

Technical bulletin 2019/1

Technical developments and emerging risks
from January to March 2019



 AUDIT SCOTLAND

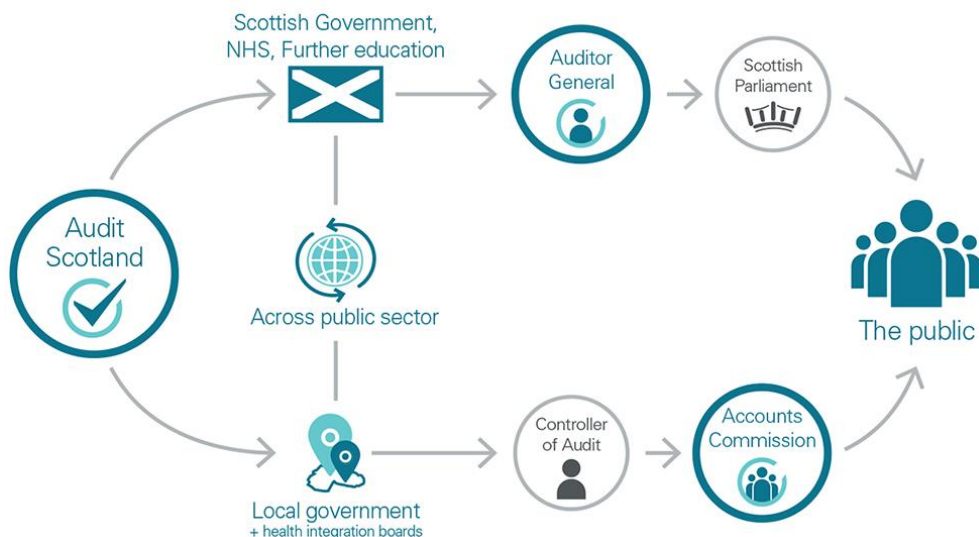
Prepared for appointed auditors and audited bodies in all sectors

15 March 2019

Who we are

The Auditor General, the Accounts Commission and Audit Scotland work together to deliver public audit in Scotland:

- The Auditor General is an independent crown appointment, made on the recommendation of the Scottish Parliament, to audit the Scottish Government, NHS and other bodies and report to Parliament on their financial health and performance.
- The Accounts Commission is an independent public body appointed by Scottish ministers to hold local government to account. The Controller of Audit is an independent post established by statute, with powers to report directly to the Commission on the audit of local government.
- Audit Scotland is governed by a board, consisting of the Auditor General, the chair of the Accounts Commission, a non-executive board chair, and two non-executive members appointed by the Scottish Commission for Public Audit, a commission of the Scottish Parliament.



About us

Our vision is to be a world-class audit organisation that improves the use of public money.

Through our work for the Auditor General and the Accounts Commission, we provide independent assurance to the people of Scotland that public money is spent properly and provides value. We aim to achieve this by:

- carrying out relevant and timely audits of the way the public sector manages and spends money
- reporting our findings and conclusions in public
- identifying risks, making clear and relevant recommendations.

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Introduction

Purpose

1. The purpose of technical bulletins from Audit Scotland's Professional Support is to provide auditors appointed by the Auditor General and Accounts Commission with:
 - information on the main technical developments in each sector and on professional matters during the quarter
 - guidance on any emerging risks identified in the quarter.
2. The information on technical developments is aimed at highlighting the key points that Professional Support considers appointed auditors require to be aware of. It may still be necessary for auditors to read the source material if greater detail is required. These can be accessed by using the hyperlinks, where provided. They are also available to appointed auditors from the *Technical reference library* maintained by Professional Support on [ishare](#) and the [Extranet](#). Auditor actions are highlighted in red.
3. Technical bulletins are also published on the Audit Scotland [website](#) and therefore are available to audited bodies and other stakeholders.

Technical bulletins provide information on developments and guidance on emerging risks

Highlights summary

4. Six of the main items in this technical bulletin that are particularly highlighted are summarised in the following table:

Professional Support has provided guidance on guaranteed minimum pension [see paragraph 12]	Professional Support has provided an update on the emerging risk on loans fund repayments [see paragraph 26]	The Scottish Government has issued revised statutory guidance on accounting for equal pay [see paragraph 39]
The Scottish Government has issued the 2018/19 NHS board accounts manual [see paragraph 112]	The Scottish Government has published a blueprint for good governance in health boards [see paragraph 116]	The Financial Reporting Council has issued revisions to ISA (UK) 540 on auditing accounting estimates [see paragraph 134]

Feedback

5. The presentation and format of this technical bulletin has been refreshed. Professional Support encourages and would welcome feedback on the changes or any other aspect of this bulletin.

Feedback on this technical bulletin is welcome

Contact point

6. The main contact point for this technical bulletin is Paul O'Brien, Senior Manager (Professional Support) – pobrien@audit-scotland.gov.uk.

Section 1

Cross-sector

Auditing developments

Contacting Professional Support

7. Auditors are encouraged to contact Professional Support to seek advice or a second opinion on a technical matter (e.g. an interpretation or application of statutory guidance, legislation, the accounting code/manual). The best way to make contact is to use one of the following email addresses depending on the relevant sector:

- TechnicalQueries-LocalGovernment@audit-scotland.gov.uk
- TechnicalQueries-CentralGovernment@audit-scotland.gov.uk
- TechnicalQueries-Health@audit-scotland.gov.uk
- TechnicalQueries-FurtherEducation@audit-scotland.gov.uk

Auditor action
Auditors should use the relevant email address when contacting Professional Support with a technical enquiry

Accounting developments

Property, plant and equipment

New manual for valuers

8. The [Royal Institute of Chartered Surveyors](#) has issued a [UK supplement](#) to the [RICS valuation – global standards 2017](#). The supplement reflects valuation standards and other authoritative requirements that are specific to the UK, and provides additional application guidance.
9. The supplement took effect from 14 January 2019 and applies to all valuations where the valuation date is on or after that day. It therefore applies to 2018/19.
10. Part 2 of the supplement sets out professional and valuation standards. Part 3 sets out a number of advisory UK valuation practice guidance applications (UK VPGA), including the following:
- UK VPGA 4 covers the valuation of local authority assets for accounting purposes.
 - UK VPGA 5 covers central government.
 - UK VPGA 9 covers relationships with auditors.
11. Auditors should note that the supplement no longer requires a full valuation by an internal valuer to be subject to review by an external valuer.

The supplement applies to valuations with a valuation date on or after 14 January 2019

Retirement benefits

Guaranteed minimum pension

12. Professional Support is aware of issues related to the *Guaranteed minimum pension* (GMP). Where a public sector pension scheme was 'contracted out'

of the additional state pension arrangements (before those arrangements ended in April 2016), the scheme was required to provide members with a GMP for service between 6 April 1978 and 5 April 1997. The GMP is broadly equivalent to the amount the members would have received had they not been contracted out.

13. Funding the annual increase in GMP was previously split between the Department for Work and Pensions and each pension scheme. However, the introduction of the new *Single state pension* in April 2016 brought uncertainty over the ongoing indexation of the GMP amount. This led to an interim solution being announced by the UK Government for members reaching statutory pension age between 6 April 2016 and 5 December 2018, which involves the pension schemes funding all the increase.
14. The UK Government's preferred permanent solution is to convert GMP to a scheme benefit. However, there are a number of complications including:
 - the need to reconcile data held by HM Revenue and Customs with that held by pension schemes
 - ongoing court cases in respect of ensuring equal payments on a gender basis.
15. The Government has therefore extended the interim solution to 5 April 2021. Actuaries and other stakeholders are currently in discussion over how best to address these matters. However, Professional Support understands that:
 - actuaries will reflect the Government's preferred long-term solution of converting GMP to scheme benefit at the next round of valuations in 2020. This will lead to an increase in liabilities as a result of the scheme paying full GMP increases for all members with a statutory pension age after 2016
 - the Chartered Institute of Public Finance and Accountancy (CIPFA) is preparing guidance on the treatment in the 2018/19 financial statements (e.g. disclosure of a contingent liability).
16. Professional Support will advise auditors when there are further developments.

As an interim solution, pension schemes fund GMP annual increases

Preferred permanent solution is to convert GMP to benefit

Contact point

17. The contact point for this section of the technical bulletin is Paul O'Brien, Senior Manager (Professional Support) - or pobrien@audit-scotland.gov.uk.

Section 2

Local government sector

Financial statements developments

New guidance on streamlining

18. CIPFA has issued [guidance](#) on streamlining local government financial statements and year end processes. The aim of the publication is to strike a better balance between compliance with accounting standards and providing clearer, simpler and more transparent information.
19. The guidance provides practical assistance through a combination of general guidance, case studies and worked examples. It considers matters such as materiality, accounting policies and presentation.

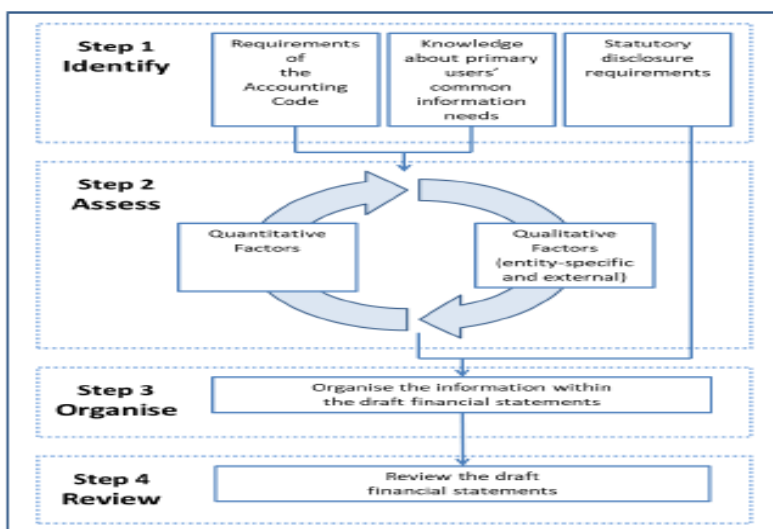
Materiality

20. Some key points in the guidance in respect of materiality are:

- An understanding of materiality is crucial to effective streamlining, particularly the recognition that materiality is often concerned with what should be left out as much as it is about what should be included.
- Consideration of materiality has to be based on a clear view of who the users of the financial statements are, the sort of decisions that they might take, and the information they would need to support these decisions.
- Information should not be included that would detract from the key messages.
- Materiality does not depend solely on the magnitude of an item, but also on the context that it might provide for other disclosures.

Use materiality to avoid key messages of the financial statements being obscured

21. The guidance sets out a four-step approach to materiality in the following diagram:



The four-step approach to materiality is based on the International Accounting Standards Board's Materiality practice statement adapted for local government circumstances

Accounting policies

22. In respect of determining the significance of accounting policies, the guidance advises that:

- Local government bodies need to assess significance for their local circumstances, based on who their primary users are deemed to be and the information that will be of most help to them
- accounting policies are not required for transactions and balances which are not material
- decisions should be made about whether policies are best presented in a single consolidated note or in each of the notes on the particular transactions or balances that they relate to.

Review accounting policies so that only important and relevant information is included

Presentation and layout

23. One of the most important aspects in respect of streamlining presentation and layout is deciding who the main users are and what key information they need. For local government financial statements, the primary users are service recipients and resource providers (including council tax payers). They also include elected representatives insofar as they act on behalf of service recipients and resource providers.

24. Bodies tend to follow the layout and ordering in the example financial statements in the guidance notes to the *Code of practice on local authority accounting in the UK* (the accounting code) but other options might include:

- separating the notes into relevant sections
- including some or all of the accounting policies and judgements in the disclosure notes they relate to
- combining disclosure requirements into a single note where possible.

25. Options for improving the presentation of the disclosures include:

- using tables instead of narrative disclosures
- ensuring that disclosure notes do not include more information than the accounting code requires unless this has been identified as a key information need
- omitting lines in tables when not required (e.g. for nil disclosures)
- providing an index to disclosure notes
- including additional lines in the financial statements instead of separate disclosure notes.

Consider presentation and layout to help users focus on key messages and navigate through the statements

Loans fund repayments update

26. [Technical bulletin 2018/4](#) (paragraph 19) highlighted an emerging risk in respect of the repayment of loans fund advances made before 1 April 2016 (pre-2016 advances). Audit Scotland has subsequently issued a position statement to the CIPFA Directors of Finance Section, CoSLA, and the Scottish Government. The main points set out in the statement are summarised in the following paragraphs.

27. [The Local Authority \(Capital Finance and Accounting\)\(Scotland\) Regulations 2016](#) came into force on 1 April 2016 and replaced the provisions in the *Local*

The 2016 regulations apply to advances made from 1 April 2016

Government (Scotland) Act 1975 in respect of the loans fund with a prudent approach. In Audit Scotland's view, the regulations have no retrospective application and apply only to loans fund advances made on or after 1 April 2016.

- 28.** Statutory guidance with [finance circular 7/2016](#) sets out proper accounting practices for administering a loans fund and:
- provides options for the repayment of loans fund advances made from 1 April 2016 under the new prudent approach
 - reflecting the legislative position, requires all pre-2016 advances to continue to be repaid as if the 1975 Act had not been repealed (the statutory method).
- 29.** A small number of councils adopted one of the options under the new prudent approach for repaying pre-2016 advances in 2017/18, i.e. they did not charge the general fund with repayment of those advances in accordance with the statutory method. Audit Scotland understands that further councils are similarly planning on adopting a prudent option for repaying pre-2016 advances in 2018/19.
- 30.** The Cabinet Secretary for Finance has announced an intention to amend the regulations to allow councils to adopt the new prudent approach for pre-2016 advances.
- 31.** Councils are required to observe proper accounting practices applicable to the year for which their financial statements are prepared. For 2018/19, applicable proper accounting practices are those in force at 31 March 2019. Any non-compliance with proper accounting practices represents a misstatement in the financial statements.
- 32.** The following table summarises Audit Scotland's view of the impact on proper accounting practices in 2018/19 depending on when the planned amendment to the regulations is made, and consequently whether a council adopting the new prudent approach in 2018/19 would result in a misstatement in the financial statements for that year:

Timing of amendment	Impact on 2018/19	Misstatement	Audit Scotland's current understanding
On or before 31 March 2019	Yes	No	Not possible in practice
After 31 March 2019 but before authorised for issue date – retrospective effect	Yes	No	Not possible in practice
After 31 March 2019 but before authorised for issue date – no retrospective effect	No	Yes	Most likely position
After authorised for issue date	No	Yes	Not expected to be the case

- 33.** It is expected therefore that the amendment to the regulations will not impact on proper accounting practices applicable to 2018/19. It follows that, in Audit Scotland's view, any council not charging their general fund with the repayment of pre-April 2016 advances in accordance with the statutory method in 2018/19 would have a misstatement in their financial statements. The nature of the misstatement would be the adoption of an illegal

Statutory guidance requires advances made before 1 April 2016 to be repaid under the statutory method

Planned amendments to the 2016 regulations are not expected to apply in 2018/19

accounting policy resulting in a misstated general fund balance at 31 March 2019.

34. Misstatements can be material by size or nature. It is understood that the amounts involved are significant and, because it relates to illegality, Audit Scotland would expect any misstatement to be judged as material by its nature even if below the monetary amount set for materiality by auditors. This is consistent with relevant auditing standards.
35. The accounting code requires the correction of material prior period errors retrospectively in the first set of financial statements after their discovery. In Audit Scotland's view, the councils which did not repay pre-2016 advances in accordance with the statutory method in 2017/18 will therefore have to correct that misstatement in the 2018/19 financial statements.
36. Under auditing standards, auditors are required to qualify their opinion if the financial statements contain a material uncorrected misstatement. While the final judgement rests with each individual appointed auditor, Audit Scotland anticipates that auditors will qualify their opinion on the 2018/19 financial statements if:
 - any council does not charge the general fund in 2018/19 with the repayment of pre-2016 advances in accordance with the statutory method
 - any of the relevant councils do not correct in 2018/19 the misstatement in the 2017/18 financial statements.
37. The wording accompanying the qualified opinion would explain the context and reason.
38. The Directors of Finance Section has recently responded to the position statement indicating that they have a different interpretation of the regulations. Dialogue on this matter therefore continues, and further updates will be provided in due course.

Equal pay provision – new statutory guidance

39. The [Scottish Government](#) has issued revised statutory guidance on accounting for equal pay in [finance circular 1/2019](#). The statutory guidance extends the statutory mitigation previously permitted by finance circular 4/2015 to:
 - enable a council to delay the impact on the general fund of recognising a provision for equal pay claims until payment is actually made
 - allow capital receipts to be used to fund the settlement of the deferred payments.
40. A deferred charge for an equal pay provision held as a statutory adjustment at 31 March 2018 under finance circular 4/2015 may continue to be held until the equal pay back pay payment is made or the provision is otherwise reduced. In addition, any increase in equal pay provision in 2018/19 and 2019/20 may also be deferred.
41. The accounting for the statutory adjustment has been simplified with effect from 2018/19. Instead of using a separate equal pay provision statutory adjustment account, the deferred charge for the equal pay provision is to be held as part of the employee statutory adjustment account. The value held in the former account at 31 March 2018 should be transferred to the latter account.

The statutory mitigation for equal pay provisions has been extended

Accounting for the statutory mitigation has been simplified

42. As part of the disclosure for the employee statutory adjustment account, a council is required to analyse the amount held in that account for equal pay and the amount held for untaken annual leave.
43. Capital receipts currently set aside for settling deferred equal pay payments may continue to be held until payment is made. Capital receipts received in 2018/19 and 2019/20 may be set aside to fund equal pay payments.
44. The accounting for this use of capital receipts has also been simplified. Capital receipts previously held in the equal pay statutory adjustment account will now be held in the capital grants unapplied account (which is to be renamed the capital grants and receipts unapplied account). A retrospective restatement is required so that the balance on the capital grants and receipts unapplied account as at 31 March 2018 is restated to include the capital receipts and renamed at that date. A council is required to identify, separately, the amount held in that account for capital grants and the amount of capital receipts held for equal pay.
45. Only those receipts set aside at the time of disposal and held in the capital grants and receipts unapplied account may be used. The amount of capital receipts held in the capital grants and receipts unapplied account cannot exceed the amount necessary to fund the deferred charge for equal pay held in the employee statutory adjustment account. Any excess of capital receipts requires to be transferred to the capital fund.

Auditor action
Auditors should confirm that the revised statutory guidance is followed in 2018/19

Financial instruments – draft guidance on earmarking general fund

46. The [Local Authority \(Scotland\) Accounts Advisory Committee \(LASAAC\)](#) has issued [draft guidance](#) on earmarking an element of the general fund in respect of increases in the fair value of financial assets. Under the accounting code's adoption of *IFRS 9 Financial instruments*, increases in the fair value of financial assets classified as fair value through profit and loss are recognised in the general fund. The draft guidance proposes that an element of the resulting general fund balance should be earmarked to the extent it is not readily convertible to cash.
47. Gains in the fair value of a financial asset are considered to be 'readily convertible to cash' if all of the following criteria apply:
- A value can be determined at which a transaction could occur to convert the change in fair value into cash.
 - In determining the value, information that market participants would consider in setting a price is observable (which is closely aligned with levels 1 and 2 in the IFRS 13 fair value hierarchy).
 - There are no circumstances that prevent the immediate conversion to cash of the change in fair value.
48. Even where an increase in fair value is considered readily convertible to cash, bodies would be required to judge whether it is prudent to use the increase to fund services where the fair value of the asset is considered to be volatile.

Draft guidance proposes that an element of the general fund be earmarked to the extent it is not readily convertible to cash

Draft guidance on internal transactions

49. LASAAC has issued [draft guidance](#) on accounting for internal transactions. The guidance is intended to assist in implementing changes to the accounting code for 2018/19 which prohibit the inclusion of income and expenditure on a trading basis between service segments in the comprehensive income and expenditure statement (CIES).

50. As a consequence of the change to the accounting code, previous LASAAC guidance on accounting for insurance which recommended internal premiums is withdrawn.
51. The draft guidance clarifies that the changes in the accounting code relate only to treatment in the CIES. This does not preclude bodies from recording, for management and control purposes, internal transactions during the year. Adjustments which reconcile a body's segment management arrangements to the required presentation in the CIES should be made in the expenditure and funding analysis. This would include, for example, the elimination of any internal insurance premiums.
52. The apportionment of external costs between segments, as the re-allocation of underlying expenditure, in the CIES continues to be allowed.

Previous guidance on insurance funds has been withdrawn

Pay awards

53. Pay awards for non-teaching local government staff have recently been agreed, and are summarised (along with the latest offer for teachers) in the following table:

Year	Increase for non-teaching staff	Increase for teaching staff
2018/19	3.5% (for those earning up to £80,000) Flat rate of £1600 (for those earning above that amount)	3%
2019/20	3%	7%
2020/21	3%	3%

Auditor action
Auditor should confirm that pay increases are properly reflected in the 2018/19 financial statements

54. It is expected that the increases for non-teaching staff with effect from 1 April 2018 will be included in March 2019 salaries. Where that is not possible, the effect of the increase will require to be accrued in the 2018/19 financial statements. Accruals will also be required for teachers based on the latest offer.
55. All increases will require to be communicated to actuaries for inclusion in pension liabilities at 31 March 2019.

Investment in subsidiaries

56. Professional Support has been asked for a view as to whether paragraph 9.1.2.61 of the accounting code allows a council to measure an investment in its subsidiary at cost if the council does not prepare group financial statements (on the grounds of materiality).
57. Paragraph 9.1.2.61 states that, within a council's single entity financial statements, investments in subsidiaries (and associates and interests in joint ventures) should be accounted for either:
- at cost; or
 - as a financial asset.
58. IAS 27 is clear that single-entity financial statements (referred to in IAS 27 as 'separate financial statements') are those statements in addition to group financial statements. It follows that the option to measure an investment in a

Auditor action
Auditors should confirm that investments in subsidiaries are measured as financial assets if group financial statements are not prepared

subsidiary at cost only applies if group financial statements are also prepared.

Revised guidance on health and social care integration

59. LASAAC has issued revised mandatory [accounting guidance](#) on health and social care integration for 2018/19. The changes are summarised in the following paragraphs.

Treatment of over and underspends

60. The guidance confirms that the accounting treatment of an over or under spend by an integration joint board (IJB) should be in accordance with its integration scheme. In summary, the integration scheme may provide that:

- an underspend is retained by one or more partners, and the funding contribution for the year is reduced
- an overspend is borne by one or more partners, and the funding contribution for the year is increased
- an underspend or overspend does not result in any adjustment to the funding contribution for the year.

61. Appendix C has been added to the guidance to summarise the scenarios that may arise and how these should be treated. The following table provides a summary by contrasting the impact on certain elements of an IJB's accounts depending on whether or not the funding contribution for the year is adjusted to reflect under or overspends:

Area	Funding adjustment	No funding adjustment
Does commissioning expenditure reflect the true cost of providing integrated services?	Yes	No
Is there transparency regarding the funding change in the financial statements?	No	N/A
Is an explanation of cost pressures provided in the financial statements?	No	No
What is the impact on the period for preparing the annual accounts?	Extended	None

62. The guidance recommends that IJBs consider whether the following information should be included in the management commentary:

- The initially agreed funding from each partner.
- Changes in the budgeted funding contributions.
- The final budget for the use of, or contribution to, reserves compared to that originally planned.
- An analysis of variances between the outturn and the final budget.

The guidance recommends information on under/overspends to be included in the management commentary

- An analysis of any variances which have been retained by the funding partners.

63. Where an IJB retains an underspend for the financial year, it should recognise a debtor rather than a cash balance. The debtor represents the amount of funding contribution retained by each partner that has not yet been used by the IJB. The practical effect is that accounting entries that would normally involve cash (e.g. debit cash, credit income) should instead involve the debtor (e.g. debit debtor, credit income).

Reserves

64. An underspend (i.e. income exceeding expenditure) would lead to a balance on the general fund which is matched by a debtor.

65. Where an accumulated deficit on the general fund (i.e. a negative reserve) arises, the guidance requires an IJB to make every effort to remedy the funding situation in year to prevent this position arising. Where this is not possible, the management commentary should include a clear explanation of the causes of the position, the implications for current and future service delivery, and financial recovery plans.

66. With reference to the use of reserves to fund expenditure, the guidance reminds IJBs that direct reserve accounting (i.e. the direct charging of expenditure to the general fund in the movement in reserves statement) is prohibited. All operational income and expenditure must be recognised in the surplus or deficit on the provision of services.

