities will, "have arrangements in place to ensure proper…risk management…and to report on the design and operation of those arrangements through annual governance statements" (Auditor Guidance Note 03: November 2017).

The Authority noted in its Annual Governance Statement 2018 that, "With regard to managing such corporate and other risks, the Council adopted a pragmatic approach some years ago, and moved away from seeking to maintain all-encompassing 'risk registers'. Instead, it seeks to ensure that alongside consideration of strategic risk, appropriate risk management is actively undertaken, through decision-making and day to day operations. A review of that approach is still due to be completed over the coming year".

As part of our work undertaken to understand the Authority's controls and processes we have made enquiries regarding the operation of the framework of risk management throughout the year and have raised a number of observations, which are set out below. We consider these observations to be significant in the context of our value for money conclusion and will require formal response from the Authority prior to the forming of that conclusion in July 2019.

Expectation	Observation	Implication
The Risk Management Strategy states Cabinet must, through Performance Review Team (PRT) reports, analyse and review the high level strategic risks relating to portfolio holders' individual areas of responsibility. The Strategy further states that the Strategic Risk Register should be reported to Cabinet by the Chief Officer (Resources) as part of the budget and policy framework.	Having reviewed the Cabinet meeting papers for the last 12 months we cannot find evidence that the high level strategic risks have been analysed or reviewed. The paper covering the budget and policy framework update 2018 to 2022 (Cabinet meeting 13 February 2018) does not appear to include the strategic risk register.	The Cabinet, as the responsible group, may not be able to; • fully articulate the full spectrum of specific risks faced, • fully appreciate any interactions or interdependencies between strategic risks faced, and • Demonstrate effective oversight of the operation of risk management within the Authority.

Value for Money

Risk Management (continued)

Expectation	Observation	Implication
The risk management strategy states that the audit committee will • monitor and review the effective management of risk by officers, and • Receive reports on the effectiveness of the Risk Management Strategy and to review assurances that business risks are being actively managed. The Audit Committee terms of reference mirror this duty at 8.18 where it states that the Audit Committee must monitor the effectiveness of the development and operation of risk management, indeed this is listed at 1.1 as part of the overall purpose of the Audit Committee.	Having reviewed the Audit Committee papers for the last 12 months we cannot find reference to either a review of the efficacy of risk management, or review of the assurances given regarding the management of risk having been undertaken by the Committee. We do note however that a action was approved to bring the Risk Register to the next meeting of the Audit Committee for review.	It is not currently clear how the Audit Committee is discharging its responsibilities in respect of risk management nor how it is able to advice the Cabinet or full Council on the validity of statements made in the Annual Governance Statement in respect of risk management.
The Authority continues to have a significant landlord / social housing function. It is an essential responsibility of providers of social housing that those charged with governance are assured both on the performance against core health and safety standards for housing (such as Annual Gas Servicing, Electrical Testing, Lift Maintenance, Water Hygiene, Fire Risk Assessment, Asbestos Surveys, Fire Safety Equipment Provision, and Portable Appliance Testing) and on the effectiveness of the mechanisms through which compliance data is gathered and reported. The regulator of social housing has commented in a number of In Depth Assessment reports on Registered Providers where oversight of these key standards is not apparent.	We note that the Audit Committee have received a report on the effectiveness of the Gas Servicing management process but that the scheduled report into Asbestos Management has been delayed into 2019/20. We did not note any of the other key areas of responsibility being addressed through the Internal Audit Plan. Review of the Cabinet meeting papers did not identify any reports on performance against key tenant health and safety standards nor assurances from subordinate committees other than a single reference to Gas Safety compliance.	The Authority may not be able to demonstrate sufficient oversight of the processes through which the key areas of responsibility are addressed.

Value for Money

Risk Management (continued)

Expectation	Observation	Implication
We have been provided with a copy of the Corporate Risk Map and example of the current Authority approach to the capture and evaluation of risk.	The Risk Map lacks a number of key features that we would expect from a document used to facilitate the management and oversight of risk, specifically: • The risks identified are insufficiently pinpointed or articulated to allow the user to clearly understand the precise nature of the risk being managed and the implications. • The items listed under controls / mitigations were frequently found not be to controls or mitigations but broad statements of intention. • No sources of assurance were noted against the controls and mitigations. • In a number of cases the impact of a risk is identified as being reduced when, due to the way in which the risk is framed, it is difficult to see how the impact can ever be reduced. • Not all risks have a named manager responsible. • The document lacks any sense of direction of travel or target risk rating against which action to management can be judged. • The document lacks any colour coding or summary to pull out those key risks that pose the greatest challenge to the Authority.	The Corporate Risk Map does not appear to be fit for the purpose of managing the risks faced by the Authority or for facilitating effective oversight of the risk by either the Audit Committee, Cabinet or Council.

Value for Money

Risk Management (continued)

Expectation	Observation	Implication
The Annual Governance Statement 2017/18 makes reference to a review of the effectiveness of the Risk Management Approach being due to be completed in 2018/19.	It is not clear from our review of the Audit Committee papers for the year to date that this review has been completed and the implications for the Annual Governance Statement 2018/19 been considered.	The Audit Committee may not be able to discharge its responsibilities in respect of Risk Management.

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; and
- 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 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.

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.

Other relevant communications

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

Newcastle | February 2019

Fraud responsibilities and representations

Responsibilities explained

Your Responsibilities:

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

Our responsibilities:

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

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 the Council 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.
Fees	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 policy for the supply of non-audit services or any apparent breach of that policy. We continue to review our independence and ensure that appropriate safeguards are in place including, but not limited to, the rotation of senior partners and professional staff and the involvement of additional partners and professional staff to carry out reviews of the work performed and to otherwise advise as necessary.
Relationships	We have no other relationships with the Council, its directors, senior managers and affiliates, and have not supplied any services to other known connected parties.

Fees

The professional fees expected to be charged by Deloitte in the period from 1 April 2018 to 31 March 2019 are as follows:

	Current year £
Financial statement audit including Whole of Government and procedures in respect of Value for Money assessment	44,959
Total audit	44,959
Total fees	44,959

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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