Negative reserves should be avoided

Direct reserve accounting is prohibited

Hosted services

67. The guidance clarifies that where an IJB manages services for another IJB, they should assess which one is acting as principal based on the practices undertaken during the financial year. The IJBs should liaise to ensure consistency of treatment.

68. Where the IJB determines it is acting as agent:

- the relevant expenditure, and related funding, should be excluded from the CIES
- information on the principal and agent relationship should be disclosed.

Set aside arrangements

69. The guidance requires the annual accounts to provide a clear explanation of the progress towards full implementation of the required arrangements for calculating the appropriate amounts of hospital set asides.

Remuneration report - pay band disclosures

70. Where there are no staff members other than those disclosed as a 'relevant person' in the remuneration report, the guidance advises that the provision of a specific table for pay band information may be unnecessary.

71. In that event, a note should be provided to the effect that "Pay band information is not separately provided as all staff pay information has been disclosed in the information above".

Pension funds – 2018/19 example accounts and checklist

72. CIPFA has issued a revised [publication](#) which illustrates the financial statements of pension funds within the local government pension scheme for 2018/19.

- 73.** The publication provides an example set of accounts that meet the minimum requirements of the 2018/19 accounting code. However, it is clear that the example accounts should not be treated as either a definitive interpretation of the accounting code or as a template (because it may not contain all the disclosures that might be appropriate for individual pension funds).
- 74.** The main change for 2018/19 results from the adoption by the accounting code of *IFRS 9 Financial instruments*. However, this is likely to have a limited impact for pension funds because most assets and liabilities are already classified as fair value through profit and loss.
- 75.** Examples of assets which pension funds may need to consider in the context of the new expected credit loss impairment model are lease rentals receivable from directly held investment property and contributions from admitted bodies not covered by Crown or third-party guarantees.
- 76.** The publication also includes a disclosure checklist that identifies the accounting code's requirements in relation to pension funds.

Grant claims developments

Housing benefits

2018/19 subsidy claims

- 77.** [The Department for Work and Pensions \(DWP\)](#) has issued a letter and guidance notes on completing the 2018/19 housing benefit (HB) subsidy claim. The letter contains details of the amounts paid for 2018/19 in respect of administration subsidy and interim benefit subsidy received. The deadlines are:
- 30 April 2019 for councils to submit the pre-certified claim to the DWP and external auditors
 - 30 November 2019 for the certified claim to be submitted to the DWP.
- 78.** The DWP has also issued module 2 of the [Housing benefit assurance process](#) (HBAP) approach to the certification of HB subsidy claims for 2018/19. HBAP replaces the previous HBCOUNT.
- 79.** Module 2 contains a checklist to help auditors ensure that the council's system is using the correct benefit parameters to calculate benefit entitlement and for the council to claim the correct amount of subsidy.

HBCOUNT has
been replaced
by HBAP

Other circulars

- 80.** The DWP has issued:
- [circular S2/2019](#) to provide details of HB administration subsidy for 2019/20
 - [circular A1/2019](#) to advise of changes to claims for claimants receiving severe disablement premium
 - [circular A3/2019](#) to advise of changes to HB for mixed age couples (i.e. where only one partner is over pension credit qualifying age)
 - [circular A8/2018](#) and [circular A2/2019](#) to advise of the benefits rates from April 2019.

Contact points

81. The contact points for this section of the technical bulletin are:

- Paul O'Brien, Senior Manager (Professional Support) - pobrien@audit-scotland.gov.uk
- Anne Cairns, Manager (Professional Support) – acairns@audit-scotland.gov.uk (grant claims items only).

Section 3

Central government sector

Auditing developments

Technical guidance notes

Audit of 2018/19 annual report and accounts

82. Professional Support has published [Audit of 2018/19 annual report and accounts \(central government\) - technical guidance note 2019/1\(CG\)](#) to provide guidance to appointed external auditors on performing the audit of the 2018/19 annual report and accounts of central government bodies.

83. The technical guidance note comprises a number of modules. The modules, along with a brief summary of the contents, are set out in the following table:

Module	Subject area
Overview	Auditors' overall responsibilities for the annual report and accounts; summary of overall financial reporting requirements; auditing standards; presentation of body-only financial statements; accounting policies, estimates, and prior year errors, events after the reporting period
1 Property, plant and equipment	Each module highlights the risks of misstatement in each financial statement area, explains the financial reporting requirements applying to that area, and sets out actions for each risk that auditors should undertake to assess whether the board has met those requirements.
2 Provisions, creditors and accruals	
3 Financial assets	
4 Group financial statements	
5 Leases and similar arrangements	
6 Grants and other income	
7 Other financial statement areas	As for modules 1 to 6 but this module includes a number of financial statement areas including investment properties, related parties etc
8 Regularity of expenditure and income	This module provides guidance on auditor's responsibilities for the regularity of expenditure and income, and the risks of irregularities. It also sets out test procedures for auditors to carry out.
9 Non-financial statements	This module covers the remuneration and staff report; performance report, governance statement and other non-financial statements. It explains auditors' responsibilities, sets out the different audit opinions required, highlights the main risks of misstatement, and sets out test procedures that auditors should undertake to assess whether the body has met those requirements.
10 Charitable NDPBs	This module applies the other modules to a charitable NDPB's statement of accounts and provides supplementary guidance.

84. Following extensive consultation with all auditors, the technical guidance note represents an agreed position on a range of complex technical issues and is a key document as auditors perform the audit of central government 2018/19 annual report and accounts.
85. For the purposes of the Audit Scotland website, all the modules have been combined into [one document](#). The individual modules are also available from the relevant subject pages on the central government site of the *Technical reference library* on [ishare](#) and the [Extranet](#).

2018/19 GBS account information

86. Professional Support will obtain information on account balances at 31 March 2019 for central government bodies from the Government Banking Service (GBS) and distribute them to relevant auditors. The GBS has confirmed that the arrangements for obtaining 2018/19 account balances are unchanged.

Annual report and accounts developments

Revised 2018/19 FReM

87. [HM Treasury](#) has issued a revised version of the [2018/19 Government financial reporting manual](#) (the FReM).
88. In addition to the changes from 2017/18 in the original version explained in [technical bulletin 2018/1](#) (at paragraph 88, i.e. the adoption of *IFRS 9 Financial instruments* and *IFRS 15 Revenue from contracts with customers*), this revised version also includes changes to reflect the impact of the general data protection regulations and trade union facility time disclosure requirements on the remuneration and staff report.

2019/20 FReM

89. Treasury has issued the [2019/20 FReM](#). The only change from 2018/19 is to allow for the early adoption of *IFRS 16 Leases* when certain criteria are met.

Financial statements developments

2018/19 disclosure checklists

90. The [National Audit Office](#) (NAO) has issued the [2018/19 FReM Disclosure guide](#) which is designed to ensure that bodies covered by the FReM have prepared their 2018/19 financial statements in the appropriate form and have complied with all disclosure requirements.
91. The guide is cross-referenced to the 2018/19 FReM, individual financial reporting standards, and the *Companies Act 2006*. Auditors will need to generate a tailored checklist by selecting the criteria that are material to their audited body.
92. While the guide is designed primarily for the NAO's internal use, auditors in Scotland may also find it helpful. When checking that the FReM's disclosure requirements have been met, auditors should:
- consider requesting that the body completes the NAO's 2018/19 disclosure guide for the financial statements
 - investigate the reasons for any non-compliance that the guide highlights

Auditor action

Auditors should use the technical guidance note when planning and performing the audit of 2018/19 annual report and accounts

Auditor action

Auditors should refer to this revised version of the FReM when auditing the 2018/19 annual report and accounts

Auditor action


Auditors should consider requesting that bodies complete this checklist

- assess whether the body's responses in the checklist are consistent with auditor's knowledge.

Non financial statements developments

New good practice note on performance reports

93. Professional Support has published a [good practice note](#) to share the findings from a review of the performance reports in the 2017/18 annual report and accounts of central government bodies. Some issues for bodies to consider highlighted in the good practice note are set out in the following table:

	<ul style="list-style-type: none"> • Stand back and consider whether the report tells a fair, balanced and understandable story • Avoid using a checklist approach which can lead to duplication and a disjointed narrative • Provide a balanced account of performance using the performance measures that the board judge to be the most effective in assessing performance • Be sufficiently specific so that users can understand why risks are important, and describe the actions to mitigate the key risks • Avoid using jargon, or explain it where it cannot be avoided
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94. Bodies are encouraged to use the findings in this good practice note to assess and enhance their own 2018/19 performance reports.

Guidance on 2018/19 remuneration and staff report

95. The [Cabinet Office](#) has issued [EPN 571 2018/19 Disclosure of salary, pension and compensation information](#) to provide guidance on the preparation of the pay pension and compensation disclosures in the remuneration and staff report for 2018/19. Example disclosures are provided at Annex 13C.
96. There are no significant changes to the remuneration disclosures set out from 2018/19. However, this guidance does not reflect the application of the FReM's requirements to Scottish bodies and therefore auditors should refer to module 9 of [technical guidance note 2019/1\(CG\)](#).

Auditor action

Auditors should confirm that bodies have considered this good practice note

Auditor action

Auditors should refer to this guidance when auditing the remuneration and staff report in the 2018/19 annual report and accounts

Wider scope developments

Financial management

97. The [Scottish Government Finance directorate](#) has published an amendment to the [Scottish Public Finance Manual](#). [Finance guidance note 2019/01](#) provides an update to the internal control checklist in the certificates of assurance section.

Contact point

98. The main contact point for this section of the technical bulletin is Neil Cameron, Manager (Professional Support) – ncameron@audit-scotland.gov.uk.

Section 4

Health sector

Auditing developments

Technical guidance notes

Audit of 2018/19 annual report and accounts

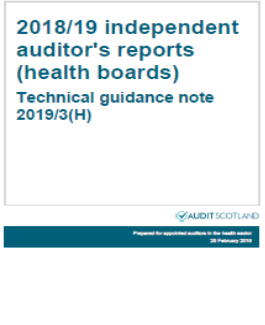
- 99.** Audit Scotland's Professional Support has published [Audit of 2018/19 annual report and accounts \(health boards\) - technical guidance note 2019/2\(H\)](#) to provide guidance to all appointed external auditors on performing the audit of the 2018/19 annual report and accounts of health boards.
- 100.** The technical guidance note highlights risks of misstatement in the financial statements, performance report and accountability report, and sets out actions for auditors to address each risk.
- 101.** In response to feedback, a new approach has been adopted this year. Instead of replicating the risks that are common to central government bodies, this technical guidance note provides only supplementary guidance on the risks of misstatements that are specific to health boards. It will therefore have to be read in conjunction with [technical guidance note 2019/1\(CG\)](#).
- 102.** Paragraph 54 of the technical guidance note states that capital grants should be charged against the non-core capital resource limit. This was based on a previous version of the accounts manual. Auditors should note that the final version of the accounts manual has been revised to remove that reference (see paragraph [113](#) on the accounts manual). Capital grants should be charged against the non-core revenue resource limit.

2018/19 model independent auditor's reports

- 103.** Professional Support has published [2018/19 independent auditor's report \(health boards\)-Technical guidance note 2019/3\(H\)](#) to provide auditors with the model independent auditor's reports which should be used for the 2018/19 annual report and accounts. The technical guidance note also provides application guidance on their use.
- 104.** In the interests of consistency, auditors are required to use the relevant model report in appendices 1 to 2 of the technical guidance note as a condition of their audit appointment. The only exception to using the wording in each model is to tailor the terminology to reflect local circumstances.
- 105.** The changes to the model independent auditor's reports for 2018/19 are summarised in the following table:

Auditor action

Auditors should use this technical guidance note when performing the audit of the 2018/19 annual report and accounts

 <p>2018/19 independent auditor's reports (health boards) Technical guidance note 2019/3(H)</p> <p>AUDIT SCOTLAND Providing the assurance Scotland needs</p>	<ul style="list-style-type: none"> • Additional wording has been added to reflect the requirements in ISA (UK) 700 requires for public interest entities • A reference has been added to highlight that risks of material misstatement are reported in the annual audit report • A similar reference has been added to highlight that conclusions on wider scope responsibilities are reported in the annual audit report • The 'Bannerman' paragraph has been moved from the beginning of the model reports to the end
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106. Any proposed modifications to any audit opinion or conclusion, or the inclusion of 'emphasis of matter' or 'other matter' paragraphs, should be discussed with Professional Support in advance of finalising the report.

107. Auditors should use this technical guidance note when reporting on 2018/19 audits. They should complete for each report the checklist at Appendix 3 which provides a list of the key auditor actions.

108. The technical guidance note also provides an assurance statement for the consolidation schedules at Appendix 4. Auditors should complete the auditor action checklist at Appendix 5.

Review of central work on CNORIS

109. Professional Support will be undertaking a review of the work carried out by the NHS Central Legal Office (CLO) relating to the *Clinical negligence and other risks indemnity scheme* (CNORIS). The objective of the review is to establish the extent to which the information prepared using the work of the CLO, as a management expert under *ISA (UK) 500 Audit evidence*, can be used as audit evidence.

110. Professional Support will also evaluate the appropriateness of the methodology adopted by the Scottish Government to establish the total national liability for CNORIS. The review will focus on the estimation of the liability as at 31 March 2019 with a view to assessing the reliability of the methodology used for 2018/19.

111. Professional Support will then provide auditors with the outcome of the reviews to:

- inform auditors' evaluation of the relevance and reliability of the information prepared by the CLO as audit evidence
- provide assurance on the methodology used in the preparation of the CNORIS figures as at 31 March 2019 which are provided to boards.

Annual report and accounts overall developments

2018/19 accounts manual

112. The [Scottish Government](#) has issued the *2018/19 NHS board manual for annual report and accounts* to complement the guidance contained in the 2018/19 FReM.

113. The main changes included in the accounts manual compared with 2017/18 are summarised the following table:

Auditor action

Auditors should use this technical guidance note when reporting the audit of the 2018/19 annual report and accounts and complete the relevant checklists

Auditor action

Auditors should refer to the accounts manual when auditing the 2018/19 annual report and accounts

Area	Change
Notes 1, 10 and 27	These notes reflect the adoption by the FReM of <i>IFRS 9 Financial instruments</i> .
Notes 3 and 4	Guidance on other operating expenses has been expanded to reflect the FReM requirement that individually material items are to be separately disclosed in the financial statements.
Note 6	References to the carbon reduction commitment scheme have been updated to reflect that the compliance phase ends in October 2019 and that excess allowances held at 31 March 2019 must be written off.
Note 13	Guidance has been added to require boards to use the Scottish life expectancy tables when calculating the provision for early pension.
Remuneration and staff report	The requirements in the FReM in respect of trade union facility time and the general data protection regulations have been reflected.
Governance statement	The amendment highlights that governance statement should reflect the group, including the endowment funds, and clarify that the governance statement should not be made publicly available before the accounts are laid in Parliament.
Parliamentary accountability report	An example disclosure has been included for fees and charges.
Summary of resource outturn	The reference to capital grants being charged to the non-core capital resource limit has been removed.

Financial statements developments

Property, plant and equipment

2018/19 capital accounting manual

- 114.** The Scottish Government has issued the *2018/19 NHS capital accounting manual (CAM)* to interpret the accounting guidance contained in the 2018/19 FReM on capital accounting issues in the health sector.
- 115.** There are no significant changes from the 2017/18 CAM.

Auditor action

Auditors should refer to the CAM when auditing property, plant and equipment in 2018/19

Non-financial statements developments

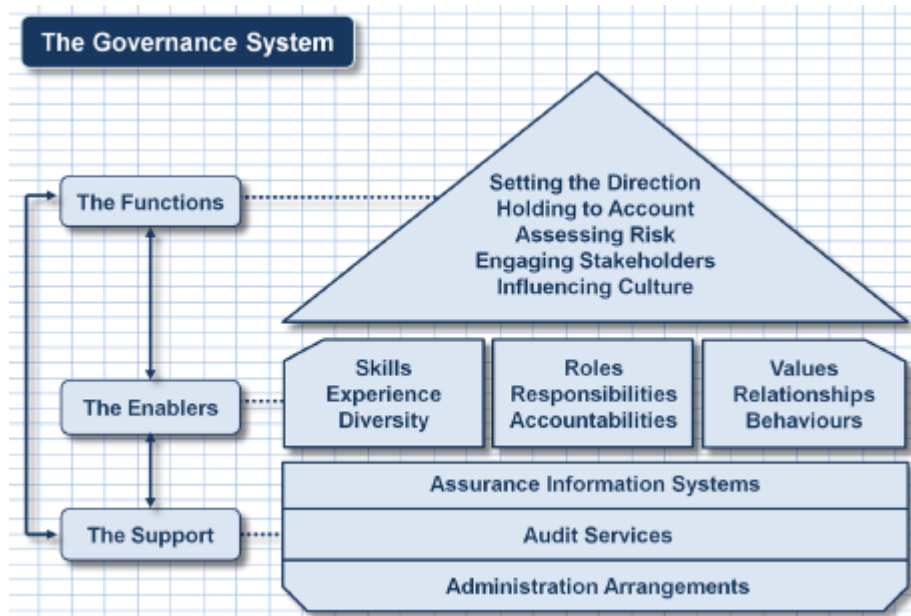
Governance statements

Blueprint for good governance

- 116.** The Scottish Government has published [A blueprint for good governance](#) to ensure that all boards assess and develop their corporate governance systems.
- 117.** Corporate governance in this context is concerned with what the board members do and should be distinguished from the day-to-day operational management.
- 118.** The corporate governance blueprint describes a three-tiered model that defines the functions of a governance system, the enablers and the support required to effectively deliver those functions. It is illustrated in the following diagram:

Auditor action

Auditors should refer to this document when considering 2018/19 governance statements



119. The blueprint sets out the importance of a consistent and systematic approach to assessing current governance arrangements. Boards are required to annually self-assess their performance using a tool developed to measure the delivery of the functions, enablers and support. The self-assessment should be validated by a tri-annual independent review of the corporate governance system.

Wider scope

Financial management

Guidance on 2019/20 operational plans

120. The Scottish Government has issued guidance to assist boards prepare their operational plans for 2019/20. The plans should set out how boards intend to deliver expected levels of performance for delivering Scottish Government priorities on: waiting times; health and social care integration; mental health; and healthcare associated infections.

121. Annex 1 to the document provides guidance on the new three-year financial planning and performance cycle which will operate from 2019/20. Boards will be required to break even over the three year planning period. Within this requirement, boards will have flexibility to report under or overspends of up to 1% of their core revenue resource limit.

122. Where boards cannot break even over the three-year period they will remain part of the [NHS board performance escalation framework](#).

123. Guidance on the presentation of the summary of resource outturn to reflect this requirement will be provided in the accounts manual for 2019/20 and examples have also been provided in the guidance.

Boards will be required to break even over each three-year period from 2019/20

Contact point

124. The main contact point for this section of the technical bulletin is Neil Cameron, Manager (Professional Support) – ncameron@audit-scotland.gov.uk.

Section 5

Professional matters

Auditing developments

Review of Financial Reporting Council

- 125.** A [report](#) has been issued by Sir John Kingman following a review of the [Financial Reporting Council](#) (FRC) carried out on behalf of the Department for Business, Energy, and Industrial Strategy (BEIS). Following criticism of the FRC (for example that it responds too slowly and is excessively close to the firms it regulates), the objective of the review was to ensure that the FRC's structures, culture, processes and powers are fit for purpose.
- 126.** The report recommends that the FRC be replaced with an independent statutory regulator, accountable to Parliament, with a new mandate, clarity of mission, leadership and powers. The BEIS has agreed to take forward this recommendation and has issued its own [consultation paper](#).
- 127.** The new regulator is to be called the Audit, Reporting and Governance Authority, and will have an over-arching duty to promote the interests of consumers, rather than producers, of financial information. It will also have duties requiring it to:
- be forward-looking
 - promote competition in the market for audit services, and monitor and report on developments in that market
 - promote brevity, comprehensibility and usefulness in corporate reporting
 - regulate and be responsible for the registration of the audit profession.
- 128.** The review did not identify major concerns in relation to auditing standards, and did not make any recommendations in this area. However, it recommended that the new regulator should work towards a position where individual audit quality inspection reports, including gradings, are published in full. As an interim step, it recommended that the audit quality reports should be published on an anonymised basis. The Government and FRC will be taking forward these recommendations.
- 129.** The review also recommended that the independent auditor's report should include 'graduated' audit findings in respect of key audit matters. For example, judgements describing an estimate as cautious, balanced or optimistic. The BEIS will consult on proposals in due course.
- 130.** The report covered the arrangements for local audit in England. Following the abolition of the Audit Commission, the review found that the framework is fragmented and expressed serious concerns that the arrangements are prioritising a reduction in cost of audit over audit quality. The report recommends bringing together in one place all the relevant responsibilities, so a single regulatory body can take an overview.
- 131.** The BEIS has indicated that it will be reviewing the effectiveness of the current arrangements once they have bedded in and will reflect on these recommendations as part of that review.

The review recommendation that the FRC be replaced with a new regulator has been accepted by the Government.

No concerns over auditing standards

Proposal to publish audit quality reports to be progressed

132. The report also considered audits carried out by the NAO under the Companies Act as the FRC monitors the quality of these audits carried out by the NAO. However, the FRC reports the results of these reviews privately to the NAO, and does not interact with the audit committee chair. The report recommends that the new regulator's individual audit quality reviews gradings and findings in relation to the NAO should be shared with the relevant audit committee and Parliament, and should be published.

133. When requested by the Controller and Auditor General (C&AG), the FRC also reviews selected non-Companies Act audits, reporting privately to the C&AG the results of this work. The report recommends that all financial audits in scope of the NAO should be brought within the audit quality monitoring scope of the new regulator, and not only at the discretion of the C&AG.

Revised auditing standard on estimates

134. The FRC has issued a revised [ISA \(UK\) 540 Auditing accounting estimates and related disclosures](#). The revised standard is effective for periods beginning after 15 December 2019, but early adoption is encouraged.

135. The revisions support an enhanced focus by auditors on management estimates and disclosures arising from changes in international financial reporting standards (IFRS), particularly the move to accounting for financial assets on an expected loss basis and revenue recognition from contracts.

136. Key revisions to ISA (UK) 540 are set out in the following table:

The standard supports an enhanced focus on estimates and disclosures - early adoption is encouraged

Revision	Further information
Enhanced requirements for risk assessment procedures and the auditor's work effort in responding to the assessed risks of material misstatement.	These include, in addition to addressing risks related to estimation uncertainty, specific attention to other risk factors in making accounting estimates such as complexity and subjectivity.
Enhanced work requirement in respect of developing an auditor's point estimate or range.	If the auditor develops a range of estimates, the auditor is specifically required to determine that the range includes only amounts that are supported by sufficient appropriate audit evidence
Audit procedures to address whether estimates and disclosures are reasonable.	This involves amending the objective and the requirements to the effect that audit procedures address whether both the accounting estimates and the related disclosures are 'reasonable' in the context of the applicable financial reporting framework (the previous standard addressed whether disclosures were 'adequate').
Enhancements to reinforce the application of professional scepticism	These include: <ul style="list-style-type: none"> • using wording to drive questioning or challenging management where appropriate • more focus on identifying indicators of possible management bias • requiring further audit procedures to be designed and performed in a manner that is not biased toward obtaining audit evidence that may be corroborative or towards excluding audit evidence that may be contradictory • an enhanced retrospective review and an overall evaluation based on procedures performed.
Emphasising the importance of the need to consider internal control.	There are improved linkages to ISAs (UK) 315 and 330.

Revision	Further information
Communicating certain matters to those charged with governance	A new requirement to remind auditors of their responsibilities to communicate certain matters to those charged with governance and to consider the matters to communicate regarding accounting estimates

Update on reviewing auditing standards

- 137.** The FRC has issued a [position paper](#) on its review of auditing and ethical standards. The paper sets out how the FRC intends to respond to the feedback from the recent consultation (referred to in [technical bulletin 2018/4](#) at paragraph 66), including a planned timetable to make revisions to the standards.
- 138.** The proposed revisions are intended to make audit more responsive to the needs and legitimate public expectations of users and require enhanced work effort to strengthen quality and consistency. The intention is to follow the position paper with a consultation in July 2019 on the revised text of a number of standards including:
- ISA (UK) 240 so that it is even clearer as to the auditor's responsibilities in respect of fraud, given recent reported confusion in this respect. The FRC will also consider whether the scope of the auditor's responsibilities in this respect should be extended.
 - ISA (UK) 250 with view to integrating sections A and B, and better meeting user expectations, including extending the current scope of ISA (UK) 250B to all regulated entities.
 - ISA (UK) 701 to expand the obligation to report in a way that provides a qualitative assessment of the auditor's judgment on key audit matters (i.e. graduated reporting).
 - ISA (UK) 720 to strengthen the work effort required of the auditor in achieving the intended outcomes of the standard, and address weaknesses identified in the recent thematic review (see paragraph 66 of [technical bulletin 2018/4](#)). The FRC will also consider the current status of 'other information' and the assurance required over it.
- 139.** Proposed revisions to ISA (UK) 570 have already been issued (see following item). There will also be proposed revisions to the ethical standard to support auditor independence and remove conflicts of interest.
- 140.** It is proposed that the effective date of the revisions will be for audits of financial periods commencing on or after 15 December 2019.

Proposed revisions to standards from 2020/21 will be consulted on over the summer

Proposed changes to ISA (UK) 570

- 141.** The FRC has issued an [exposure draft](#) of proposed changes to ISA (UK) 570 in respect of going concern. Given the fundamental importance of going concern in a set of financial statements, the FRC believes it is in the public interest to propose revisions to this standard to drive necessary improvements in audit quality.
- 142.** This consultation is based on the current statutory and accounting framework, and does not propose changes beyond that framework. A summary of the main proposed changes is set out in the following table:

Area	Proposed change
Linking the ISA to other ISAs	<p>Links from ISA (UK) 570 to important principles in other ISAs are to be enhanced to:</p> <ul style="list-style-type: none"> • better demonstrate how they are applied in respect of going concern • provide an improved basis for the evaluation of management's assessment of the body's ability to continue as a going concern.
Strengthening the objectives	The objectives of the ISA are to be revised to require the auditor to obtain sufficient appropriate audit evidence about whether a material uncertainty related to going concern exists.
Enhancing risk assessment procedures	Clearer links are to be drawn between the auditor's responsibilities in respect of going concern and the auditor's understanding of the body and its environment, the applicable financial reporting framework, and the body's system of internal control.
Evaluating management's assessment	The auditor's work effort in relation to the evaluation of management's assessment to be more robust including a more rigorous challenge of the method, information and assumptions.
Professional scepticism and management bias	Additional requirements and application material are to be added designed to enhance the auditor's application of professional scepticism and consideration of the potential for management bias. This includes a definition of management bias being added (i.e. a lack of neutrality by management in the preparation of information).
Enhanced auditor reporting	<p>Where the going concern basis of accounting is appropriate, a new requirement for the auditor's report has been added to include:</p> <ul style="list-style-type: none"> • an explanation of how the auditor evaluated management's assessment of the body's ability to continue as a going concern and where relevant, key observations arising with respect to that evaluation • a conclusion that management's use of the going concern basis of accounting is appropriate • where no material uncertainty has been identified, a statement that the auditor has not identified a material uncertainty related to going concern.
Strengthening communication with those charged with governance	A new requirement is to be added to place more emphasis on communications with those charged with governance in situations where management is unwilling to make or extend its assessment when requested to do so by the auditor.
Communicating with regulators	A new requirement is to be added for the auditor to consider whether there are any requirements beyond the ISAs which would require the auditor to report to a regulator.

143. Comments should be sent to AAT@frc.org.uk by Friday 14 June.

Report into commercial audit market

144. The [Competition and Markets Authority](#) (CMA) has issued a [report](#) on the market for the provision of statutory audit in the UK commercial sector. The report follows a review (referred to in [technical bulletin 2018/4](#) – paragraph 68) which considered whether the audit market is working as well as it should.

145. The review comes amid growing concerns about statutory audits, in particular following the collapse of Carillion and the criticism of those charged with governance, as well as recent poor results from the FRC's reviews of audit quality.

146. The CMA report asserts that a well-functioning market would produce high-quality audits. Competition must be focused on quality, and there must be sufficient choice of viable competitors. The review identified the following main reasons why the CMA believes that audit quality is falling short:

- companies choose their own auditor and, for example, may seek 'cultural fit' over 'challenging scrutiny' and attach too much weight to price
- choice is a prerequisite of effective competition but is too limited, with 97% of the audits of the biggest companies undertaken by the Big Four accountancy firms (i.e. PWC, EY, KPMG and Deloitte), and barriers facing mid-tier firms
- auditor's focus on quality may be diluted by 75% of revenue of the Big Four coming from non-audit services such as consulting, which provides a weak incentive to challenge

147. To address these concerns, the CMA is proposing a package of reforms to create incentives for better audit quality as set out in the following table:

A well-functioning market would produce high quality audits

Concern	Proposed reform
<p>Auditor independence - Auditors must be properly incentivised to deliver sceptical audits. This requires auditors to be independent and willing to challenge company management. Companies selecting and paying their own auditors is an impediment to high quality audits. One way to achieve this would be to transfer responsibility for the audit selection processes, and audit engagement monitoring, from companies to an independent body.</p> <p>However, most stakeholders are opposed to this reform as they are concerned it would disenfranchise shareholders. In addition, a blanket generic removal of shareholders' rights to appoint the auditor would be inconsistent with the current EU legislative framework.</p>	<p>Regulatory scrutiny of audit committees - Audit committees should be subject to specific regulatory requirements and obligations. The CMA's current view is that this regulation should include:</p> <ul style="list-style-type: none"> • A requirement that audit committees report directly to the regulator before, during and after a tender selection process. The regulator would also have the ability to include an observer on all or a sample of audit committees. • A requirement that audit committees report directly to the regulator throughout the audit engagement. • The ability for the regulator to issue public reprimands or direct statements to shareholders.
<p>Barriers to mid-tier firms auditing large companies - There are concerns about the capability of mid-tier firms to carry out the most complex audits. However, the CMA found that the firms were frequently ruled out of tenders on the basis of lack of experience; but they would only be able to build that experience by gaining a more substantial foothold in the market. Mid-tier firms consequently appear reluctant to bid for the largest audits due to the cost of tendering relative to the likelihood of winning.</p>	<p>Mandatory joint audit - A joint audit would require two firms to sign off on the accounts of their audit client. Responsibility for the audit opinion, and audit liability, would rest with both auditors.</p> <p>The CMA's preferred way of achieving this would be by mandating that at least one of the audit pair is a mid-tier firm. This would give mid-tier firms access to the largest clients, allowing them to develop their experience and credibility.</p> <p>Market share cap - An alternative approach, but less favoured by the CMA, is imposing a market share cap on the Big Four.</p>

Concern	Proposed reform
<p>Conflicts between audit and non-audit services - The CMA do not believe that the rules that limit the effect of conflicts caused by combined audit / non-audit structures are sufficient to focus attention on high quality audit because:</p> <p>(a) Profit pooling means that audit partners directly benefit from the commercial success of the non-audit part of the business</p> <p>(b) The significant revenue derived from non-audit services means that governance and investment decisions are heavily driven by non-audit considerations.</p> <p>(c) There are underlying cultural concerns of the same firm providing audit and non-audit services.</p>	<p>Operational split between audit and non-audit parts of the firm - An operational split with separate profit pools and governance arrangements for audit and non-audit.</p> <p>The CMA want to test whether an operational split could be designed in a way that would make it almost as effective as structural separation. If that is not the case, full structural separation (prohibiting audit firms from providing non-audit services) will be revisited</p>
<p>Under-performance - The report highlights the importance of a regulatory regime that makes visible the differences in audit quality between firms and then holds firms to account for any underperformance.</p>	<p>External peer review - The regulator would determine which companies were subject to a peer review as an additional, independent quality check. External peer reviews could be funded by a levy on audit fees. A peer review firm, unconnected to the auditor, would be appointed by the regulator. In contrast with the regulator's audit quality reviews, the peer review would occur prior to the signing-off of the accounts.</p>

Independent review into audit standards

148. A review led by Donald Bryden (the [Bryden Review](#)) has been launched by the UK Government into audit standards. Building on the Kingman and CMA reviews, this review will now consider audits as a product and what the standards and requirements should be for audits in the future. Specifically, it will consider:

- how far audit can and should evolve to meet the needs of investors and other stakeholders
- how auditors verify information
- how to manage any residual gap between what audit can and should deliver
- the public's expectations from audit.

149. The new review will also test the current model and ask whether it can be made more effective as well as looking at how audit should be developed to better serve the public interest in the future, taking account of changing business models and new technology.

The review will consider audit standards and requirements for the future

Accounting developments

Financial reporting framework after EU withdrawal

150. [The International Accounting Standards and European Public Limited-Liability Company \(Amendment etc.\) \(EU Exit\) Regulations 2019](#) have been laid to set out how new or amended IFRS issued by International Accounting

Standards Board (IASB) will be adopted for use in the UK after 29 March (or later date if the UK's exit is delayed). The provisions are summarised in the following table:

Start of financial year	Financial reporting framework
On or before 29 March	EU-adopted IFRS
After 29 March	UK-adopted IFRS

2018/19 financial statements will continue to be prepared under EU-adapted IFRS

- 151.** This means that public sector financial statements for 2018/19 will be prepared under EU-adopted IFRS, but the basis of preparation will move to UK-adopted IFRS from 2019/20.
- 152.** On 30 March 2019, EU-adopted IFRS and UK-adopted IFRS will remain the same. However, the regulations will give the UK Government power to endorse and adopt new or amended IFRS from that date. A separate instrument will delegate the adoption function in practice to a UK endorsement body. New or amended IFRS that are still in the process of being endorsed in the EU will be assessed for adoption in the UK by this body.

Contact point

- 153.** The contact point for this section of the technical bulletin is Paul O'Brien, Senior Manager (Professional Support) - pobrien@audit-scotland.gov.uk.

Section 6

Fraud and irregularities

154. This chapter contains a summary of fraud cases and other irregularities facilitated by weaknesses in internal control at audited bodies that have recently been reported by auditors to Professional Support.

Expenditure

Change of bank details

155. Third parties defrauded a total of over £30,000 from three public bodies by infiltrating email accounts and re-directing payments intended for legitimate suppliers.

Key features (case 1)

The perpetrator set up rogue email addresses containing very slight changes from the legitimate addresses for both the public sector body and one of its partners. All emails between the two parties could then be intercepted and amended by the perpetrator.

A regular payment was due to be made to the partner and confirmation of the bank details was requested by email. The perpetrator modified the bank details to a fraudulent account, and the payment was made to that account.

The fraud was identified after the partner was contacted on social media and asked to respond to a sequence of emails. It then became apparent that the email addresses and the new bank details were fraudulent.

Weakness in internal control

The fraud was possible as no phone call was made to the partner to confirm the change of bank account.

Auditor action
Auditors should consider whether weaknesses in internal control which facilitated each fraud may exist in their bodies and take the appropriate action

Key features (cases 2 and 3)

Emails purporting to be from two legitimate suppliers were received by the public bodies advising of a change in their bank details. In one case, the email contained a letter on headed paper to this effect. In the other case, the public sector body asked for confirmation of the 'old' bank details, and email confirmation of this was received.

The bodies amended the bank details, and two payments were then made. The fraud was identified when the suppliers queried non-receipt of their payments.

Weakness in internal control

The frauds were possible as no phone call was made to the suppliers to confirm the change of bank account.

Income

Admission ticket sales

156. Perpetrators defrauded £12,000 from an NDPB through fraudulent ticket sales.

Key features

The perpetrators purchased a number of tickets for events from overseas using stolen credit card details, and then re-sold the tickets. The fraud was not identified until when the genuine card holders queried the transactions and requested refunds. A subsequent review identified an unusual increase in refunds for disputed card transactions.

The NDPB has now moved to an enhanced card payment system. The IP addresses used for the fraudulent ticket sales have also been blocked.

Weakness in internal control

The fraud was facilitated by a card payment system which did not include secondary authentication for payments.

Fraudulent refunds

- 157.** An environmental services employee defrauded £12,500 from a council by failing to bank income and by processing false refunds.

Key features

The employee legitimately sold refuse sacks to residents, but subsequently processed a refund and retained the cash. The individual also identified council tax and housing rent accounts that were in credit, processed a refund for the overpayment, and again retained the cash.

No issues were initially detected as the cash recorded in the ledger agreed to the cash in the till.

The fraud was identified following a review of transactions by the sales ledger team, who identified that it was unusual to expect refuse sack refunds. Further investigation identified that refunds were being processed by the same officer for council tax and housing rents payments.

Management have now introduced a daily review of all refunds processed. Council tax and housing rent account credit balances are now being identified and highlighted to customers.

Weakness in internal control

The fraud was facilitated by the absence of regular performance reviews to highlight unusual items and inadequate segregation of duties.

Failure to bank income

158. A housing officer defrauded £6,000 from a council by failing to bank income.

Key features

The officer did not record cash income on income records. The main control was to reconcile the income records to the bank statement, and therefore the missing income was not timeously detected.

The fraud was identified when a finance officer discovered that expected income was not in the relevant bank account. Following investigation, it was established that this income had not been banked and that the issue went back to 2016.

A review of the system controls is being undertaken to allow weaknesses to be identified and addressed.

Weakness in internal control

The fraud was possible due to a failure in budget monitoring processes and the income reconciliation process relying upon income details being recorded in the income records.

Failure to bank income (2)

159. A modern apprentice has defrauded £11,000 from a council's licensing department by failing to bank income.

Key features

The fraud was identified after a member of the public who had paid for a license asked for a copy of the receipt. When the transaction was investigated by a licensing officer, the money was found in the apprentice's work tray. It was then identified that cash receipts were not being recorded on any internal system nor had the corresponding money been banked. Controls have since been strengthened to address a number of weaknesses.

Weakness in internal control

The fraud was possible due to a number of basic control weaknesses including:

- inadequate segregation of duties relating to the receiving, recording and banking of income
- financial reconciliations not being carried out
- poor supervision
- receipts not being issued to customers
- cash not being banked regularly.

Client funds

Embezzlement of care home residents' funds

160. The owner of a council-funded care home defrauded £38,000 from residents.

Key features

The owner was not managing residents' funds through individual bank accounts, as required by the contract with the council, in order to hide the fraudulent transactions.

A council employee responsible for managing the contract initially identified that residents were having financial difficulty and cash flow problems. A subsequent investigation of residents' funds identified unusual bank transfers with a lack of supporting information.

The business owner was reported to the Procurator Fiscal and is awaiting trial, but has repaid the funds.

Weakness in internal control

The fraud was facilitated by inadequate contract management arrangements.

Theft

Theft of laptops

161. An unknown third party stole laptops valued at £7,000 from a school.

Key features

The equipment was stolen from a secure storage area within the school. The theft was discovered when an employee went to retrieve the equipment prior to use. The matter has been reported to the Police.

Weakness in internal control

An internal audit investigation identified physical control weaknesses including:

- key boxes not being locked
- annual asset returns not being completed
- computer equipment not being security marked.

Contact point

162. The contact point for this section of the technical bulletin is Anne Cairns, Manager (Professional Support) - acairns@audit-scotland.gov.uk.

Technical bulletin 2019/1

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T: 0131 625 1500

Technical bulletin 2019/2

Technical developments and emerging risks
from April to June 2019



 AUDIT SCOTLAND

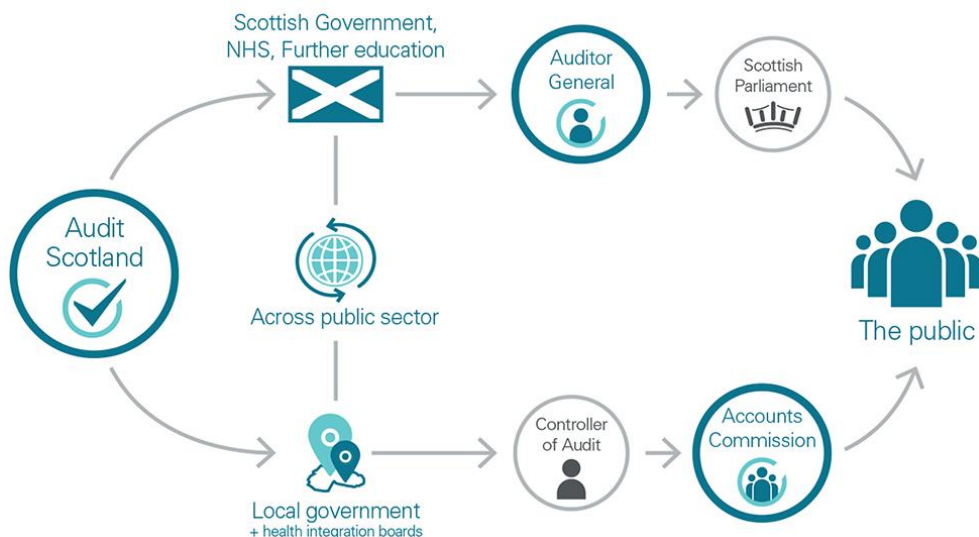
Prepared for appointed auditors and audited bodies in all sectors

12 June 2019

Who we are

The Auditor General, the Accounts Commission and Audit Scotland work together to deliver public audit in Scotland:

- The Auditor General is an independent crown appointment, made on the recommendation of the Scottish Parliament, to audit the Scottish Government, NHS and other bodies and report to Parliament on their financial health and performance.
- The Accounts Commission is an independent public body appointed by Scottish ministers to hold local government to account. The Controller of Audit is an independent post established by statute, with powers to report directly to the Commission on the audit of local government.
- Audit Scotland is governed by a board, consisting of the Auditor General, the chair of the Accounts Commission, a non-executive board chair, and two non-executive members appointed by the Scottish Commission for Public Audit, a commission of the Scottish Parliament.



About us

Our vision is to be a world-class audit organisation that improves the use of public money.

Through our work for the Auditor General and the Accounts Commission, we provide independent assurance to the people of Scotland that public money is spent properly and provides value. We aim to achieve this by:

- carrying out relevant and timely audits of the way the public sector manages and spends money
- reporting our findings and conclusions in public
- identifying risks, making clear and relevant recommendations.

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Introduction

Purpose

1. The purpose of technical bulletins from Audit Scotland's Professional Support is to provide auditors appointed by the Auditor General and Accounts Commission with:
 - information on the main technical developments in each sector and on professional matters during the quarter
 - guidance on any emerging risks identified in the quarter.
2. The information on technical developments is aimed at highlighting the key points that Professional Support considers appointed auditors require to be aware of. It may still be necessary for auditors to read the source material if greater detail is required. These can be accessed by using the hyperlinks, where provided. They are also available to appointed auditors from the Technical Reference Library maintained by Professional Support on [ishare](#) and the [Extranet](#).
3. The actions by auditors recommended by Professional Support in respect of each item are highlighted in red and summarised at the end of each section.
4. Technical bulletins are also published on the Audit Scotland [website](#) and therefore are available to audited bodies and other stakeholders.

Technical bulletins provide information on developments and guidance on emerging risks

Highlights summary

5. Particular attention is drawn to nine of the items in this technical bulletin summarised in the following table:

Professional Support has published an update to technical guidance note 2018/10(LG) [see paragraph 7]	The Scottish Government has issued statutory guidance on using capital receipts to fund transformation projects [see paragraph 18]	Professional Support has provided revised guidance on loans fund repayments [see paragraph 30]
Professional Support has provided an update on Guaranteed Minimum Pension [see paragraph 58]	Professional Support has provided guidance on the McCloud judgement [see paragraph 62]	Treasury has issued application guidance on IFRS 16 [see paragraph 98]
Professional Support has published a good practice note on governance statements [see paragraph 130]	The Competition and Markets Authority has issued their final report on the audit market [see paragraph 141]	The Brydon Review has called for views [see paragraph 144]

Contact point

6. The main contact point for this technical bulletin is Paul O'Brien, Senior Manager (Professional Support) – pobrien@audit-scotland.gov.uk.

Feedback on this technical bulletin is welcome

Section 1

Local government sector

Auditing developments

Update to technical guidance note 2018/10(LG)


7. Professional Support has published an [update](#) to [technical guidance note 2018/10\(LG\)](#) to summarise the events since the technical guidance note's publication on 19 November 2018 which impact directly on its contents.
8. Auditors have been advised of these events in technical bulletins. The purpose of this update is to pull the events together in one document and set out the auditor actions arising.

Auditor action

Auditors should refer to this update when auditing the 2018/19 annual accounts of local government bodies

2018/19 model independent auditor's reports

9. Professional Support has published [2018/19 independent auditor's report \(local government\) - Technical guidance note 2019/5\(LG\)](#) to provide auditors with the model independent auditor's reports which should be used for the 2018/19 annual accounts. The technical guidance note also provides application guidance on their use.
10. In order to comply with section 101(4) of the Local Government (Scotland) Act 1973 which requires the independent auditor's report to be in the form directed by the Accounts Commission, the Code of Audit Practice requires auditors to use the relevant model report in the appendices of the technical guidance note as a condition of their audit appointment. The only exception to using the wording in each model is to tailor the terminology to reflect local circumstances.
11. The changes to the model independent auditor's reports for 2018/19 are summarised in the following table:

	<ul style="list-style-type: none"> • Additional wording has been added to reflect the requirements in ISA (UK) 700 for public interest entities • A reference has been added to highlight that risks of material misstatement are reported in the annual audit report • A similar reference has been added to highlight that conclusions on wider scope responsibilities are reported in the annual audit report • The 'Bannerman' paragraph has been moved from the beginning of the model reports to the end
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12. Any proposed modifications to any audit opinion or conclusion, or the inclusion of 'emphasis of matter' or 'other matter' paragraphs, should be discussed with Professional Support in advance of finalising the report.
13. Auditors should use this technical guidance note when reporting on 2018/19 audits. They should complete for each report the checklist at Appendix 6 which provides a list of the key auditor actions.

Auditor action

Auditors should use this technical guidance note when reporting the audit of the 2018/19 annual accounts and complete the relevant checklist

Financial statements developments

Guidance on internal transactions

14. The [Local Authority \(Scotland\) Accounts Advisory Committee](#) (LASAAC) has issued an [advisory note](#) to assist local government bodies in implementing changes to the Code of Practice on Local Authority Accounting (the accounting code) for 2018/19 which no longer permit transactions between segments to be reported in the Comprehensive Income and Expenditure Statement (CIES), i.e. they should not be included in income and expenditure in service segments.
15. The note emphasises that:
 - the change does not preclude bodies from recording inter-segment transactions for internal management purposes. Adjustments which reconcile a body's management arrangements for segments to the required presentation in the CIES should be included in the Expenditure and Funding Analysis
 - the re-allocation of underlying expenditure from one segment to another in the CIES continues to be allowed. This should be accounted for as an increase in the expenditure of the segment that consumed the resources and the reduction in the expenditure (rather than increase in income) of the segment which initially procured the resources.
16. Auditors should confirm that:
 - any inter-segment transactions for management purposes during 2018/19 have been removed from both segments in the Expenditure and Funding Analysis
 - any underlying expenditure re-allocated between segments in 2018/19 resulted in an increase in the expenditure of the segment that consumed the resources and a reduction in the expenditure of the segment which initially procured the resources.
17. As a consequence of the change to the accounting code, previous LASAAC guidance on accounting for insurance, which recommended internal premiums, is withdrawn.

Reconciling adjustments should be in the Expenditure and Funding Analysis

Auditor action
Auditors should carry out the actions set out at paragraph 16

Use of capital receipts to fund transformation projects

18. The [Scottish Government](#) has issued statutory guidance with [finance circular 4/2019](#) which permits councils to use capital receipts to fund projects designed to transform service delivery to reduce costs and/or reduce demand.
19. In addition to capital receipts received during the period 2018/19 to 2021/22, any balance on the Severance Provision Statutory Adjustment Account at 31 March 2018 is also eligible to be used under the scheme. Capital receipts in the Capital Fund are not eligible.
20. The eligibility of the expenditure that may be funded from capital receipts is summarised in the following table:

Capital receipts can be used to fund eligible expenditure on transformation projects

Qualifying	Non-qualifying
<p>Non-recurring, set up and implementation costs including statutory, lump sum severance payments to non-teachers</p> <p>Incurred on a qualifying transformation/service redesign project</p> <p>Incurred during the period from 1 April 2018 to 31 March 2022</p>	<p>Ongoing revenue costs</p> <p>Severance costs related to teachers</p> <p>Severance costs for non-teachers that are simply applying to service cuts or discretionary payments to enhance severance packages</p>

- 21.** Qualifying projects are those which transform service delivery in a way that reduces either the cost of, or demand for, that service in the future. The key criterion is whether the project will generate ongoing savings. It is for each council to demonstrate that a project qualifies. Examples of transformation projects are provided at paragraph 7 of the statutory guidance and include:
- setting up a shared back-office or administrative services with other public bodies
 - expanding the use of digital approaches to the delivery of services.
- 22.** The full council must approve the use of capital receipts to fund qualifying expenditure. A report requires to be presented to full council that sets out the:
- total estimated cost of each project
 - expected saving/service demand reduction
 - types and amounts of qualifying expenditure
 - amount of capital receipts planned to be used.
- 23.** Capital receipts to be applied to fund qualifying expenditure cannot be transferred directly to the General Fund. They should first be credited to the Capital Grants and Receipts Unapplied Account as a statutory adjustment. The decision to do so must be taken on receipt. The amount credited in any financial year to the General Fund can exceed the amount of qualifying expenditure for that year. However, over the four-year period, the total capital receipts cannot exceed total expenditure. Any unused capital receipts at 31 March 2022 are to be transferred to the Capital Fund.
- 24.** An analysis of the reason for each transfer from the Capital Grants and Receipts Unapplied account to the General Fund requires to be disclosed. Paragraph 29 of the statutory guidance provides suggested descriptors for the analysis.
- 25.** There is a requirement to disclose separately the amount held in the Capital Grants and Receipts Unapplied Account for:
- funding service transformation projects
 - capital grants (under finance circular 3/2018)
 - equal pay (under finance circular 1/2019).
- 26.** Where a body intends to fund a project from capital receipts in 2018/19, auditors should confirm that the:
- project is a qualifying one

The decision on whether to apply capital receipts must be taken on receipt

Auditor action
Auditors should carry out the actions set out at paragraph 26

- expenditure meets the eligibility criteria
- capital receipts to be applied have first been credited to the Capital Grants and Receipts Unapplied Account as a statutory adjustment.

Accounting for teachers 2018/19 pay award

27. The Scottish Government has sent an email to local government bodies on accounting for the teachers' pay award for 2018/19. The email explains that the share of the increase funded by the Scottish Government was not included in the redetermination of the 2018/19 general revenue grant (it will instead be included in the 2019/20 grant). The allocation of the £10 million funding is set out in a table.
28. The email advised that the Scottish Government will accrue their share in their 2018/19 financial statements, and Local Financial Returns for 2018/19 will assume a local government body will accrue the income in that year.
29. In Professional Support's view, it is appropriate for a local government body to recognise its share of the funding as income in 2018/19 as the Scottish Government email provides reasonable assurance that it will be received.

Funding for the 2018/19 teachers' pay award will be paid as part of 2019/20 grant

The funding can be recognised in 2018/19

Loans fund repayments – update

30. Auditors will be aware, from [technical bulletin 2019/1](#) (paragraph 26) and from other communications, of discussions that have taken place between Audit Scotland, the CIPFA Directors of Finance Section, CoSLA, the Scottish Government and other stakeholders on the repayment of loans fund advances made prior to 1 April 2016 (pre-April 2016 advances).
31. Professional Support's previous guidance was that pre-April 2016 advances should continue to be repaid as if paragraph 15 of Schedule 3 of the Local Government (Scotland) Act 1975 had not been repealed. That position reflected the treatment set out in statutory guidance contained in [finance circular 7/2016](#), and was on the basis that [The Local Authority \(Capital Finance and Accounting \(Scotland\) Regulations 2016](#) (the 2016 Regulations), which permit other repayment options, did not apply to pre-April 2016 advances.
32. Having carefully considered all the available evidence, including obtaining independent legal opinion, Professional Support is now satisfied that the 2016 Regulations can be applied to pre-April 2016 advances. Specifically, this includes Regulation 14(2) which permits a local government body to vary the period and amount of the repayment if it considers it prudent to do so.
33. While the ultimate judgement rests with each appointed auditor, in Professional Support's view, any local government body wishing to vary the amount and/or period of loans fund repayment of pre-April 2016 advances in 2018/19 has the statutory power to do so subject to the repayment being considered prudent. Similarly, the councils which varied repayment in 2017/18 had the power to do so and therefore no restatement in 2018/19 is necessary, again subject to the repayment being considered prudent.
34. The 2016 Regulations do not define prudent repayment, but the statutory guidance explains that it is a repayment which is reasonably commensurate with the period and pattern of benefits provided to the community from the capital expenditure. The statutory guidance also sets out a number of options that are considered to be prudent.
35. In making decisions about prudent repayment, it is important that local government bodies follow appropriate governance processes. The statutory guidance refers to the requirement for the policy on prudent repayment, and

Professional Support is satisfied that the 2016 Regulations can be applied to pre-April 2016 advances

any proposed variation of repayments, to be approved by the full council (or equivalent for other bodies).

36. Auditors should:

- confirm that the body's policy on prudent repayment, and any proposed variations of repayments in 2018/19, have been approved by the full council (or equivalent)
- assess whether the policy meets the requirements for prudence set out in the statutory guidance
- assess whether the repayments for 2018/19 comply with the approved policy.

Auditor action

Auditors should carry out the actions set out at paragraph 36

Financial instruments – modified loans

37. The [CIPFA/LASAAC Local Authority Code Board](#) has issued an [update](#) to the 2018/19 accounting code. The need for the update arises from clarification contained in IFRS 9 Financial Instruments: Prepayment Features with Negative Compensation in respect of loan exchanges which result in the modification (rather than derecognition) of the original loan.

38. The update provides transitional provisions for changes in accounting treatment as a result of the IFRS 9 clarification. The [Chartered Institute of Public Finance and Accountancy](#) (CIPFA) has issued [Bulletin 3](#) to explain the accounting treatment. Paragraphs 1 to 18 explain that it involves the new amortised cost of a modified loan being measured using the original (rather than the new) effective interest rate.

The update provides transitional provisions where the accounting treatment for modified loans changes in 2018/19

39. The difference in accounting treatment is therefore summarised in the following table:

IFRS 9	IAS 39
Calculate a new carrying amount by discounting the revised contractual cash flows with the original effective interest rate (resulting in a gain or loss on modification)	Retain the old carrying amount
Take the difference between the new carrying amount and the old carrying amount to the Comprehensive Income and Expenditure Statement as a gain/loss on modification	Recalculate the effective interest rate using the revised cash flows
Adjust the new carrying amount and recalculate the effective interest rate to amortise any other costs and fees incurred in the modification	

40. The clarification applies on the adoption of IFRS 9 and therefore to the 2018/19 financial statements. Any change in accounting treatment is to be applied retrospectively, but the transitional provisions set out in the code update allow recognition as an opening adjustment to reserves.

41. The update includes tracked changes to appropriate extracts of the 2018/19 accounting code with both new and amended paragraphs forming the revised 2018/19 code.

42. It should be noted that CIPFA's IFRS 9 Financial Instruments - An Early Guide for Local Authority Practitioners does not reflect the amended treatment. Paragraph 14 of bulletin 3 replaces the affected guidance in that early guide.

Financial instruments – negative compensation

43. [CIPFA bulletin 3](#) also provides guidance on IFRS 9 Financial Instruments: Prepayment Features with Negative Compensation more generally. Paragraphs 19 and 20 of the bulletin explain that negative compensation arises in a financial instrument where:
- the contractual terms permit the borrower to prepay the financial instrument before its contractual maturity; and
 - the prepayment amount could be less than unpaid amounts of principal and interest.
44. Under the previous IFRS 9 requirements, a lender having to make a settlement payment in the event of termination by the borrower led to the financial asset being classified as fair value through profit or loss (FVPL). The amendment to IFRS 9 allows bodies to classify such assets at amortised cost or at fair value through other comprehensive income (FVOCI) if the relevant criteria are met.
45. Some local government bodies lend to other entities with prepayment terms at a discount. Where that is the case, bodies will be permitted to apply this amendment in 2018/19 on transition to IFRS 9.

Financial assets with negative compensation can be classified as amortised cost or FVOCI

Financial instruments – earmarking unrealised gains

46. LASAAC has issued [mandatory guidance](#) on earmarking an element of the General Fund balance arising from the increase in the fair value of financial assets.
47. Under IFRS 9, increases in the fair value of financial assets classified as FVPL are recognised in the General Fund. The guidance requires that an element of the resulting unrealised gains in the General Fund balance should be earmarked as not being available to fund the delivery of services. The element relates to the net cumulative gains arising from increases in fair value to the extent they are not readily convertible to cash.
48. Gains in the fair value of a financial asset are considered to be 'readily convertible to cash' if all of the criteria set out in the following table apply:

Gains on FVPL financial instruments in the General Fund should be earmarked if not available to fund service delivery

Criteria	Explanation
Value determination	A value can be determined at which a transaction could occur to convert the change in fair value into cash
Observable information	In determining the value, information that market participants would consider in setting a price is observable (closely aligned with levels 1 and 2 in the IFRS 13 fair value hierarchy)
Immediate conversion	There are no circumstances that prevent the immediate conversion to cash of the change in fair value

49. Even where an increase in fair value meets the above criteria, bodies are required to judge whether it is prudent to use the increase to fund services where the fair value of the asset is considered to be volatile.
50. Where earmarking of the General Fund is required, it should be disclosed in a note along with an explanation.
51. Where there is a net cumulative gain in respect of financial assets included in the General Fund balance at 31 March 2019, auditors should confirm that an element of the balance has been earmarked to the extent the gains are:

Auditor action
Auditors should carry out the actions set out at paragraph 51

- not readily convertible to cash; or
- considered to be volatile.

52. The guidance also applies to any unrealised gains arising from recalculating the carrying amount of modified loans (explained at paragraph 39).

Retirement benefits – 2018/19 report on actuarial information

53. PWC has prepared a report to provide support to auditors when assessing the actuaries who produce retirement benefits figures under IAS 19 Employee Benefits as at 31 March 2019.

54. The work carried out for the report involved assessing the competence and objectivity of, and assumptions and approach adopted by, the relevant actuaries. It found that actuaries signing-off the calculation of the figures are appropriately qualified, and the actuarial firms are experienced and well-reputed. There are no known circumstances which would impair their objectivity to produce the figures.

55. PWC also consider that the assumptions proposed, when taken together, will produce liability figures in line with their expectations. However, the report advises auditors to consider whether:

- local issues have been adequately covered in instructions issued by employers to actuaries
- to subject the source data provided to the actuaries by employers to further audit procedures as discussed in section 4 of the report
- material significant events have been communicated to the actuary and undertake additional audit procedures as appropriate.

56. Where intending to make use of the report, auditors are reminded of the need to first evaluate PWC as an auditor's expert under ISA (UK) 620.

Retirement benefits - guaranteed minimum pension update

57. [Technical bulletin 2019/1](#) (paragraph 12) drew auditors' attention to issues related to the indexation of Guaranteed Minimum Pension (GMP). In summary, a pension scheme that was 'contracted-out' of additional state pension arrangements before contracting-out ended on 6 April 2016 is required to provide a GMP to members for contracted-out service between 6 April 1978 and 5 April 1997. If the contracted-out pension benefits are less than the pensioner would otherwise have received, the pension scheme would be required to increase the pension paid to reach the GMP.

58. Page 22 of the PWC report (referred to in the previous item) provides a summary of the approach each actuary is taking to GMP indexation. The report considers the approaches to be reasonable on the basis that the likely impact on liabilities is estimated to be low (0.1% of liabilities for those reaching pension age before April 2021 and 0.2% after that date).

59. Paragraphs 71 to 74 of [CIPFA bulletin 3](#) provide guidance on GMP requirements and advise that bodies should liaise with their relevant pension schemes' administrators and consider what evidence is available regarding the potential impact to inform a relevant accounting treatment for 2018/19, e.g. disclosure of a contingent liability.

60. Auditors should:

- consider the likely impacts against materiality levels

The report considers the proposed actuarial assumptions to be reasonable in typical cases

Auditor action

Auditors should evaluate PWC as an auditor's expert before using the report

The report considers the approaches by actuaries to be reasonable subject to materiality considerations

Auditor action

Auditors should carry out the actions set out at paragraph 60

- assess whether the accounting treatment in 2018/19 is appropriate.

Retirement benefits – McCloud judgement

- 61.** Auditors will be aware of recent court rulings (generally referred to as the [McCloud judgement](#)) regarding transitional provisions in public sector pension schemes being unlawfully age discriminatory which may have implications for the Local Government Pension Scheme (LGPS).
- 62.** The PWC report advises that actuaries are not proposing to make any allowance for the rulings because of uncertainty around an appeal by the UK Government.
- 63.** The CIPFA Pension Network has issued a [briefing note](#) to advise that the Government Actuary's Department (GAD) is currently undertaking a scheme level review of the LGPS for England and Wales to:
- assess the scale of the overall impact
 - estimate the change in pension liabilities and service cost
 - carry out a sensitivity analysis to identify the impact that changes in key factors may have.
- 64.** The review may assist local government bodies in evaluating the impact on their 2018/19 annual accounts and inform any disclosure within the accounts. It is currently unclear what arrangements will be made to provide similar information for the LGPS in Scotland. Bodies will need to consider:
- whether they have sufficient information, having taken appropriate advice, to amend the pension liabilities
 - appropriate disclosures on risks and cash flow uncertainties.
- 65.** The briefing suggests that disclosure should set out:
- the background and reason for the uncertainty concerning the pension liability (i.e. the court case and implications)
 - an indication of the scale of the uncertainty and, if quantification is not currently possible, an explanation of why that is the case
 - an indication of 'scheme level' estimates where appropriate and available
 - an indication of any uncertainties affecting the cash flows (e.g. appeal by government)
 - an explanation of the impact that this may have on funding arrangements, specifically the employer contributions in future years and any deficit recovery plan arrangements.

Actuaries are not making allowances for the McCloud judgement

GAD is reviewing LGPS in England and Wales

The briefing suggests appropriate disclosures

Auditor action
Auditors should assess whether the accounting treatment/disclosure (e.g. contingent liability) in 2018/19 is appropriate

Pension funds – illustrative accounts for 2018/19

- 66.** CIPFA has issued [Preparing the annual report - guidance for LGPS funds \(2019\)](#) on preparing LGPS annual reports from 2018/19.
- 67.** This guidance represents a general framework for reference purposes only. It identifies the topics that need to be covered and provides illustrations of how these requirements could be addressed in practice, but does not prescribe the format or level of detail required.

This guidance provides illustrations but does not prescribe the format or level of detail

68. There is no requirement for annual reports to follow the ordering or structure of this guidance, and there is no recommended length or layout.

2019/20 accounting code

69. CIPFA/LASAAC has issued the accounting code for 2019/20. It has been prepared on the basis of accounting standards and other pronouncements in effect for accounting periods commencing on or before 1 January 2019 (except for IFRS 16 Leases which will not apply until 2020/21).

IFRS 16 has not been adopted in 2019/20

70. The main changes in the 2019/20 accounting code are as follows:

- Updates to reflect the issue of the IFRS Conceptual Framework 2018.
- Augmented description of adaptations and interpretations.
- Amendment to the Movement in Reserves Statement (MiRS).
- The ability to transfer an element of the revaluation gain to the General Fund.
- Amendments to section 7.1 on financial instruments.

Auditor action

Auditors should assess whether bodies are making the necessary preparations to comply

Updates to reflect the issue of the IFRS Conceptual Framework 2018

71. Section 2.1 of the accounting code has been extensively re-written to reflect the IFRS Conceptual Framework 2018. The main changes are briefly outlined in the following paragraphs.
72. Changes to the qualitative characteristics of useful financial information at paragraph 2.1.2.15 include those set out in the following table:

Subject	Change
Prudence	A reference to prudence has been re-introduced. The paragraph states that neutrality is supported by the exercise of prudence, which it defines as the exercise of caution when making judgements under conditions of uncertainty. It also explains that prudence does not mean requiring more persuasive evidence to support the recognition of assets than the recognition of liabilities
Substance over form	There is an explicit reference to substance over form. The paragraph states that in many circumstances, the substance of an economic phenomenon and its legal form are the same, but when they are not, providing information only about the legal form will not faithfully represent the economic phenomenon.
Measurement uncertainty	The paragraph advises that even a high level of measurement uncertainty does not necessarily prevent an estimate from providing useful information.

73. Paragraphs 2.1.2.28 and 29 contain revised definitions for assets and liabilities which are expressed in terms of economic resources. An economic resource is a right that has the potential to produce economic benefits or service potential. Paragraph 2.1.2.27 also refers to substance over form by stating that, when assessing whether an item meets the definition of an asset or liability, attention needs to be given to its underlying substance and economic reality and not merely its legal form. The new definitions are set out in the following table:

Assets and liabilities are defined in terms of economic resources

Item	Definition
Asset	Present economic resource controlled by the body as a result of past events
Liability	Present obligation of the body to transfer an economic resource as a result of past events

74. Paragraphs 2.1.2.36 and 37 cover the recognition process and criteria by explaining that:

- recognition captures items in the Balance Sheet and CIES that meet the definition of one of the elements of financial statements
- only items meeting the definition of an asset, a liability or reserves are recognised in the Balance Sheet
- only items meeting the definition of income or expenses are recognised in the CIES.

75. Paragraph 2.1.2.38 explains that derecognition is the removal of all or part of an asset or liability from the Balance Sheet, and normally occurs when the item no longer meets the definition of an asset or liability. Derecognition normally occurs when the body:

- loses control of all or part of an asset; or
- no longer has a present obligation for all or part of a liability.

76. Paragraph 2.1.2.54 clarifies that the term measurement basis means either historical cost, fair value or current value.

Measurement bases are historical cost, fair value or current value

Augmented description of adaptations and interpretations

77. Paragraphs 1.2.5 to 1.2.13 explain the application of the code in respect of proper accounting practices. It explains that IFRS may be subject to adaptations or interpretations for the local government context and defines these as follows:

Item	Definition
Adaptation	Amendment to the requirements of a standard
Interpretation	Specifies more precisely how a body is required to apply the requirements in a standard

78. The paragraphs also confirm that that when accounting requirements conflict with statutory requirements, the latter determines what is chargeable to the general fund.

79. Paragraph 1.2.13 explains that IFRS increasingly uses application guidance to support the provisions in standards. Where particularly relevant to local government, such application guidance may be included directly in the accounting code. However, even where that is not the case, if a standard is clear that the application guidance is an integral part of it, bodies are required to refer to that application guidance when relevant transactions, events or circumstances arise.

Application guidance in a standard may have to be referred to

Amendment to the movement in reserves statement

80. An additional line has been added to the MiRS at paragraph 3.4.2.55 for transfers between statutory reserves. This brings the code into line with existing normal practice.

Transferring an element of revaluation gain to general fund

- 81.** Paragraph 4.1.2.48 allows Scottish local government bodies to transfer the difference between annual depreciation based on the revalued carrying amount of an asset and the depreciation based on the asset's historical cost from the Revaluation Reserve to the General Fund. This is instead of being treated as part of the statutory adjustment and being routed through the Capital Adjustment Account.
- 82.** A line has been added to the MiRS to reflect that option.

An element of revaluation gain may be transferred to the General Fund rather than Capital Adjustment Account

Amendment to section 7.1 on financial instruments

- 83.** Paragraph 7.1.1.3 has been amended to clarify the accounting code's interpretation of a loan contract with Lender Option Borrower Option (LOBO) clauses. The interpretation previously stated that LOBO options should not be separately accounted for. The amendment clarifies that the options referred to are only those that allow the lender to increase the interest charge by any amount chosen at specified option exercise dates embedded in a LOBO.
- 84.** Paragraph 7.1.5.6 has been added as a result of IFRS 9 Prepayment Features with Negative Compensation (explained at paragraph 43). It advises bodies to refer to IFRS 9 in the unlikely event that they have previously designated a financial instrument at FVPL.

Grant claims developments

Technical guidance notes for 2018/19

- 85.** Professional Support has published [Certification of 2018/19 approved local government grant claims and returns - Technical guidance note TGN/GEN/19](#) to provide general guidance to auditors on the certification of 2018/19 local government grant claims and returns and to explain the approach and procedures to be adopted. The technical guidance note:
- explains the arrangements for the certification of grant claims and other returns
 - provides a list of grant claims and other returns which external auditors are required to certify in 2018/19 under their audit appointment
 - considers the roles and responsibilities of Professional Support, grant-paying bodies, local government bodies, and appointed auditors
 - sets out the overall approach to be adopted by auditors
 - provides guidance on auditor reporting.
- 86.** Professional Support also separately publishes a technical guidance note on each significant approved claim to provide auditors with specific guidance on certifying that claim. The following have been published to date for 2018/19:
- [Auditor certification of the 2018/19 housing benefit subsidy claim - technical guidance note TGN/HBS/19](#)
 - [Auditor certification of the 2018/19 Bellwin scheme claims - technical guidance note TGN/BEL/19](#)
 - [Auditor certification of 2018/19 education maintenance allowances grant claim - technical guidance note TGN/EMA/19.](#)

Auditor action
Auditors should follow these technical guidance notes when reviewing and reporting on 2018/19 grant claims

Housing benefits

2018/19 HBAP modules

87. [The Department for Work and Pensions \(DWP\)](#) has issued the following modules of the Housing Benefit Assurance Process ([Housing Benefits Assurance Process \(HBAP\)](#)) approach to the certification of housing benefit (HB) subsidy claims for 2018/19:

- Module 3 comprises workbooks to be completed for detailed testing, incorporating a test result summary. A Helpfile has been provided separately providing guidance for each cell tested.
- Module 5 contains a control matrix that requires to be completed by auditors. The aim of this module is to ensure that subsidy claims have been completed using the correct software and that the HB system has been internally balanced in terms of benefit 'granted' and benefit 'paid'.

Other circulars

88. The DWP has issued the following adjudication circulars:

- [HB Circular A4/2019](#) provides details on the treatment of disguised remuneration schemes for HB purposes.
- [HB Circular A7/2019](#) provides details of a new 'basis of stay' rules being created for European Economic Area and Swiss nationals under the EU Settlement Scheme (EUSS), and the associated treatment for HB administration purposes.
- [HB Circular A8/2019](#) provides details of how the Windrush Compensation Scheme should be treated for HB administration purposes.
- [HB Circular A9/2019](#) provides clarification on changes to HB policy for mixed age couples which came into force from 15 May 2019. [HB Circular S5/2019 \(Revised\)](#) set out information on funding.

89. The DWP has also issued circulars [S4/2019](#), [S6/2019](#), [S7/2019](#), [S8/2019](#), [S9/2019](#) and [S10/2019](#) to announce funding for various new burdens in 2018/19 and 2019/20.

Non-domestic rates

2018/19 return

90. The Scottish Government has issued the 2018/19 return and accompanying guidance notes for non-domestic rates. The most significant changes from 2017/18 are summarised in the following table:

Line	Relief	Change
8	Fresh Start	Expanded from 50% to 100%, extended to all properties (except payday lending) and is now available to properties unoccupied for six months or more
10a and 11a	Charities and Sports Clubs	Separate analysis required for reliefs to Arm's-Length External Organisations
15	Hydro schemes	Removed from Transitional Relief and replaced under the Renewable Energy Relief scheme

Auditor action

Auditors should use these modules when reviewing 2018/19 subsidy claims

Line	Relief	Change
20	Day Nurseries	New
21	Business Growth Accelerator	New relief for new and improved properties that have been added to the valuation roll on or after 1 April 2018 and re occupied (separately identifying the relief paid in respect of occupied properties, from relief paid as unoccupied new build relief)
22	Unoccupied New Buildings	New relief for new and improved properties that have been added to the valuation roll on or after 1 April 2018 and are not yet occupied
23	Mobile Mast	Separate reporting now required

Whole of government accounts developments

2018/19 guidance

91. Treasury has issued [guidance](#) on preparing whole of government accounts returns for 2018/19. There are no significant changes from 2017/18.
92. Professional Support will shortly provide a technical guidance note for auditors.

Wider audit scope developments

Financial management

93. CIPFA has issued a [consultation draft](#) of a new Financial Management Code. The draft code is designed to support good practice in financial management and to assist local government bodies in demonstrating their financial sustainability. It is proposed that bodies be required to apply the requirements of the code with effect from 1 April 2020.
94. The draft code is based on a series of principles supported by specific standards and statements of practice which are considered necessary to provide the strong foundation to:
 - financially manage the short, medium and long term finances of a local government body
 - manage financial resilience to meet foreseen demands on services
 - financially manage unexpected shocks in their financial circumstances.
95. Rather than prescribing the financial management processes that local government bodies should adopt, the draft code requires that a body demonstrate that its processes satisfy the principles of good financial management for a body of its size, responsibilities and circumstances. The proposed underlying principles are set out in the following table:

The draft code is based on principles supported by standards and statements of practice

Area	Principle
Organisational leadership	Demonstrating a clear strategic direction based on a vision in which financial management is embedded into organisational culture
Accountability	Based on medium term financial planning which drives the annual budget process supported by effective risk management, quality supporting data and whole life costs

Area	Principle
Transparency	Financial management is undertaken with transparency at its core using consistent, meaningful and understandable data, reported frequently with evidence of periodic officer action and elected member decision-making
Professional standards	Adherence to professional standards is promoted by the leadership team and is evidenced
Assurance	Sources of assurance are recognised as an effective tool mainstreamed into financial management and includes political scrutiny and the results of external audit, internal audit and inspection
Sustainability	The long-term sustainability of local services is at the heart of all financial management process and is evidenced by prudent use of public resources

Guide to capital finance

96. CIPFA has issued an updated [Guide to Local Government Finance](#) which includes analysis of capital finance arrangements under the Prudential Code and explanations and definitions of:

- capital expenditure
- credit arrangements
- capital financing, including loans fund repayment arrangements and local authority borrowing.

97. It includes worked examples throughout to illustrate the practical application of theoretical concepts and extracts from the relevant legislation and the Prudential Code.

The guide includes analysis of capital finance arrangements under the Prudential Code

Summary of auditor actions in this section

Paragraphs	Auditor actions
7 - 8	Refer to the update to technical guidance note 2018/10(LG) when auditing the 2018/19 annual accounts of local government bodies
9 - 13	Use technical guidance note 2019/5(LG) when reporting the audit of the 2018/19 annual accounts and complete the relevant checklist
14 - 17	Carry out the actions set out at paragraph 16 in respect of inter-segment transactions and allocations
18 - 26	Carry out the actions set out at paragraph 26 in respect of capital receipts being used to fund transformation projects
30 - 36	Carry out the actions set out at paragraph 36 in respect of loans fund repayments
47 - 53	Carry out the actions set out at paragraph 52 in respect of earmarking unrealised gains in financial instruments
58 - 61	Carry out the actions set out at paragraph 61 in respect of GMP
62 - 66	Assess whether the accounting treatment/disclosure (e.g. contingent liability) in 2018/19 to reflect the McCloud judgement is appropriate

Paragraphs	Auditor actions
70 - 85	Assess whether bodies are making the necessary preparations to comply with the 2019/20 accounting code
86 - 87	Use the applicable technical guidance notes when reviewing and reporting on 2018/19 grant claims
88	Use the HBAP modules when reviewing 2018/19 subsidy claims

Contact points for this section

98. The contact points for this section of the technical bulletin are:

- Paul O'Brien, Senior Manager (Professional Support) - pobrien@audit-scotland.gov.uk
- Anne Cairns, Manager (Professional Support) – acairns@audit-scotland.gov.uk (grant claims items only).

Section 2

Central government sector

Financial statements developments

Leases - IFRS 16 application guidance

- 99.** [HM Treasury](#) has published [guidance](#) on applying IFRS 16 Leases to public bodies covered by the Government Financial Reporting Manual (FReM) from 2020/21. IFRS 16 sets out the principles for the recognition, measurement, presentation and disclosure of leases and will replace IAS 17 Leases and related interpretations.
- 100.** IFRS 16 introduces a single lessee accounting model that requires a lessee to recognise assets and liabilities for all leases (apart from specified exemptions). This will replace the dual lessee accounting model in IAS 17. At a high level, the IFRS 16 lessee accounting model treats leases in a similar way to finance leases under IAS 17.
- 101.** IFRS 16 retains the definition of a lease in IAS 17 (i.e. a contract that conveys the right to control the use of an identified asset for a period of time in exchange for consideration) but changes the application guidance around how to apply that definition. The most substantive change is around the concept of control used within the definition of a lease.
- 102.** In addition, the definition of a contract (and therefore, of a lease) is expanded to include:
- intra-UK government agreements that are not legally enforceable
 - agreements that have nil consideration.
- 103.** The guidance in IFRS 16 on the definition of a lease is only relevant for contracts that are entered into, or amended, after 1 April 2020. However, on transition, bodies are required to carry forward the assessments that were made in accordance with the requirements in IAS 17 and IFRIC 4.
- 104.** IFRS 16 provides two recognition and measurement exemptions that are to be applied in central government as follows:
- All bodies are required to apply the exemption for short-term leases (i.e. with a lease term of 12 months or less).
 - The exemption for leases where the underlying asset is of low value is optional for leases entered into from 1 April 2020 and undertaken on a lease-by-lease basis. However, the FReM mandates that there should be no adjustments made for leases of low-value asset leases on transition to IFRS 16.
- 105.** A lessee is required to recognise a right-of-use asset representing its right to use the underlying leased asset and a lease liability representing its obligation to make lease payments.
- 106.** An interpretation has been introduced in the FReM for the subsequent measurement of right-of-use assets. In most cases, the cost measurement model in IFRS 16 will be an appropriate proxy for current value in existing use

IFRS 16 applies from 2020/21

IFRS 16 introduces a single lessee accounting model

IAS 17 and IFRIC 1 assessments are carried forward on transition

IFRS 16 cost model to be used as a proxy for current value

or fair value. However, it will not be appropriate when both of the following conditions are met:

- A longer-term lease has no provisions to update lease payments for market conditions (such as rent reviews), or there is a significant period of time between those updates; and
- The fair value or current value in existing use of the underlying asset is likely to fluctuate significantly due to changes in market prices. This is more likely to be the case with property assets.

107. IFRS 16 includes an overarching disclosure objective that requires lessees to disclose information that enables a user to understand the effect that leases have on the financial position, financial performance and cash flows.

108. IFRS 16 has been interpreted so that bodies are required to recognise the cumulative effect of initially applying the standard at 1 April 2020 as an adjustment to taxpayers' equity. This should include the elimination of any revaluation reserves associated with existing finance leases.

Retrospective
restatement as
adjustment to
opening taxpayers'
equity

Employees in LGPS

109. Auditors of any bodies with employees who are members of the LGPS (or other affected schemes) should refer to paragraphs 55 to 67 of the local government section which cover:

- a report on actuaries from PWC
- an update on GMP
- guidance on the McCloud judgement.

Government financial reporting review

110. Treasury has published a document called [Government financial reporting review](#) to:

- share the results of its review of progress in government financial reporting since the Simplifying and Streamlining review in 2014
- respond to recommendations from a UK parliamentary committee to make the annual report and accounts more usable and understandable.

111. The parliamentary committee proposed that the four purposes of government financial reporting should be to:

- maintain and ensure the parliamentary control of government spending, enabling the Government to be accountable for its spending
- enable the public and researchers to understand and consider the value for money offered by public spending, so that they can make decisions about the effectiveness, efficiency and economy of particular policies or programmes
- provide a credible and accurate record which can be relied upon
- provide managers with the information they require to run the bodies efficiently and effectively.

Four proposed
purposes of
financial
reporting

112. In order to respond to the recommendations, the Treasury will:

- carry out a zero-based review of the FReM

- establish a bank of best practice examples
- engage with departments to share the findings of the review and support continuous improvement
- publish a map of the financial reporting landscape online and look for other ways to help users navigate financial reports
- carry out regular thematic reviews on specific issues in financial and performance reporting

113. Chapters 6 and 7 provide a detailed review of best practice and areas for improvement in government financial reporting. Chapter 8 highlights recommendations and actions to drive continuous improvement in government financial reporting.

Whole of government accounts developments

2018/19 guidance

- 114.** Treasury has issued [guidance](#) on preparing whole of government accounts returns for 2018/19. There are no significant changes from 2017/18.
- 115.** Professional Support will shortly provide a technical guidance note for auditors.

Contact point

- 116.** The main contact point for this section of the technical bulletin is Neil Cameron, Manager (Professional Support) – ncameron@audit-scotland.gov.uk.

Treasury to
carry out a zero-
based review of
the FReM

Section 3

Health sector

Auditing developments

Going concern conclusion

- 117.** Auditors have raised with Professional Support the issue of whether the receipt of brokerage by a health board calls into question the going concern basis of accounting and whether this has implications for the independent auditor's report.
- 118.** ISA (UK) 700 requires auditors to report in accordance with ISA (UK) 570 in respect of going concern. ISA (UK) 570 requires auditors to conclude on:
- the appropriateness of the board's use of the going concern basis of accounting
 - whether a material uncertainty exists about the board's ability to continue to adopt the going concern basis of accounting.
- 119.** [Technical guidance note 2019/3\(H\)](#) (paragraph 33) advises auditors that, while a health board may face financial sustainability issues, it is highly unlikely that there will be a material uncertainty regarding the use of the going concern basis of accounting or that it would not be considered appropriate. In assessing whether this may be the case, it also advises auditors to refer to the guidance on applying ISA (UK) 570 in [practice note 10](#).
- 120.** Practice note 10 (paragraphs 144 to 159) advises that the operational existence of a public sector body will not always cease as a result of an inability to finance its operations or of net liabilities. Cessation is most likely to result from a legislative change or a decision made by Parliament. The auditor should ascertain whether there is a known intention to abolish, transfer or privatise the activities of the audited body. If there is not, then the going concern basis of accounting is likely to remain appropriate.
- 121.** The FReM interprets the IAS 1 going concern basis of accounting for the public sector. Key extracts are as follows:
- “the anticipated continuation of the provision of a service in the future, as evidenced by inclusion of financial provision for that service in published documents, is normally sufficient evidence of going concern”
 - “entities whose statements of financial position show total net liabilities should prepare their financial statements on the going concern basis unless, after discussion with their sponsors, the going concern basis is deemed inappropriate”
- 122.** A health board in receipt of brokerage prepares financial plans demonstrating how it will return to financial balance. Health boards are required to prepare financial plans for three years, as a minimum, which are submitted to the Scottish Government.
- 123.** In accordance with the FReM interpretation, even where a particular health board ceased to exist, the functions that the health board delivered would still require to be provided under the National Health Scotland Act 1978.

Auditors are required to conclude on the appropriateness of the going concern basis of accounting

- 124.** In Professional Support's view, these expectations are sufficient for a health board in receipt of brokerage to satisfy the criteria set out in the FReM to continue to adopt the going concern basis of accounting. Brokerage therefore does not have any implications on the going concern conclusion in the independent auditor's report.
- 125.** However, auditors should consider the impact of brokerage on their wider scope conclusions on financial management and financial sustainability reported in the annual audit report.

Brokerage does not have implications for the going concern basis of accounting

Review of clinical negligence claims

- 126.** Professional Support has undertaken a review of the work carried out by the NHS Central Legal Office (CLO) relating to the Clinical Negligence and Other Risks Indemnity Scheme (CNORIS). The objective of the review was to establish the extent to which the information prepared using the work of the CLO, as a management expert under *ISA (UK) 500 Audit evidence*, can be used as audit evidence.
- 127.** Professional Support has also evaluated the appropriateness of the methodology adopted by the Scottish Government to establish the total national liability for CNORIS. The review focused on the estimation of the liability as at 31 March 2018 and identified an understatement of £6.321 million in relation to the national liability figures notified by Scottish Government. Following discussions with Scottish Government, they have confirmed that where adjustments are required to the amounts recognised in the financial statements, they would be in a position to amend boards' Annual Managed Expenditure (AME) allocations to provide budget cover, if required.
- 128.** Professional Support has provided auditors with the results of the above reviews.

£6.3 million understatement in national clinical negligence liability

Financial statements developments

Deferral of research and development income

- 129.** Auditors have asked Professional Support for a view on whether it is appropriate for research and development income received from pharmaceutical companies to be deferred. Under the accounts manual, deferred income represents an obligation where a future service is required to be performed before the income can be recognised.
- 130.** IFRS 15 Revenue from Contracts with Customers applies to this income from 2018/19, and requires bodies to follow five steps when recognising income. These steps include identifying the performance obligations in the contract and the transaction price. The transaction price is allocated to the performance obligations in the contract and income is recognised when (or as) the body satisfies a performance obligation.
- 131.** Professional Support has carried out a review of the contracts in place and confirmed that the board in question has performance obligations that it satisfies on a quarterly basis. It should recognise the income as these quarterly obligations are met. In Professional Support's view, the structure of the reviewed contracts make it unlikely that income would require to be deferred.

Research and development income should be recognised as performance obligations are satisfied

Contact point

- 132.** The main contact point for this section of the technical bulletin is Neil Cameron, Manager (Professional Support) – ncameron@audit-scotland.gov.uk.


Section 4

College sector

Non-financial statements developments

New good practice note on governance statements

133. Professional Support has published a [good practice note](#) to share the findings from a review of the governance statements in the 2017/18 annual report and accounts of colleges. Some issues for colleges to consider highlighted in the good practice note are set out in the following table:

 <p>Good practice note on improving the quality of college annual report and accounts Governance statements</p> <p>AUDITSCOTLAND Prepared for colleges and approved colleges 14 May 2018</p>	<p>Structure the statement in a way that allows a cohesive and clear narrative</p> <p>Include an action plan and progress on implementing previous year action plans</p> <p>Include a clear assessment of whether governance arrangements are fit for purpose</p> <p>Be sufficiently specific so that users can understand why risks are important, and describe the actions to mitigate the key risks</p> <p>Avoid using jargon, or explain it where it cannot be avoided</p>
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134. Colleges are encouraged to use the findings in this good practice note to assess and enhance their own 2018/19 governance statements.

Auditor General reports

2017/18 overview

135. The Auditor General has issued [Scotland's colleges 2019](#) to provide an overview of the further education sector in Scotland.
136. The report states that the sector remains financially stable and reported a small, but improved, underlying financial surplus in 2017/18. However, this sector-wide increase masks significant variations between colleges.
137. The report notes that, in calculating and reporting their underlying operating positions, colleges continue to interpret the accounts direction inconsistently. While the differences are small overall, they can be significant at an individual college level.
138. Fifteen colleges received funding from arm's-length foundations (ALFs) in 2017/18. Colleges have typically used income from ALFs to fund voluntary severance, capital works and investment in equipment and digital infrastructure. ALF balances vary significantly, with some colleges having little or no scope to access any ALF income. For the remainder of colleges, the ability to apply for income from ALFs is becoming increasingly limited as balances reduce.

Auditor action

Auditors should confirm that bodies have considered this good practice note

Inconsistent reporting of underlying operating position

Summary of auditor actions in this section

Paragraphs	Auditor action
130 - 131	Auditors should confirm that bodies have considered the good practice note on governance statements

Contact point

- 139.** The main contact point for this section of the technical bulletin is Helen Cobb, Senior Adviser (Professional Support) – Hcobb@audit-scotland.gov.uk.

Section 5

Professional matters

Auditing developments

Consultation paper on Kingman proposals

- 140.** The [Department for Business, Energy and Industrial Strategy](#) has issued a [consultation paper](#) to take forward the recommendations from the Kingman Review (explained at paragraph 125 of [technical bulletin 2019/1](#)).
- 141.** The UK Government welcomed the Kingman Review's recommendations to establish a new regulator called the Audit, Reporting and Governance Authority (ARGA). Taking some of the recommendations forward will require primary legislation, which the Government intends to introduce as soon as Parliamentary time allows.
- 142.** The consultation splits the various Kingman recommendations into three categories as set out in the following table:

Category	Examples of recommendations
1 Reforms to be taken forward immediately	<p>The publication of audit quality review reports on an anonymised basis</p> <p>Revisiting and strengthening audit quality review resourcing</p> <p>ARGA to promote brevity and comprehensibility in accounts and annual reports, engage meaningfully with users and asset owners about their information needs, and ensure the proportionality and value of reports</p> <p>ARGA to be more sparing and disciplined in promulgating guidance and discussion documents</p> <p>ARGA to develop a robust market intelligence function to identify emerging risks at an early stage</p>
2 Reforms to be delivered in advance of legislation but implementation choices to be considered	<p>ARGA to have a strategic objective to protect the interests of users of financial information</p> <p>The proposed new core functions for ARGA</p> <p>ARGA to be funded by a statutory levy rather than on a voluntary basis</p>
3 Reforms that require primary legislation and require deeper consideration and wider consultation	<p>To work towards a position where individual audit quality inspection reports, including gradings, are published in full upon completion of audit quality reviews</p> <p>The arrangements for local audit in England to be fundamentally rethought, with the role undertaken by a separate body</p> <p>Individual audit quality reviews in relation to the NAO to be shared with the relevant audit committee and Parliament, and published, and apply to all of the NAO's financial audits.</p>

- 143.** This consultation focuses on category 2 recommendations. For example, respondents are asked for comments on ARGA's proposed strategic objective:

Proposed strategic objective

“To protect the interests of users of financial information and the wider public interest by setting high standards of statutory audit, corporate reporting and corporate governance, and by holding to account the companies and professional advisers responsible for meeting those standards.”

144. The consultation asks for views on the category 3 recommendations but consultation on detailed proposals will follow.

Statutory audit services market study - final report

145. The [Competition and Markets Authority](#) has issued the [final report](#) on their market study into statutory audit in the private sector. The report follows discussion with stakeholders on the previous update (covered at paragraph 144 of [technical bulletin 2019/1](#)).

146. The report concludes that the market exhibits the following deep-seated problems:

- Audit committees are only a partial solution to the problem that companies select their own auditors.
- High concentration among four big audit firms, resulting in limited choice and a market that is not resilient.
- Audits being carried out by firms whose main business is not in audit.

147. The market, supported by the right regulation, should consistently reward high quality audits above all else, and penalise poor quality. The CMA's recommendations to address the issues identified are summarised in the following table:

The market should reward high quality audits and penalise low quality

Recommendation	Features
Audit committee scrutiny: Audit Committees should come under greater scrutiny by ARGA. This should include selection and oversight of auditors based on audit quality, while also mitigating any bias against non-Big Four firms.	<p>ARGA should:</p> <ul style="list-style-type: none"> • mandate minimum standards for the appointment and oversight of auditors • monitor compliance with these standards, including placing an observer on a committee if necessary • take remedial action where necessary, for example, by issuing public reprimands or making direct statements to shareholders.
Mandatory joint audit: FTSE 350 companies (unless exempt) to be jointly audited by at least two audit firms.	<ul style="list-style-type: none"> • At least one joint auditor should be a non-Big Four firm. • ARGAs should establish criteria on which companies should be exempted, covering the largest and most complex companies, and those with very simple single-entity accounts. • Any company should also be exempt if it appoints a non-Big Four firm as its sole auditor.
Peer reviews: Companies exempt from mandatory joint audit should instead be subject to periodic peer reviews commissioned by ARGAs.	<ul style="list-style-type: none"> • The peer reviewer should not generally be one of the Big Four. • These should be 'hot' reviews and should report to, and be accountable only to, ARGAs. • ARGAs should consider how to select peer review targets, either on rotation or incorporating an element of risk assessment, as is the case with its current quality reviews.

Recommendation	Features
<p>An operational split between the audit and non-audit practices of the Big Four: The Big Four to put in place a strong strategic and operational split between their audit and non-audit services practices, including separate governance and strategy, and separate accounts and remuneration policies.</p>	<ul style="list-style-type: none"> • No profit-sharing between the audit practice and the non-audit practice, with audit partner remuneration linked to the profits of the audit practice only. • Transparent transfer pricing, checked by ARGA, particularly for the use of non-audit specialists on audits. • ARGAs should be able to add other firms in later years.
<p>Review of progress: The regulator to set a specific point at which progress can be reviewed (e.g. five years from full implementation) and to assess the effectiveness of the overall package of remedies.</p>	<p>The review should consider in particular:</p> <ul style="list-style-type: none"> • the merits of moving to independent appointment of auditors • the possible need for a structural split between audit and non-audit services • how to fine tune joint audit to adapt to market developments.

Brydon Review call for views

148. The [Brydon Review](#) (explained at paragraph 148 of [technical bulletin 2019/1](#)) has issued a [paper](#) calling for views on the quality and effectiveness of audit. The review is examining the existing purpose, scope and quality of statutory audit in the UK, in order to determine:

- the needs and expectations of users of financial and non-financial corporate reporting
- how far the audit process and product may need to improve and evolve to meet the needs of users and to serve the wider public interest
- what specific changes to the statutory audit model and wider regulatory framework for audit may be needed
- whether other forms of business assurance should be developed or enhanced to enable stakeholders to assess better the future financial prospects and sustainability of companies.

149. The paper is requesting views on the extent of assurance that audit currently provides to the users of financial statements, and how it might develop to meet better those users' needs and to serve the interests of other stakeholders and the wider public interest. Many of the proposed changes are already features of public audit in Scotland. Some of the specific points are summarised in the following paragraphs.

Users

150. The paper asks:

- for whose benefit should audit be conducted
- whether the audit should be designed to enhance the degree of confidence of intended users in the company or just in the financial statements
- whether UK law should be amended to provide greater clarity regarding the purpose of an audit, and for whom it is conducted.

Review calls for views on quality and effectiveness of audit

Should legislation set out the purpose of an audit?

Wider assurance

151. The paper raises the need for independent assurance concerning the statements made by directors of companies. It discusses whether such assurance should all be delivered through:

- a statutory audit or one commissioned by shareholders; or
- the statutory audit might have two parts, with different liabilities attaching to the providers of the parts and possibly different requirements for independence.

Internal audit

152. The paper explores the interaction between internal and external audit. It notes that, while the international auditing standard allows internal audit to provide direct assistance to the external auditor, the UK standard specifically prohibits this.

Risk management and internal controls

153. The review asks whether:

- directors should make an explicit statement in respect of risk management and internal controls and, if so, should such a statement be subject to audit
- auditors' responsibilities regarding assessing the effectiveness of a company's system of internal control should be extended or clarified.

Should directors make an explicit statement on internal control that is subject to audit?

Unaudited information

154. The paper highlights that information published alongside the audited financial statements in annual reports is not generally subject to audit. Rather, the auditor is required to read it and identify whether the information is materially inconsistent with the financial statements or the auditor's knowledge obtained in the audit, or otherwise appears to be materially misstated.

155. The paper requests views on whether audit or assurance over information outside the annual financial statements (e.g. key performance indicators or non-financial metrics, payment practices or half-yearly reports) enhance its reliability and therefore be of benefit to users.

Should other information be audited?

Audit reporting

156. The paper notes that audit at the moment is largely a 'pass or fail test', and in practice a modified opinion is rare. The review is interested in views on possible models for published auditor reporting that may provide more meaningful insight and narrative, across the whole of the audit or perhaps on particular elements. It asks:

- what additional benefit might a switch from a binary audit opinion to a more graduated disclosure of auditor conclusions provide
- whether further narrative could be disclosed alongside the opinion to provide more informative insights.

Should there be a switch from a binary audit opinion to graduated reporting

Fraud

157. Auditors' responsibilities relating to fraud have been the subject of considerable debate over the years. Recent potentially fraudulent financial reporting practices have again attracted considerable attention which have given rise to renewed debate regarding the nature of auditors' responsibilities for detecting fraud and whether auditors are fulfilling these responsibilities in practice.

158. The paper requests views on whether:

- users' expectations of the role of auditors in fraud detection are consistent with the requirements in UK law and auditing standards
- auditors should be given greater responsibility to detect material fraud
- existing auditing standards help to engender an appropriate fraud detection mindset on the part of auditors
- it would be possible to devise a 'reasonable person' test in assessing the auditor's work in relation to fraud detection
- auditors should be required to evaluate and report on a company's systems to prevent and detect fraud.

Should auditors be given greater responsibility for detecting fraud?

Report on future of audit enquiry

159. The UK Parliament's [Business Energy and Industrial Strategy \(BEIS\) Committee](#) has issued a [report](#) on the future of audit. The report sets out the findings from the BEIS's recent inquiry into audit in the private sector which is intended to feed into the Brydon Review and the CMA market study.

The report feeds into the Brydon Review and CMA market study

160. The report includes a number of recommendations including the following:

- Auditors should state how they have investigated potential fraud.
- Audits of companies should be more forward-looking.
- Reporting graduated findings should be mandatory.
- The scope of audit should be extended to cover the entire annual report with different levels of assurance and reporting.
- There should be full legal separation of audit and non-audit services.
- There should be greater reporting on audit fees, potentially including the disclosure of audit hours, staff mix, and rate per hour. Auditors should also report instances where they have performed additional procedures but have been unsuccessful at increasing their fee.
- The potential independent appointment of auditors of companies should be considered with a view to developing it as a viable option if other remedies and reforms fail.
- Joint audits should be piloted in the upper reaches of the FTSE 100 in conjunction with a market cap for the rest of the FTSE 350
- Audit quality reports should be published in full, but not anonymised even in the first instance.
- Audit quality reviews should move beyond process-driven box ticking and offer a robust appraisal of the opinions offered and on the quality of the analysis and evidence used to drive those opinions. This should include reviewing what steps an audit had taken to identify fraud.
- The ARGA should inspect firms' audit software to ensure that it is sound and that the audit trail cannot be tampered with.

Mandatory graduated findings recommended

Scope of audit recommended to be extended to entire annual report

Full publication of audit quality reports recommended

Contact point

- 161.** The contact point for this section of the technical bulletin is Paul O'Brien, Senior Manager (Professional Support) - pobrien@audit-scotland.gov.uk.

Section 6

Fraud and irregularities

162. This chapter contains a summary of fraud cases and other irregularities facilitated by weaknesses in internal control at audited bodies that have recently been reported by auditors to Professional Support.

Expenditure

Social work direct payments

163. A council was defrauded of over £55,000 by recipients of social work direct payments over a six-year period.

Auditor action

Auditors should consider whether weaknesses in internal control which facilitated each fraud may exist in their bodies and take the appropriate action

Key features

Following an assessment of care needs for a social work client, relatives received direct payments to pay for the assessed care.

Subsequent checks on the use of the bank account were not undertaken in accordance with scheduled timescales. When a check was eventually carried out, it identified spending that was outwith the care identified in the care plan. The bank account was also being used for other purposes including funds being transferred to and from a personal bank account and cash withdrawals. The multiple uses of the account was in breach of the service agreement, which states that a bank account must be opened for the sole purpose of managing direct payment income and expenditure.

A direct payment option has been removed for this particular case and the frequency of checks of direct payment spending in all cases has been increased. A recent internal audit review has confirmed improved controls within direct payments, whilst highlighting further areas where improvements can be made. To date £50,000 has been repaid.

Change of bank details

164. A third party defrauded £5,000 from a public sector body by hacking into a staff email account and re-directing payments intended for legitimate suppliers.

Key features

A member of staff received an email, purporting to be from another staff member, containing an invoice where the bank details had been amended. This email was then passed through to finance and paid.

The fraud was identified when the genuine supplier sent a reminder invoice. Investigations then revealed that the staff email account had been hacked.

The fraud was possible as the established procedure to independently verify a change of bank details was not followed.

Income

Non-domestic rates income

165. A third party purporting to be a business owner made a non-domestic rates payment of £6,000 to a council using a stolen credit card and then subsequently requested a refund.

Key features

The perpetrator contacted the council and stated that they had leased commercial premises. The council amended their business rates records and created a liability for business rates. The perpetrator made a £6,000 payment but then reported that they had terminated the tenancy and requested that it be refunded.

A business rates employee reported the case as being suspicious. Inquiries established that the business was fictitious and that the payment had been made using a stolen credit card. It was also established that the perpetrator had undertaken similar scams with several councils in England.

The bank account to which the refund would have been, and other bank accounts related to the perpetrator, were 'red flagged' to the banks. A £6,000 refund was made to the bank associated with the stolen card. Guidance on the fraud vulnerabilities in the rates system has been produced and disseminated to all relevant employees.

Misappropriation of income and misuse of assets

166. Up to £500,000 of potential income was lost to a public body when employees used the body's assets for their own personal gain.

Key features

Employees used the body's vehicles to conduct unauthorised activities for cash payments during work hours.

The fraud was discovered when a member of the public and a whistle-blower both contacted the body to report their concerns regarding the employees' activities. An internal investigation identified the fraud was possible due to:

- too much flexibility given to the drivers in scheduling their work
- a lack of monitoring of the driver's activities and the vehicles' movements.

Four employees have left the body's employment as result of these activities. The body is currently assessing opportunities for recovery of the lost revenue. An action plan has been put in place to strengthen controls.

Payroll

Diversion of salary payments

167. A third party defrauded £2,000 from a public body by hacking staff email accounts to request changes to employee details.

Key features

The payroll team received instructions to change bank account details for two employees by email. The emails appeared genuine and, in both cases, a reply was given, and a further response received.

Payroll then paid the salary of the two employees into the new bank accounts. The fraud was uncovered when one of the employees alerted payroll about the non-payment of their salary. In one case, emailed payslips appear also to have been misdirected, revealing personal details.

The fraud was possible as payroll did not seek independent confirmation from the employee, either in person or on the phone, prior to making a change to their bank account details.

Contact point

- 168.** The contact point for this section of the technical bulletin is Anne Cairns, Manager (Professional Support) – acairns@audit-scotland.gov.uk.

Technical bulletin 2019/2

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Audit Scotland, 4th Floor, 102 West Port, Edinburgh, EH3 9DN
T: 0131 625 1500

Technical Bulletin

2019/3

Technical developments and emerging risks
from July to September 2019



 AUDIT SCOTLAND

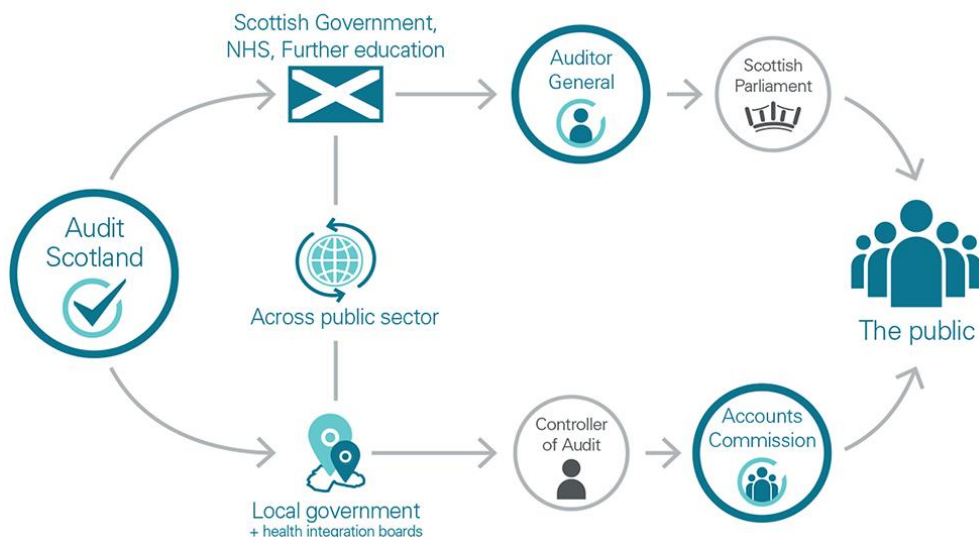
Prepared for appointed auditors and audited bodies in all sectors

10 September 2019

Who we are

The Auditor General, the Accounts Commission and Audit Scotland work together to deliver public audit in Scotland:

- The Auditor General is an independent crown appointment, made on the recommendation of the Scottish Parliament, to audit the Scottish Government, NHS and other bodies and report to Parliament on their financial health and performance.
- The Accounts Commission is an independent public body appointed by Scottish ministers to hold local government to account. The Controller of Audit is an independent post established by statute, with powers to report directly to the Commission on the audit of local government.
- Audit Scotland is governed by a board, consisting of the Auditor General, the chair of the Accounts Commission, a non-executive board chair, and two non-executive members appointed by the Scottish Commission for Public Audit, a commission of the Scottish Parliament.



About us

Our vision is to be a world-class audit organisation that improves the use of public money.

Through our work for the Auditor General and the Accounts Commission, we provide independent assurance to the people of Scotland that public money is spent properly and provides value. We aim to achieve this by:

- carrying out relevant and timely audits of the way the public sector manages and spends money
- reporting our findings and conclusions in public
- identifying risks, making clear and relevant recommendations.

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Introduction

Purpose

1. The purpose of Technical Bulletins from Audit Scotland's Professional Support is to provide auditors appointed by the Auditor General and Accounts Commission with:
 - information on the main technical developments in each sector and on professional matters during the quarter
 - guidance on any emerging risks identified in the quarter.
2. The information on technical developments is aimed at highlighting the key points that Professional Support considers appointed auditors require to be aware of. It may still be necessary for auditors to read the source material if greater detail is required. These can be accessed by using the hyperlinks, where provided. They are also available to appointed auditors from the Technical Reference Library maintained by Professional Support.
3. The actions by auditors recommended by Professional Support in respect of each item are highlighted in red and are also summarised at the end of each section.
4. Technical Bulletins are also published on the Audit Scotland [website](#) and therefore are available to audited bodies and other stakeholders.

Technical Bulletins provide information on developments and guidance on emerging risks

Highlights summary

5. Particular attention is drawn to nine items in this Technical Bulletin in the following table:

Highlights summary		
Professional Support has provided advice to auditors on matters arising from the audit of 2018/19 local government Annual Accounts [see paragraph 7]	CIPFA/LASAAC has issued a consultation paper on the 2020/21 accounting code [see paragraph 9]	Professional Support has published guidance on auditing the 2018/19 Annual Report and Accounts of colleges [see paragraph 24]
Professional Support has published model 2018/19 Independent Auditor's Report for colleges [see paragraph 27]	The SFC has issued the 2018/19 Accounts Direction for colleges [see paragraph 32]	The SFC has issued guidance on colleges' 2018/19 financial statement [see paragraph 37]
Professional Support has published guidance on reviewing 2018/19 WGA returns [see paragraph 43]	The FRC has issued proposed revisions to auditing standards [see paragraph 46]	The IASB has issued proposed amendments in respect of accounting policies [see paragraph 56]

Contact point

6. The main contact point for this technical bulletin is Paul O'Brien, Senior Manager (Professional Support) – pobrien@audit-scotland.gov.uk.

Feedback on this technical bulletin is welcome

Section 1

Local government sector

Advice provided to auditors on 2018/19 Annual Accounts

7. The following table summarises a selection of requests for technical advice recently made by auditors to Professional Support in respect of the audit of the 2018/19 Annual Accounts, along with the advice offered.

Auditor action

Auditors should consider the application of this advice to their own audits

Property, plant and equipment

Question from auditor	Advice from Professional Support
<p>There is a substantial increase in the value of school property following the five-yearly revaluation. This is partially due to the council changing to an internal valuer who has adopted a different valuation method in respect of obsolescence.</p> <p>How should this increase be treated?</p>	<p>The council should be able to demonstrate that the new valuation method is more appropriate. If it can do so, it is a case of adequately disclosing that judgement and the nature of the change. If the council cannot demonstrate that the change results in a more accurate estimate, auditors should consider whether the change is arbitrary. ISA (UK) 540 states that arbitrary changes result in inconsistent financial statements over time and may give rise to a misstatement or be an indicator of possible management bias.</p> <p>Given the magnitude of the increase, it would be reasonable to expect the council to appoint an external valuer to review the revaluation on a sample basis.</p> <p>If there is still a substantial increase from the previous year not explained by the change in methodology, this would indicate that the five year interval between valuations is too long. Paragraph 4.1.2.37 of the Code of Practice on Local Authority Accounting in the UK (the accounting code) requires revaluation to be made with sufficient regularity to ensure that the carrying amount does not differ materially from the current value at the year end. Five years is the maximum interval but assets must be revalued more regularly where that interval does not keep pace with material changes in asset value. The failure to revalue at a more appropriate interval may indicate that the carrying amount in previous years was understated and an element of the increase should be treated as correcting that understatement (by adjusting the opening balance and comparatives) rather than treating it all as an increase since last year.</p>
<p>The council has made a capital contribution to the construction of a trunk road. Part of the contribution was funded from borrowing. The council has benefitted from enhancements to its own local roads, and has treated the whole contribution as an asset under construction. Is that treatment correct?</p>	<p>The substance of the transaction is that the council has made a contribution towards the cost of a third party asset. The full amount should have been accounted for as revenue expenditure in the Comprehensive Income and Expenditure Statement (CIES) as incurred with the element funded by borrowing transferred from the Capital Adjustment Account in the Movement in Reserves Statement (MiRS).</p> <p>The acquisition of enhanced roads etc was ancillary to the money spent and should be accounted for as a donated asset. Donated assets should be recognised in the CIES at fair value, with a transfer to the Capital Adjustment Account in the MiRS.</p> <p>Assets under construction is therefore not an appropriate treatment for any element of the contribution.</p>

Question from auditor	Advice from Professional Support
<p>The council has changed from expensing to capitalising borrowing costs incurred while assets are under construction. Is this permissible and should it be treated as a change in accounting policy?</p>	<p>The accounting code allows bodies to select an accounting policy of capitalising borrowing costs on an asset that necessarily takes a substantial period of time to get ready for its intended use or sale. This is an accounting policy choice and moving from expensing to capitalising borrowing costs is a change in accounting policy.</p> <p>As with all changes in accounting policy, unless required to do so by the accounting code, the council can change policy only if it will result in more relevant or reliable information. The change in policy will require to be applied retrospectively and therefore borrowing costs on completed projects will require to be capitalised where material.</p> <p>Under the accounting code, borrowing costs can be capitalised only if they are directly attributable to the construction of an asset. The borrowing does not have to be specifically for the asset construction; the costs of general borrowing used to construct an asset can also be capitalised. If the council has not used borrowing to fund the construction of the asset in the period, there are clearly no borrowing costs that are directly attributable, and therefore a policy of capitalisation would not be appropriate.</p> <p>If the council does change its policy, and it is appropriate to do so, it will need to make the disclosures required by the code for accounting policy changes (paragraph 3.3.4.2), and for capitalised borrowing costs (paragraph 4.8.4.2).</p>

Retirement benefits

Question from auditor	Advice from Professional Support
<p>What is the impact of the Supreme Court ruling on how councils should account for the impact of the McCloud Judgement?</p>	<p>Paragraph 62 of Technical Bulletin 2019/2 advised that actuaries were not proposing to make any allowance for the McCloud Judgements because of uncertainty around an appeal by the UK Government. The expected treatment was the disclosure of a contingent liability. The Supreme Court ruling that the UK Government had no grounds to appeal the McCloud Judgement removes that uncertainty, and therefore a liability should be recognised for the requirement to compensate certain members for any discrimination suffered as a result of the transitional protections.</p> <p>The nature of the remedy is not yet known. However, the Government Actuary Department's (GAD) report referred to at paragraph 63 of Technical Bulletin 2019/2 has been issued following its review of the Local Government Pension Scheme (LGPS) in England and Wales which provides an assessment of the potential financial impact. For example, based on an earnings increase of CPI (2.3%) plus 1.5%, the report estimates a potential impact of 3.2% of active scheme liabilities. Actuaries are using this report to re-calculate pension liabilities at an employer level.</p>
<p>Where the actuary can provide an estimate of the Guaranteed Minimum Pension (GMP) liability, should this be recognised?</p>	<p>Paragraphs 57 to 60 of Technical Bulletin 2019/2 provided an update on GMP. The Government's 'interim solution' for funding inflationary increases for GMP applies for schemes members retiring between 6 April 2016 and 6 April 2021. Where an actuary has provided a council with liability information that reflects GMP, auditors should expect the council to recognise that liability. The estimated impact of the 'interim solution' is 0.1% of liabilities. Where the actuary has not provided the information, auditors should compare the expected impact with their own materiality levels.</p> <p>There remains uncertainty around the long term solution for members reaching pension age after 6 April 2021, and therefore actuaries are generally not making any allowance in their figures for this aspect. Due to the level of uncertainty, and the consequent difficulties in arriving at a reliable estimate, it is expected that the disclosure of a contingent liability would be the appropriate treatment.</p>

Financial instruments

Question from auditor	Advice from Professional Support
<p>Should a loan to a registered social landlord (RSL) at a prescribed rate lower than the market rate be accounted for as a soft loan?</p>	<p>Soft loans are lending made at below prevailing market rates. The fair value of a soft loan does not equal the consideration given as it needs to reflect that the contractual interest rate is lower than the market rate.</p> <p>The consent for lending to RSLs does not prescribe an interest rate for the loans. It sets out cases where the rate must be equal to or higher than the rate set by the EU to ensure the loan does not provide state aid. That minimum does not apply where the lending supports innovative investment models.</p> <p>Where the interest rate on a loan to an RSL is below the prevailing market rates (as defined in the accounting code), it should be accounted for as a soft loan.</p>
<p>In previous years, the council has had specific bad debt provisions and a general bad debt provision. It no longer has a general bad debt provision in 2018/19 – should it?</p>	<p>The previous terminology of ‘bad debt provisions’ was replaced with ‘impairment of financial assets’ when IAS 39 was implemented in 2007/08. IFRS 9 replaces IAS 39 from 2018/19 and introduces a new ‘expected credit loss’ model for the recognition of impairment losses. This represents a change from the previous IAS 39 ‘incurred loss’ model.</p> <p>IFRS 9 allows a collective assessment of credit risks for groups of financial assets where reasonable and supportable information is not available for individual assets without undue cost or effort, provided the grouped assets share similar characteristics.</p> <p>IFRS 9 allows practical expedients to be used when measuring losses. The example given in the standard is the use of a matrix for trade receivables which calculates a fixed rate based on the number of days that a receivable is past due, assessed on the basis of historical experience adjusted (if necessary) to reflect current conditions and forecasts of future conditions.</p>
<p>The council is unsure whether it has any ‘modified loans’ but has not had any loan restructuring since 1 April 2007. Does the new treatment of modified loans under IFRS 9 apply to loan exchanges prior to 1 April 2007?</p>	<p>IFRS 9 requires the carrying amount of modified loans to be recalculated by discounting the modified contractual cash flows by the original effective interest rate.</p> <p>The issue is relevant for any council that accounted for a loan exchange by modifying the existing loan (as opposed to extinguishing the existing loan and recognising the replacement loan). The main impact is that any premium is recognised as expenditure immediately for an extinguished loan, whereas for a modified loan the expenditure is spread over the remaining life of the loan. The change for 2018/19 is that IFRS 9 requires the carrying amount of the modified loan to be recalculated.</p> <p>This relates to any modified loan still in the balance sheet at 1 April 2018 (regardless of whether the loan exchange took place before 1 April 2007). The 1 April 2007 date is only relevant in so far as that is the date that financial instrument standards were first implemented. As part of the transitional arrangements, there was no need to reconsider recognition and derecognition decisions made before 1 April 2006. That continues to apply under IFRS 9. The date is also relevant because there is a difference in the calculation of the annual charge of premiums to the General Fund between those held at 31 March 2007 and those arising from 1 April 2007.</p> <p>Most councils in Scotland did not go through the process of identifying whether the criteria for treating loans as being modified were met at 31 March 2007 as the effect of the statutory guidance on extinguished loans meant there was no difference as far as the impact on the General Fund is concerned (i.e. the charge to the General Fund is spread under both treatments).</p>

Question from auditor	Advice from Professional Support
<p>The council recognises the amortisation of premiums as a charge each year in the CIES. They do not want to charge the amortisation directly to the General Fund as direct reserve accounting is not allowed. Is this correct?</p>	<p>The annual amortisation for the premium should result in a debit to the General Fund and a credit to the Financial Instruments Adjustment Account (FIAA). This spreads the charge that should have been made to the FIAA in the year the premium was originally incurred. The premium should have been recognised as expenditure in the CIES in that year; there should therefore not be an annual charge to the CIES.</p> <p>Direct reserve accounting is not permitted. However, direct reserve accounting means charging expenditure directly to a reserve (e.g. debiting the Renewals and Repair Fund with expenditure on repairs, rather than charging it to the CIES and transferring an equivalent amount from the renewals and repairs fund to the General Fund in the MiRS). The entry for premiums is not direct reserve accounting as the expenditure was previously correctly charged to the CIES. These entries are reserve transfers/statutory adjustments to spread the cost to the General Fund.</p>

Internal transactions

Question from auditor	Advice from Professional Support
<p>As transactions between segments are no longer permitted in the CIES, does that mean that all internally provided services should be removed from the CIES and the Expenditure and Funding Analysis (EFA)?</p>	<p>The requirement that was implemented in 2016/17 for the CIES to meet IFRS 8 segmental reporting requirements has been removed from 2018/19. This included reporting the impact of internal trading whereby one segment charged another segment (with the charge including a 'profit' element) for the provision of a service in the CIES; the provider segment recognised the income and the other segment recognised the expenditure. The removal of the requirement means that any such transactions between segments are no longer permissible in the CIES, i.e. they should not be included in income and expenditure in service segments.</p> <p>As explained at para 15 of Technical Bulletin 2019/2, the change does not preclude bodies from recording inter-segment transactions for internal management purposes. The transactions should be included in column 1 of the EFA to meet IFRS 8 requirements, but be removed in column 2 so that they are not included in column 3 (i.e. the CIES amounts).</p> <p>It is important to note that the internal transactions outlined above are distinct from the re-allocation of underlying expenditure from one segment to another which continues to be allowed and should be reflected in the CIES. This should be accounted for as an increase in the expenditure of the segment that consumed the resources and the reduction in the expenditure (rather than increase in income) of the segment which initially procured the resources.</p>
<p>The council presented a separate line in CIES to eliminate segmental transactions in 2017/18. For 2018/19, the line has been removed from the CIES. Do they need to show a prior year adjustment for this?</p>	<p>Retrospective application of the above change is required. Councils should therefore restate 2017/18 comparatives to remove segmental transactions from income and expenditure. The 'elimination line' is therefore not needed in 2018/19 and should also be removed from the 2017/18 comparatives.</p>

Grant income

Question from auditor	Advice from Professional Support
<p>The council do not want to carry forward unspent Pupil Equity Funding (PEF) grant at the year end because there is a condition in the offer letter which requires repayment and also because the council does not control the expenditure. What is the appropriate treatment?</p>	<p>In normal circumstances, a condition that unspent grant requires to be repaid would result in the unspent element being recognised as a creditor at the year end. However, in this case the operational guidance for PEF states that unspent grant can be carried forward. This would suggest that the repayment condition will not be enforced in practice. Unless there is evidence that the Scottish Government will require repayment (e.g. they did so last year), it would be reasonable to recognise the unspent element as income in 2018/19.</p> <p>Although responsibility for spending the grant has been delegated to head teachers, schools are not third parties, and it is still part of the council's education income and expenditure. However, as there are restrictions on the use of the PEF grant, the unspent element should be treated as an earmarked part of the General Fund.</p>
<p>The council has recognised a debtor and accrued income for European Social Fund (ESF) grant from Scottish Government. However, it has also disclosed the ESF grant as a contingent asset. Is this correct?</p>	<p>Debtors are assets which should be recognised when the recognition criteria have been met. A contingent asset is a possible asset the existence of which will be confirmed by a future event. Contingent assets are disclosed in the notes but not recognised in the balance sheet. It is therefore not possible for the same item to be both a debtor and a contingent asset.</p> <p>The council need to consider whether receipt of the funding is expected (and recognise a debtor) or whether it is uncertain (derecognise the debtor and income, and disclose the contingent assets instead).</p>
<p>The body receives capital grant from a third party. Although the conditions require repayment of unspent grant, the paying body has waived that requirement in previous years. However, the paying body advised after 31 March 2019 that unspent grant is to be repaid. Is this an adjusting event after the reporting period?</p>	<p>Paragraph 82 of the Overview Module of Technical Guidance Note 2018/10(LG) includes in the list of examples of adjusting events changes in grant entitlement other than those caused by a change in grant conditions after the year-end.</p> <p>In this case, the grant conditions require repayment of unspent grant but in previous years this has not been enforced. However, the paying agency has decided to enforce that condition for 2018/19. This does not therefore represent a change in conditions.</p> <p>The notification after 31 March 2019 from the paying body of the requirement to repay provides evidence of conditions that existed at that date and is therefore an adjusting event. Any reliable, available information that is not adjusted for represents a misstatement. The body should therefore recognise a creditor at 31 March 2019 for the unspent grant.</p>
<p>How should an unspent contribution from a developer be treated at the year end?</p>	<p>If there are conditions that could lead to the contribution being returned that are not yet satisfied it should be recognised in the Grants Received in Advance Account. If there are no such unsatisfied conditions, the contribution should be recognised as income, and credited to the Comprehensive Income and Expenditure Statements (included in the Taxation and Non-Specific Grant Income line). As the contribution was unspent at the year end, there should be a statutory adjustment that debits the General Fund and credits the Capital Grants and Receipts Unapplied Account.</p>

Statutory trading operations

Question from auditor	Advice from Professional Support
<p>How should income and expenditure of a trading operation be reflected in the CIES?</p>	<p>Where a trading account is maintained for a trading operation, they are essentially memorandum accounts. Income and expenditure relating to the delivery of local government services requires to be included in the cost of that service in the CIES in the normal way.</p>

Question from auditor	Advice from Professional Support
Are statutory services or services provided internally subject to the prescribed financial objective to break even over 3 years?	No. Only discretionary activities provided to external customers are subject to the prescribed financial objective and therefore require, where significant, a trading account to be maintained.
Can a body choose to maintain and disclose a trading account even if not required?	There is nothing to prevent a body from voluntarily maintaining a trading account. However, if included in the accounts, it is recommended that they be disclosed separately from the trading accounts to which the prescribed financial objective applies.

Housing Revenue Account

Question from auditor	Advice from Professional Support
The council has netted off the void rent loss against the dwelling rent income figure in the Housing Revenue Account (HRA). Is this netting off correct and if not where should they include this figure?	Schedule 15 of the Housing (Scotland) Act 1987 sets out the statutory debits and credits for the HRA. It requires the HRA to be credited with the income from standard rents and debited with any income receivable from any houses during any period for which they were not let (i.e. void rents). These two amounts should be shown gross as there is no general right to net off items. Any income lost to voids should be treated as expenditure rather than being netted off income.
The council is using income from council tax on second homes to fund new build affordable housing. In previous years, it has treated this as a reserve transfer to the HRA. This year it is treating it as income in the HRA. Which treatment is better?	<p>Statutory credits to the HRA include any income receivable for that year, relating to expenditure debited to the HRA. Expenditure that can be debited to the HRA is also set out in the 1987 Act and includes loans charges, repairs and maintenance, rent arrears etc. Guidance from the Scottish Government on the use of council tax on second homes does not appear to allow the council tax income to be spent on these areas so that does not apply.</p> <p>Crediting the HRA with a contribution from the General Fund is explicitly not allowed by the 1987 Act, without consent from the Scottish Ministers. Provided consent has been obtained, the previous treatment of treating the contribution as a reserve movement from the General Fund to the HRA would appear to be the most appropriate.</p>

Disclosures

Question from auditor	Advice from Professional Support
What information should be disclosed to meet the new disclosure requirements in respect of debtors for local taxation?	<p>The accounting code was amended to require the following information to be disclosed in respect of council tax:</p> <p>a) An analysis of the age of the assets that are past due at the year end but not impaired.</p> <p>b) An analysis of the assets that are individually determined to be impaired at the year end, including the factors the body considered in determining that they are impaired.</p> <p>Page 462 of the guidance notes to the accounting code provides an example of disclosure a). CIPFA bulletin 3 suggests that clarification be added that the disclosure applies to balances where no impairment is required. There is no specific guidance on disclosure b) and therefore, if applicable, the information disclosed will depend on each body's judgment.</p>

Question from auditor	Advice from Professional Support
<p>What is meant by paragraph 3.4.2.101 of the accounting code which requires the disclosure of a segmental analysis of items that are included in column 1a) of the EFA.</p>	<p>Paragraph 3.4.2.101 requires a segmental analysis to be disclosed in the financial statements for any items listed at that paragraph that are reported internally to management (and therefore included in column 1a of the EFA).</p> <p>For the majority of local government bodies, the most likely item that this will be relevant to is revenues from external customers. This is reflected in the example financial statements on page 422 of the guidance notes to the accounting code. There is also an example in the good practice note on the EFA analysis from Professional Support at Exhibit 12.</p> <p>It is unlikely that the requirement will apply to many of the other items, but where they are reported internally the relevant disclosure would need to be made.</p>
<p>What should be included in a council's disclosures around judgements and estimates?</p>	<p>Paragraph 3.4.2.88 of the accounting code requires disclosure of the judgements made in applying the accounting policies that have the most significant effect on the amounts recognised in the financial statements. The aim of the disclosure is to highlight significant areas where others may have formed different judgements and provide justification for the view taken. Examples of such judgements include whether an item should be recognised as a provision or disclosed as a contingent liability, and judgments on appropriate valuation techniques.</p> <p>Paragraph 3.4.2.90 of the accounting code requires the disclosure of assumptions, and other major sources of estimation uncertainty, that have a significant risk of resulting in a material adjustment within the next financial year. Estimation uncertainty disclosures deal with situations where a body has incomplete or imperfect information which will only be enhanced as a result of future events.</p> <p>The disclosure should focus on assets and liabilities whose carrying amount relies on estimates where there is a risk that correction or re-estimation may be required in 2019/20. The disclosure should explain where the body's view sits within a range of outcomes to enable users to evaluate the possible effects of estimates on future accounts. For 2018/19 such disclosures could reasonably be expected in respect of the McCloud Judgement and GMP issues.</p> <p>These disclosures are not required for assets and liabilities measured at fair value based on a quoted price in an active market. Although these fair values might change materially within the next financial year they would not arise from assumptions or other sources of estimation uncertainty.</p>
<p>Is the level of external borrowing directly related to the Capital Financing Requirement (CFR)?</p>	<p>The CFR is a concept under the Prudential Code for Capital Finance in Local Authorities. It is basically the underlying need to finance capital expenditure (by borrowing or other means) in the future. It is used to ensure that debt will only be for a capital purpose so the council should ensure that gross external debt does not exceed the CFR. The construction of CFR is set out in the prudential code but in summary it is calculated by taking the figures from the Balance Sheet for:</p> <ul style="list-style-type: none"> • Capital expenditure (property, plant and equipment; investment properties; intangible assets etc) • Less the balance on the revaluation reserve (as it is only the cost of the assets that require to be financed not the value) • Less the balance on the Capital Adjustment Account (as that equates to the capital expenditure that has already been financed) <p>External borrowing is therefore not directly connected to the CFR. For example, using capital reserves or capital grants during the year to finance capital expenditure will reduce the CFR but will not have any impact on borrowing levels.</p>

Question from auditor	Advice from Professional Support
<p>Are councils required to disclose the salaries, allowances and expenses of members in the Remuneration Report?</p>	<p>Paragraph 3.4.4.1 of the accounting code requires the information on members' salaries, allowances and expenses to be disclosed as a note to the accounts. Some councils choose to instead make the disclosure in the Remuneration Report rather than a note. In Professional Support's view, this meets the requirement of the accounting code and should be permitted.</p> <p>Where the disclosure is included within the Remuneration Report, it is covered by the opinion on the Remuneration Report and should therefore be in the audited part.</p>
<p>Is the analysis of debtors and creditors over public sector bodies required in 2018/19?</p>	<p>The requirement to disclose debtors and creditors analysed over public sector bodies has been removed from 2018/19.</p> <p>Instead, paragraph 3.4.2.63 of the accounting code requires bodies to either present on the face of the Balance Sheet or disclose in the notes, sub-classifications of debtors and creditors, e.g. for creditors this could be amounts payable to trade suppliers, related parties, and other amounts.</p>

Remuneration report

Question from auditor	Advice from Professional Support
<p>Where a council employee receives an exit package in excess of £150,000, should they be named in the Remuneration Report where there is a confidentiality agreement in place?</p>	<p>There is a requirement to disclose the number and cost of all exit packages. Individuals are not named.</p> <p>However, there is also a requirement to disclose the remuneration of a 'relevant person' as defined by The Local Authority Accounts (Scotland) Regulations 2014 (the accounts regulations), and those individuals do require to be named. The definition of 'relevant persons' includes an individual whose annual remuneration is in excess of £150,000. An element of that annual remuneration is compensation for loss of office. An individual with an exit package greater than £150,000 would require therefore to be named.</p> <p>The existence of a confidentiality agreement does not impact on the disclosure requirement. Finance circular 8/2011 explains that where a contractual confidentiality agreement existed which was agreed prior to 7 February 2011, no information in respect of that person required to be provided for 2010/11. However, the disclosure requirements apply from 2011/12 regardless of any agreement.</p>
<p>Should the disclosure of remuneration analysed by pay band include any taxable expenses?</p>	<p>The accounts regulations provide a definition of remuneration which includes not only salary but also sums paid by way of taxable expenses allowance. This definition applies to the remuneration tables for 'relevant persons' as well as to the pay band disclosure.</p>

Management Commentary

Question from auditor	Advice from Professional Support
<p>The council's CIES shows a deficit, but the reference to financial performance in the Management Commentary reports a surplus. Does this represent a misstatement?</p>	<p>If the reference in the Management Commentary is intended to refer to the CIES performance, this inconsistency means there is a misstatement. However, councils often focus in the Management Commentary on the movement in the General Fund which could legitimately show a surplus while there is a deficit in the CIES due to the impact of statutory adjustments. In that case, the Management Commentary should explicitly state that, to avoid misleading users. Auditors should consider whether the misstatement is material (e.g. would users be influenced by its effects?), and if so request that it be corrected (e.g. by adding a clear explanation). Uncorrected material misstatements should result in a qualified opinion on the Management Commentary and be reported in the Independent Auditor's Report.</p>

Question from auditor	Advice from Professional Support
<p>The council's Management Commentary does not include financial key performance indicators. There is a hyperlink to a document containing all the performance indicators. Is that acceptable?</p>	<p>Appendix 2 in Module 10 of Technical Guidance Note 2018/10(LG) provides a checklist of all the items that the statutory guidance requires to be included in the Management Commentary. Any omission of an item on the checklist is non-compliance with the statutory guidance which represents a misstatement.</p> <p>Required items include a review of the body's business including an analysis using financial key performance indicators. A hyperlink to another document is not sufficient to meet this requirement. Where judged to be material, if uncorrected, this misstatement should result in a qualified opinion on the Management Commentary and be reported in the Independent Auditor's Report.</p>
<p>The council have not included a reference in the Management Commentary to the Annual Strategy and Annual Report on treasury management because this is not a requirement of the statutory guidance in Finance Circular 5/2015. Is this acceptable?</p>	<p>Statutory guidance for the Management Commentary is in the main set out in Finance Circular 5/2015 but there is also one requirement in Finance Circular 7/2016. The latter circular requires at paragraph 69 that the Management Commentary should refer to the Annual Strategy and Annual Report which provides detailed information, and narrative, on the council's capital investment plans, treasury management (borrowing and investments), prudential indicators and loans fund liabilities.</p> <p>The failure to include the required reference is a misstatement. If considered material, this should be reported in the Independent Auditor's Report and result in a qualified opinion on the Management Commentary.</p>

Miscellaneous

Question from auditor	Advice from Professional Support
<p>The Leader of the Council will be absent when the accounts are due to be signed. What should the council do?</p>	<p>Regulation 10(3) of the accounts regulations requires the Leader of the Council to sign the Management Commentary, Statement of Responsibilities, Annual Governance Statement and Remuneration Report. The accounts regulations allow another person to be nominated to sign where a body does not have a Leader of the Council. They also allow another officer to be nominated when the section 95 officer is unable to sign. However, there are no explicit provisions if the Leader of the Council is simply not available to sign, and the council is responsible for ensuring it can meet this statutory responsibility. If the Leader's absence is unavoidable, it may be acceptable on the grounds of pragmatism for the council to nominate another person to sign the accounts. However, auditors should report this failure to comply with the accounts regulations in the Annual Audit Report.</p>
<p>The council describe the 'bottom line' on the CIES as 'Total Comprehensive Income and Expenditure' which means it is not clear whether there is a net income or net expenditure overall. What terminology should they use?</p>	<p>The accounting code requires the CIES to total to Total Comprehensive Income and Expenditure so the terminology used by the council is correct. It should be clear from the signage (brackets) and narrative used elsewhere whether that represents a net income or net expenditure position. The bracket in the line narrative should be consistent with the presentation of the figures in the CIES.</p>
<p>Should the unaudited Annual Accounts be removed from the website at the end of the inspection period?</p>	<p>Regulation 8(8) of the accounts regulations requires the unaudited Annual Accounts to remain on the website until the audited versions are published.</p> <p>Auditors should report any non-compliance with this requirement in the Annual Audit Report.</p>

Question from auditor	Advice from Professional Support
Should the council recognise an impairment for 'expected loss' due to successful non-domestic rates (NDR) appeals prior to the date the accounts are authorised for issue?	<p>An allowance for impairment should be recognised in the Non-Domestic Rate Income Account. NDR debtors are not subject to the new 'expected loss' model for impairment introduced by IFRS 9, and impairment should continue to be recognised on the same basis as previous years.</p> <p>However, finding out about the outcome of appeals before the authorised for issue date provides information in respect of NDR debtors that will be uncollectable. Uncollectable debt written off should also be recognised in the Non-Domestic Rate Income Account. The information on the outcome of appeals should be treated as an adjusting event after the year end that requires to be reflected in the amount recognised for uncollectable debt written off.</p>
The integration joint board (IJB) has two segments presented in the CIES, i.e. health services and social care services. Does this level of analysis satisfy the reporting requirements?	<p>The analysis of service segments in the CIES should follow the segmental structure used in the EFA. The service segments in the EFA should be based on the organisational structure used by the IJB for reporting performance internally to the board for it to consider the allocation of financial resources. Consequently, the number of segments presented in the CIES are determined based on each IJB's arrangements. However, it would seem unlikely that the board is not provided with a more detailed analysis than two high level segments.</p> <p>It may be that the IJB has aggregated a number of segments. This is permitted where segments are similar in terms of economic characteristics, nature and type of service recipient. However, the IJB should consider whether aggregating the number of segments down to two provides users of the accounts with sufficient information to meet their needs.</p>

8. Auditors should send any further enquiries to TechnicalQueries-LocalGovernment@audit-scotland.gov.uk.

Financial statements developments

Consultation on 2020/21 accounting code

9. The [CIPFA/LASAAC Local Authority Code Board](#) has issued a [consultation paper](#) on proposed changes to the accounting code for 2020/21. The main proposals in this consultation arise from:

- Definition of Material: Amendments to IAS 1 and IAS 8
- the Government Financial Reporting Review
- the CIPFA/LASAAC review for improving clarity and streamlining disclosures
- the new 2018 Pensions SORP.

10. Responses should be sent to cipfalasaac@cipfa.org by 27 September 2019.

11. IFRS 16 Leases will apply from 2020/21 but as implementation of that standard was subject to consultation with the 2019/20 accounting code, it is not included in this consultation. However, the text of the accounting code is provided at Appendix B in order to encourage preparation work.

Auditor action
Auditors should note the proposed changes to the accounting code from 2020/21

Definition of material

12. The consultation proposes amendments to paragraph 2.1.2.14 to implement the revised definition of material in Definition of Material: Amendments to IAS 1 and IAS 8, as set out in the following table:

Proposed revised definition of material

Current definition	Proposed revised definition
Information is material if omitting it or misstating it could influence decisions that users make on the basis of financial information about a specific reporting authority	Information is material if omitting, misstating or obscuring it could reasonably be expected to influence decisions that users of general purpose financial statements make on the basis of those financial statements about a specific reporting entity

13. It is also proposed to provide the following examples of practices which may obscure material information:

- Vague or unclear language.
- Information is scattered throughout the financial statements.
- Dissimilar items are inappropriately aggregated, or similar items inappropriately disaggregated.
- Information regarding a material item is hidden by immaterial information.

14. A requirement to disclose the basis on which materiality has been assessed, such as the benchmarks applied, and the users considered in doing so, is also proposed.

15. The consultation also invites suggestions to support bodies in making appropriate materiality decisions. Aspects of materiality which respondents are particularly asked to consider are summarised in the following table:

Area	Explanation
Overall materiality	The assessment of overall materiality, including the identification of, or suggestions concerning, overall materiality and the benchmark used to determine this.
Lower specific materiality	Items for which particular materiality levels, below the overall materiality figure, may be considered appropriate.
Cumulative errors	The treatment of cumulative (prior period) errors which may have been immaterial in preceding years but are material for the current period.
Group materiality	The determination of materiality for group accounts application.
Qualitative materiality	Qualities or characteristics which are particularly important in local government in assessing the qualitative materiality of an item.

Government Financial Reporting Review

16. The Government Financial Reporting Review from HM Treasury (covered at paragraphs 110 to 113 of [Technical Bulletin 2019/2](#)) indicates that the Government Financial Reporting Manual (FRoM) will include a number of questions to be used by a central government body in determining whether to add new disclosures to the Annual Report and Accounts. The consultation proposes adding to the accounting code the same questions which are set out in the following table:

Main question	Prompt
Should the information be published?	<ul style="list-style-type: none"> • Is the information required by statute? • Is there a user need, and who is the user? • Is the information accurate and reliable? • Do the benefits of disclosure outweigh the costs and give value for money?
How should the information be published?	<ul style="list-style-type: none"> • Are the Annual Accounts the right place for it? • Is this information already available elsewhere, or could it be? • How will the new disclosure affect the overall balance of the Annual Accounts?

17. The consultation asks for specific views regarding the extent of disclosures which is relevant for group accounts.

18. There is also a proposal to add a paragraph stating that, in accordance with the IFRS Practice Statement 2: Making Materiality Judgements, bodies may summarise prior-period information, subject to the need to retain the information necessary for users to understand the current-period financial statements.

Proposal to summarise prior period information

Review for improving clarity and streamlining disclosures

19. CIPFA/LASAAC is undertaking a [review](#) to inform the strategic direction and development of the accounting code. The review is focusing on identifying the principal users of the accounts and the information they need; improving clarity by removing unnecessary detail; and conveying key messages which enables users to better understand the financial position and performance.

Feedback requested on strategic review of accounting code

20. Specific areas where feedback is requested in this consultation are: capital, pensions, financial instruments, and cashflow. The consultation poses the following questions in respect of these areas:

- Do the current disclosures appropriately meet user needs?
- What are the resource implications of the current disclosure requirements, and where should attention be focused on ensuring appropriate cost-benefit balance?
- Are there grounds to further adapt or interpret the disclosure requirements for local government circumstances?

Pension SORP

21. There are a few proposed changes to align with the 2018 Pension SORP including:

- revising the analysis of pooled investment vehicles
- removing the requirement to analyse investment assets between UK and overseas and between quoted and unquoted.

Grant claims developments

Housing benefits

22. The [Department for Work and Pensions](#) has revised [HB Circular A9/2019](#) to provide clarification on changes to housing benefit policy for mixed age couples.

Summary of auditor actions in this section

Paragraphs	Auditor actions
7	Consider the application to other audits of the advice provided by Professional Support on matters arising from 2018/19 audits
9-21	Note the proposed changes to the accounting code from 2020/21

Contact points for this section

23. The contact points for this section of the Technical Bulletin are:

- Paul O'Brien, Senior Manager (Professional Support) - pobrien@audit-scotland.gov.uk
- Anne Cairns, Manager (Professional Support) – acairns@audit-scotland.gov.uk (grant claims items only).

Section 2

College sector

Auditing developments

Technical Guidance Notes

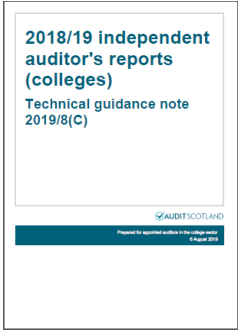
Audit of 2018/19 Annual Report and Accounts

24. Professional Support has published [Audit of 2018/19 Annual Report and Accounts \(Colleges\) - Technical Guidance Note 2019/7\(C\)](#) to provide guidance to appointed external auditors on performing the audit of colleges' 2018/19 Annual Report and Accounts.
25. The Technical Guidance Note highlights risks of misstatement in the financial statements, Performance Report and Accountability Report, and sets out actions for auditors to address each risk.
26. In response to feedback, a new approach has been adopted this year. Instead of replicating the risks that are common to central government bodies, this Technical Guidance Note provides only supplementary guidance on the risks of misstatements that are specific to colleges. It will therefore have to be read in conjunction with [technical guidance note 2019/1\(CG\)](#).

Auditor action
Auditors should use this Technical Guidance Note when planning and performing the audit of the 2018/19 Annual Report and Accounts

2018/19 model Independent Auditor's Reports

27. Professional Support has published [2018/19 Independent Auditor's Report \(Colleges\) - Technical Guidance Note 2019/8\(C\)](#) to provide auditors with the model Independent Auditor's Reports which should be used for the 2018/19 Annual Report and Accounts. The Technical Guidance Note also provides application guidance on their use.
28. In the interests of consistency, auditors are required to use the relevant model report in appendices 1 to 2 of the Technical Guidance Note as a condition of their audit appointment. The only exception to using the wording in each model is to tailor the terminology to reflect local circumstances.
29. The changes to the model Independent Auditor's Reports for 2018/19 are summarised in the following table:

	<ul style="list-style-type: none"> • Additional wording has been added to reflect the requirements in ISA (UK) 700 requires for Public Interest Entities • A reference has been added to highlight that risks of material misstatement are reported in the Annual Audit Report • A similar reference has been added to highlight that conclusions on wider scope responsibilities are reported in the Annual Audit Report • The 'Bannerman' paragraph has been moved from the beginning of the model reports to the end
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30. Any proposed modifications to any audit opinion or conclusion, or the inclusion of 'emphasis of matter' or 'other matter' paragraphs, should be discussed with Professional Support in advance of finalising the report.
31. Auditors should use this Technical Guidance Note when reporting on 2018/19 audits. They should complete for each report the checklist at Appendix 3 which provides a list of the key auditor actions.

Auditor action

Auditors should use this Technical Guidance Note when reporting the audit of the 2018/19 Annual Report and Accounts and complete the relevant checklists

Annual report and accounts overall

2018/19 Accounts direction

32. The [Scottish Funding Council](#) (SFC) has issued their [Accounts Direction](#) for colleges for 2018/19. The direction requires colleges to:
- comply with the 2015 Statement of Recommended Practice: Accounting for Further and Higher Education (the 2015 SORP) in preparing their financial statements. However, the 2018/19 direction notes that early adoption of the 2019 SORP is permitted
 - include a Performance Report and Accountability Report in their annual report and accounts in accordance with the 2018/19 Government Financial Reporting Manual.
33. Specific mandatory disclosure requirements for colleges are set out at Appendix 2. The main changes in the 2018/19 Accounts Direction are summarised in the following table:
34. Paragraph 15 has been added to require colleges to submit the calculation of their Adjusted Operating Position (AOP) to SFC for review prior to the accounts being signed off.
35. The following requirements of the previous direction have been dropped:
- Details of the resource outturn for the financial year (i.e. to 31 March) are no longer required in the performance report.
 - Details of the estates strategy is no longer required to be included in the Governance Statement.
36. Paragraphs 37 and 38 continue to require the remuneration of the Principal and banded remuneration of higher paid staff to be disclosed in the notes. However, in order to avoid duplication, paragraph 39 has been added to allow this information to be disclosed in the Remuneration and Staff Report and cross referred to the note.

AOP calculations require to be submitted to the SFC

Financial statements developments

Guidance on 2018/19 financial statements

37. The SFC has issued [Detailed Notes for Guidance on Completion of the 2018/19 Financial Statements](#) which are designed to supplement the Accounts Direction for 2018/19. The guidance covers key disclosures in the financial statements, including model disclosure notes set out at Annexes A to F. The main changes in the guidance notes from 2017/18 are summarised in the following paragraphs.
38. Paragraph 25 has been extended to emphasise that adjustments made in arriving at the AOP should only include figures which are separately disclosed elsewhere in the accounts. Colleges are required to provide a short explanation of the adjusting items and cross references to the figures in the Statement of Comprehensive Income or notes.
39. Paragraph 19 has been added to advise that harmonisation costs for support staff and middle management will not be known until after the national job evaluation exercise is complete. The paragraph requires colleges to base their estimates on Colleges Scotland's calculations in February 2019.

Harmonisation costs should be based on College Scotland calculations

Guidance for early retirement provision

40. The SFC issued [Guidance for early retirement provision spreadsheet completion](#) to advise that the suggested net interest rate for early retirement pension calculations in 2018/19 has been changed to 0.00%. for CPI indexed schemes. The rate for schemes using RPI is -1.00%.

41. Auditors should confirm their colleges have used an appropriate discount rate when calculating their early retirement provision, and have paid due regard to the rate suggested by the SFC.

Auditor action
Auditors should carry out the action set out at paragraph 41

Summary of auditor actions in this section

Paragraphs	Auditor action
24 - 26	Use Technical Guidance Note 2019/7(C) when planning and performing the audit of the 2018/19 Annual Report and Accounts
27 - 31	Use Technical Guidance Note 2019/8(C) when reporting the audit of the 2018/19 Annual Report and Accounts and complete the relevant checklists
40 - 41	Carry out the action set out at paragraph 41

Contact point for this section

42. The main contact point for this section of the Technical Bulletin is Helen Cobb, Senior Adviser (Professional Support) – Hcobb@audit-scotland.gov.uk.

Section 3

All sectors

Whole of Government Accounts developments

Technical Guidance Note

43. Professional Support has published [Technical Guidance Note 2019/6](#) to provide guidance for auditors on reviewing and reporting on the 2018/19 Whole of Government Accounts (WGA) returns of public bodies. The approach set out in the technical guidance note has been agreed with the National Audit Office.
44. The changes in the content of the Technical Guidance Note compared with 2017/18 are as follows:
- The calculation of gross assets for the purposes of the auditor assurance threshold has been revised.
 - There are new elements to fieldwork test 1.
 - The threshold for reporting financial statement errors separately has been increased.
 - The Assurance Statement has been significantly restructured.
 - The requirement to submit the ISA (UK) 260 report has been reintroduced.

Auditor action
Auditors should use this Technical Guidance Note when planning and performing the review of 2018/19 WGA returns

Summary of auditor actions in this section

Paragraphs	Auditor action
43 - 44	Use Technical Guidance Note 2019/6 when planning and performing the review of 2018/19 WGA returns

Section 4

Professional matters

Auditing developments

Consultation on revisions to auditing standards

46. The [Financial Reporting Council](#) (FRC) has issued a [consultation paper](#) on proposed revisions to the auditing and ethical standards.
47. Comments on the proposals should be sent to AAT@frc.org.uk by 27 September 2019. The intention is for the revised standards to apply to financial periods commencing on or after 15 December 2019.

Ethical standard

48. There are a number of proposed revisions to the Ethical Standard to strengthen auditor independence including those set out in the following table:

Element	Proposed change
Objective, reasonable and informed third party test	Strengthening the 'objective, reasonable and informed third party' test by replacing the extant definition with one which has greater focus on the perspective of stakeholders who are the ultimate beneficiaries of assurance, and also to provide more application guidance that firms should use when making an assessment
Ethics Partner	Enhancing the authority of the Ethics Partner function, in order to ensure firm-wide focus on ethical matters and the public interest, and to require reporting to those charged with governance, where an audit firm does not follow the Ethical Partner's advice
Public Interest Entity requirements	Extending the application of the more stringent requirements that apply to Public Interest Entities (PIEs) to additional entities which are of significant public interest, e.g. larger privately-owned companies
Prohibited services	Moving from a list of prohibited services to a shorter list of permitted non-audit services

ISA (UK) 700

49. It is proposed to extend the existing ISA (UK) 700 requirement for auditors of PIEs to explain the extent to which their audits are considered capable of detecting irregularities, including fraud, to all audits. This would bring the standard into line with existing Audit Scotland requirements.

Explanation of ability to detect irregularities to apply to all audits

50. Further application guidance will be added that the explanation should:
- enable a user to understand their significance in the context of the audit of financial statements as a whole
 - relate the matters directly to the specific circumstances of the entity and are not therefore, generic or abstract matters expressed in standardised or boilerplate language.
 - explain how the auditor obtained an understanding of the legal and regulatory framework and how the entity is complying with that framework
 - set out the laws and regulations that the auditor identified as being of significance in the context of the entity

- include the auditor's assessment of the susceptibility of the financial statements to material misstatement, including how fraud might occur.

ISA (UK) 701

- 51.** It is proposed that performance materiality in addition to materiality should be specified in the Independent Auditor's Report, and that an explanation of the significant judgements made in determining these amounts should be provided.

Performance materiality to be specified in IAR

ISA (UK) 720

- 52.** There are proposed revisions to ISA (UK) 720 to make it easier to apply, for example by moving material relating to the UK-specific requirements for statutory other information to application guidance, and enhancing the guidance relating to work effort.
- 53.** There is also a proposed new requirement to include a description of the auditor's responsibilities relating to statutory other information.

Description of responsibilities for other statutory information

Initial consultation arising from market study on audit services

- 54.** The [Department for Business, Energy and Industrial Strategy](#) of the UK Government has issued an [initial consultation](#) on the recommendations from the Competition and Markets Authority (CMA) in their market study into statutory audit services (set out at paragraph 147 of [Technical Bulletin 2019/2](#)). In summary, the recommendations are to:
- enhance regulatory oversight of audit committees
 - mandate joint audits of FTSE 350 companies
 - give the regulator powers to design an operational split between the audit practices and non-audit practices of the 'Big Four' firms
 - require a five-year review of progress by the new regulator.
- 55.** The UK Government is committed to acting on the recommendations to create a regulatory regime that delivers a competitive and resilient audit market. The consultation requests views on implementing the recommendations, as well as proposals on what could be done to address the CMA's concerns on a voluntary basis prior to legislation. A full set of proposals for reform taking account of both the recommendations from the CMA and the outcome of Sir John Kingman's Review of the Financial Reporting Council will then be produced.

Accounting developments

Proposed change to disclosure of accounting policies

- 56.** The [International Accounting Standards Board](#) has issued [Exposure Draft 2019/6](#) which proposes amendments to IAS 1 Presentation of Financial Statements and IFRS Practice Statement 2 Making Materiality Judgements to help entities provide accounting policy disclosures that are more useful.

- 57.** The exposure draft proposes amending IAS 1 to require entities to disclose 'material' rather 'significant' accounting policies.

- 58.** In addition, there are proposed amendments to IAS 1 and the practice statement to help entities apply the concept of materiality in making decisions about accounting policy disclosures. It is proposed to amend IAS 1 to state that:

- information about an accounting policy is material if, when considered together with other information included in an entity's financial statements, it can reasonably be expected to influence decisions of primary users of the financial statements
- accounting policies that relate to immaterial items need not be disclosed

Proposal to disclose 'material' accounting policies

- not all accounting policies relating to material items are themselves material.

Not all policies relating to material items are material

59. For example, an accounting policy is likely to be considered material if it relates to material items and:

- was changed during the year and this resulted in a material change to the amounts in the financial statements
- was chosen from a number of alternatives
- was developed in accordance with IAS 8 in the absence of a standard that specifically applies
- relates to an area for which an entity is required to make significant judgements or assumptions in applying an accounting policy
- applies the requirements of a standard in a way that reflects the entity's specific circumstances.

60. Information about accounting policies that focuses on how an entity has applied the requirements in a standard to its own circumstances is more useful than standardised descriptions or information that only duplicates the requirements of the standard.

Disclosures should apply to an entity's own circumstances

61. To support the proposed amendments to IAS 1, the exposure draft also proposes amending the practice statement to illustrate how an entity could judge whether information about an accounting policy is material to its financial statements. In particular, there are proposals to add guidance and examples to help entities by:

- clarifying that an accounting policy may be material by nature, even if related amounts in the financial statements are not material by size
- linking the application of materiality to accounting policy disclosures with the four-step materiality process described in the practice statement
- highlighting the need to focus on useful information for users of financial statements.

62. Comments should be sent to commentletters@ifrs.org by 29 November 2019.

Contact point for this section

63. The contact point for this section of the Technical Bulletin is Paul O'Brien, Senior Manager (Professional Support) - pobrien@audit-scotland.gov.uk.

Section 5

Fraud and irregularities

- 64.** This chapter contains a summary of fraud cases and other irregularities facilitated by weaknesses in internal control at audited bodies that have recently been reported by auditors to Professional Support.

Income

Council tax income

- 65.** Three separate council tax payers defrauded over £30,000 of council tax.

Auditor action

Auditors should consider whether weaknesses in internal control which facilitated each fraud may exist in their bodies and take the appropriate action

Key features

The perpetrators failed to declare that their properties were unoccupied long term and consequently avoided paying the double council tax for which they were liable.

Two of the frauds were identified after neighbours contacted the council to complain about the poor state of repair of the properties. Subsequent investigations by the councils identified that:

- a company purchased the first house in 2012. A visit to the property confirmed it was clearly uninhabited.
- the other house had been in receipt of a second home discount since 2013. However, investigations of utility supplies and a visit identified that the property was clearly not a second home.

In the third case, the fraud was identified after a housing association approached the council for information on the property. Investigations identified that the property had previously been subject to an empty property exemption due to the previous occupant being deceased. However, the deceased's nephew failed to notify the council that he had inherited the property in 2016.

The frauds were possible as the councils did not have adequate arrangements in place to identify long term empty properties or second homes.

Council tax bills have been raised based on the double council tax charge. The debt has been passed to Sheriff Officers for collection in two cases and the council tax payer has paid the debt in the third case.

Housing rent

- 66.** A former tenant defrauded a council of an estimated £93,000.

Key features

The genuine tenant moved out of the property but did not advise the council. A family member then moved in.

The fraud was not identified until a Housing Officer reported their suspicion that the tenant had moved out of the property. Investigations identified that the original tenant had moved out three years ago. The property was recovered and reallocated.

This case is being used in training for Housing Officers to help raise awareness and enable other issues to be identified and addressed more quickly in future.

Payroll

Redundancy payment

67. A council paid out a redundancy payment to a former employee that was £18,000 overstated.

Key features

An error was made in the calculation of the redundancy payment. However, there were no controls in place to check that the figure was correct. The incorrect figure was therefore input to the payroll system, and the payment was made.

The error was not identified immediately after payment was made despite the former employee querying the value. It was eventually identified almost a year later by Internal Audit during routine monitoring of payroll.

A process is now in place to ensure that two members of staff are involved in the payment of any employee redundancies. One team member processes the payment and a second more senior team member checks and authorises the payment.

The former employee is repaying the overpayment.

Private funds

Social work client

68. A senior social work practitioner defrauded over £6,500 from clients.

Key features

The perpetrator claimed money on behalf of clients and provided signed forms requesting the sums to the council. The forms had been prepared and countersigned by the perpetrator but not the claimant. The money was then retained by the perpetrator.

The fraud was identified after a social work manager reported a financial irregularity in relation to a client's cash account. A subsequent internal audit investigation into the system for making payments identified that the fraud was possible as:

- the social work system records were not kept up to date
- there was a lack of documented procedures in place
- payments were made by both direct debit and cash, resulting in double counting
- there was a lack of receipts on file.

All recommendations for addressing the above have now been implemented. The employee was dismissed and taken to court where they received a community payback order. To date, £1,800 has been repaid by the employee.

Summary of auditor actions in this section

Paragraphs	Auditor action
65 - 68	Consider whether weaknesses in internal control which facilitated each fraud may exist in other bodies and take the appropriate action

Contact point

69. The contact point for this section of the Technical Bulletin is Anne Cairns, Manager (Professional Support) – acairns@audit-scotland.gov.uk.

Technical bulletin 2019/3

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Technical Bulletin

2019/4

Technical developments and emerging risks
from October to December 2019



 AUDIT SCOTLAND

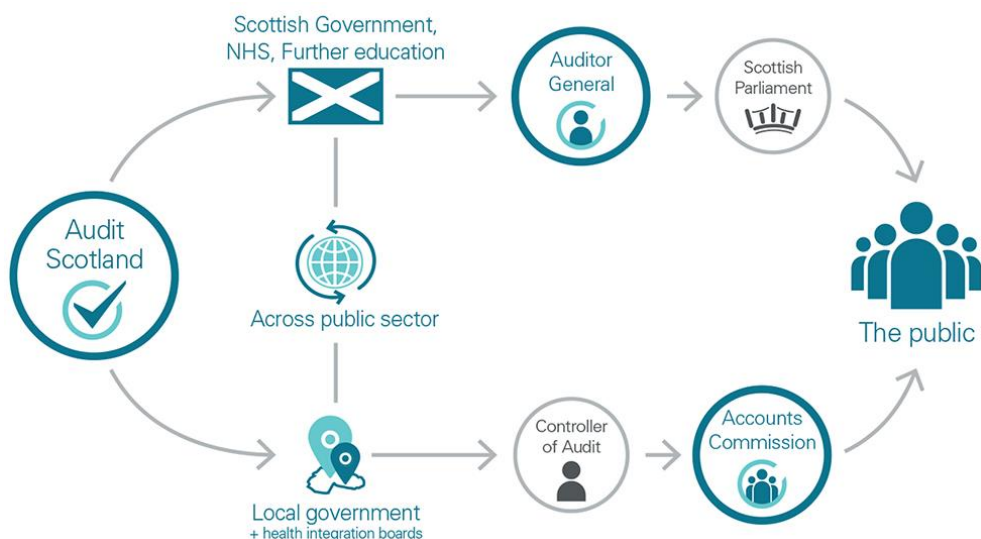
Prepared for appointed auditors and audited bodies in all sectors

11 December 2019

Who we are

The Auditor General, the Accounts Commission and Audit Scotland work together to deliver public audit in Scotland:

- The Auditor General is an independent crown appointment, made on the recommendation of the Scottish Parliament, to audit the Scottish Government, NHS and other bodies and report to Parliament on their financial health and performance.
- The Accounts Commission is an independent public body appointed by Scottish ministers to hold local government to account. The Controller of Audit is an independent post established by statute, with powers to report directly to the Commission on the audit of local government.
- Audit Scotland is governed by a board, consisting of the Auditor General, the chair of the Accounts Commission, a non-executive board chair, and two non-executive members appointed by the Scottish Commission for Public Audit, a commission of the Scottish Parliament.



About us

Our vision is to be a world-class audit organisation that improves the use of public money.

Through our work for the Auditor General and the Accounts Commission, we provide independent assurance to the people of Scotland that public money is spent properly and provides value. We aim to achieve this by:

- carrying out relevant and timely audits of the way the public sector manages and spends money
- reporting our findings and conclusions in public
- identifying risks, making clear and relevant recommendations.

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Introduction

Purpose

1. The purpose of Technical Bulletins from Audit Scotland's Professional Support is to provide auditors appointed by the Auditor General and Accounts Commission with:
 - information on the main technical developments in each sector and on professional matters during the quarter
 - guidance on any emerging risks identified in the quarter.
2. Appointed auditors are required to pay due regard to Technical Bulletins. The information on technical developments is aimed at highlighting the key points that Professional Support considers auditors in the Scottish public sector require to be aware of. It may still be necessary for auditors to read the source material if greater detail is required. These can be accessed by using the hyperlinks. They are also available from the [Technical Reference Library](#) maintained by Professional Support.
3. The actions by auditors recommended by Professional Support in respect of each item are highlighted in red and are also summarised at the end of each section.
4. Technical Bulletins are also published on the Audit Scotland [website](#) and therefore are available to audited bodies and other stakeholders. Hyperlinks indicated with an asterisk link to the Technical Reference Library and therefore are active only for auditors.

Technical Bulletins provide information on developments and guidance on emerging risks

Highlights summary

5. Particular attention is drawn in the following table to twelve items in this Technical Bulletin:

Highlights summary		
Professional Support has published guidance on planning 2019/20 audits [see paragraph 7]	Professional Support has published guidance on planning and performing the audit of 2019/20 local government annual accounts [see paragraph 12]	Sir Tony Redmond has issued a call for views on his review into the quality of local government external audit and financial reporting in England [see paragraph 18]
CIPFA has issued guidance notes on the 2019/20 accounting code [see paragraph 23]	CIPFA has issued a 2019/20 disclosure checklist for local government financial statements [see paragraph 26]	CIPFA/LASAAC has issued discussion papers on improving local government financial reporting [see paragraph 30]
CIPFA has issued a code on financial management [see paragraph 54]	Treasury has issued an exposure draft of the 2020/21 FReM [see paragraph 61]	Scottish Government has issued a revised severance policy [see paragraph 68]
The FRC has issued a revised audit standard on going concern [see paragraph 71]	The FRC has issued a report on impairment disclosures [see paragraph 85]	The FRC has issued a report on lease disclosures under IFRS 16 [see paragraph 88]

Contact point

6. The main contact point for this Technical Bulletin is Paul O'Brien, Senior Manager (Professional Support) – pobrien@audit-scotland.gov.uk.

Feedback on this Technical Bulletin is welcome

Section 1

Cross-sector

Guidance on planning 2019/20 audits

7. Professional Support has issued [guidance](#) to assist all appointed auditors in planning their 2019/20 audits. The guidance covers the main activities that comprise core audit work and the products associated with each activity.
8. The following table provides a summary of the key changes from last year, along with the section of the guidance in which further information is provided:

Nature of change	Section
Auditors are required to ensure their work in respect of Statutory Other Information in the annual accounts meets good practice set out by the Financial Reporting Council (FRC).	2
There is a requirement to assess the risk of fraud and corruption in the procurement function and report, where relevant, on the arrangements to counter the risk in either the 2019/20 or 2020/21 Annual Audit Reports.	3A
There is a requirement to report in the Annual Audit Report a conclusion on the effectiveness and appropriateness of the arrangements in place for complying with the Accounts Commission's direction on statutory performance information.	3D
The requirement to prepare a Current Issues Return has been dispensed with for all sectors except local government (provided auditors keep Audit Scotland up-to-date by other means).	5D
Prior approval from Audit Scotland's Audit Quality and Appointments (AQA) is now required for any certification of grant claims or similar returns in the central government, health and college sectors.	5E
Clarification has been added regarding the fee arrangements for statutory objections.	5H
The requirement for Fraud Returns has been extended to all bodies.	5I
Guidance on fees has been moved to separate Audit Management and Quality Guidance from AQA.	N/A

9. The guidance supplements the Code of Audit Practice, and auditors are therefore required to pay due regard to it when planning their 2019/20 audits.

Auditor action
Auditors should pay due regard to the 2019/20 planning guidance

Summary of auditor actions in this section

Paragraphs	Auditor actions
7 - 9	Pay due regard to the guidance on planning 2019/20 audits

Contact point for this section

10. The contact for this section of the Technical Bulletin is Paul O'Brien, Senior Manager (Professional Support) - pobrien@audit-scotland.gov.uk.

Section 2

Local government sector

Auditing developments

Technical Guidance Note on risks of misstatement in 2019/20

12. Professional Support has published Technical Guidance Note (TGN) 2019/9(LG) to provide auditors with guidance on planning and performing the audit of 2019/20 annual accounts of local government bodies.
13. The TGN is intended to inform auditors' judgement when identifying and assessing the risks of material misstatement in 2019/20. The TGN supplements the Code of Audit Practice and auditors are expected to pay it due regard and use it as a primary reference source when performing 2019/20 audits.
14. The TGN structure comprises a number of modules:
 - The Overview Module provides an overall introduction and covers risks of misstatement in areas that are pervasive to the financial statements as a whole.
 - Modules 1 to 9 set out risks of misstatement for specific classes of transactions, balances and disclosures in the financial statements. These modules explain the appropriate related accounting treatment and set out the action auditors should undertake to evaluate whether the body has followed the required treatment.
 - Module 10 covers the audited part of the Remuneration Report
 - Module 11 sets out procedures for Statutory Other Information (i.e. Management Commentary and Annual Governance Statement).
15. The TGN also provides specific guidance on the application of the above modules to integration joint boards (Module 12), pension fund accounts (Module 13) and section 106 charity accounts (Module 14).
16. As part of the package of enhancements being made to the Technical Reference Library, a [dedicated page*](#) has been created for auditors to access which contains hyperlinks to each module. A version of the TGN which combines all the modules is also freely available from the Audit Scotland [website](#).
17. In summary, TGN 2019/9(LG) has been updated/revised as follows:
 - The modules have been streamlined to focus solely on risks of misstatement in the annual accounts.
 - New risks of misstatement have been added to reflect frequently asked questions arising from 2018/19 audits and changed requirements in 2019/20 (particularly Modules 1, 2, 3 and 9); guidance has been refreshed/enhanced on some pre-existing risks; and a number of risks included last year have been removed as their likelihood or impact has reduced.
 - Risks related to employee benefits are now all within the same module (Module 4).
 - Risks related to the audited part of the Remuneration Report are now in a separate module (Module 10).
 - Module 11 on Statutory Other Information has been revised to align with the audit quality report from the FRC into audit quality in that area.

Auditor action
Auditors should pay due regard to TGN 2019/9(LG)

Review into external audit in England

18. The [UK Government](#) has appointed Sir Tony Redmond to conduct a review of the arrangements in place to support the transparency and quality of local government financial reporting and external audit in England (the Redmond Review). The main aim is to review the effectiveness of the statutory framework set out in the Local Audit and Accountability Act 2014 (the 2014 Act) which provided for the Audit Commission to be disbanded.

The review scope is restricted to England

19. However, the review has assumed greater significance due to other concurrent reviews into audit quality not least the Kingman Review (explained at paragraph 125 of [Technical Bulletin 2019/1](#)) which recommended that the arrangements for local audit in England needed to be fundamentally rethought.
20. The Redmond Review is examining the existing purpose, scope and quality of local government audits and the supporting regulatory framework in order to determine whether:
- they are operating in line with the policy intent set out in the 2014 Act
 - the reforms have improved the effectiveness of the framework along with the transparency of financial information presented by local government bodies
 - the current statutory framework for local government financial reporting supports the transparent disclosure of financial performance and enables users of the accounts to hold bodies to account.
21. In order to inform its conclusions, the Redmond Review has issued a [call for views](#) on the quality and effectiveness of the audit of local government in England and the transparency of financial reporting. Views are particularly sought on how the accounts and audit could be improved to provide greater assurance to locally elected members along with local taxpayers and service users. The paper asks for views on whether:
- the external audit process covers the right things given the interests of the primary users
 - auditors have sufficient understanding of the business to focus on the right risks
 - going concern reporting by auditors is meaningful when assessing the body's resilience
 - auditor reporting is timely and communicates useful information
 - statutory adjustments drive sub-optimal behaviours.
22. Views should be sent to Redmond.Review@communities.gov.uk by 20 December. Although the scope of the review is restricted to England, Audit Scotland has submitted a response to explain how the public audit model in Scotland operates.

The paper questions the meaningfulness of going concern audit reporting

Financial statements developments

2019/20 guidance notes

23. The [Chartered Institute of Public Finance and Accountancy](#) (CIPFA) has issued [guidance notes*](#) on the [2019/20 accounting code*](#). The overall aim of the guidance notes is to explain and illustrate how to apply the accounting requirements of the accounting code, provide background to those requirements, and illustrate how they might be applied in practical situations. The guidance is not mandatory.
24. This edition of the guidance notes has been updated to reflect changes to the 2019/20 accounting code including the following:
- Module 1 augments the description of adaptations and interpretations of standards, explains the process for identifying statutory adjustments, and confirms the relevance of application guidance within standards.
 - Module 2 (Section A) reflects changes to the accounting code arising from the revisions to the Conceptual Framework in relation to: the objectives of the financial statements; qualitative characteristics of useful financial information; and definitions of assets, liabilities, income and expenses.
 - Module 3 (Section A and Section F) includes guidance on how to reflect voluntary transfers between the Revaluation Reserve and the General Fund in the Movement in Reserves Statement and Expenditure and Funding Analysis.
 - Module 4 provides guidance on accounting for voluntary transfers of an element of the revaluation gain to General Fund balances.
25. Other aspects of the guidance notes that auditors may find it helpful to refer to are summarised in the following table:

The guidance notes are not mandatory

The guidance notes have been updated to reflect changes to the 2019/20 accounting code

Subject	Pages	Guidance
Example financial statements and notes	373 to 516	The example is intended to meet the minimum requirements of single-entity financial statements, but it is not intended to consider materiality or be internally consistent.
Regularity of valuations	560	Guidance is provided on determining the appropriate frequency for revaluing property, plant and equipment.
Borrowing costs	216, 217 and 712 to 715	Pages 216 to 217 illustrate a disclosure note where a body changes accounting policy to capitalising borrowing costs. Pages 712 to 715 provide guidance on the requirements for such a change.
Retirement benefits	775 to 777	Guidance is provided on actuarial assessments and working with actuaries.
Grant income	72 to 91	Guidance is provided on the recognition and presentation of grants.
Untaken holiday liability	747 to 757	Guidance is provided, with illustrations, on how to calculate the liability for employees' untaken holiday.
Note to the Expenditure and Funding Analysis	413 to 415	An illustration is provided of the note to the Expenditure and Funding Analysis.
Judgements and estimation uncertainty	409 to 411	Illustrations are provided of the notes on judgements in applying accounting policies and assumptions about estimation uncertainty.
Related parties	361 to 369 and 478 to 479	Pages 361 to 369 provide guidance on determining related parties in local government and 478 to 479 provide an illustrative note.

2019/20 disclosure checklist

26. CIPFA has issued a [disclosure checklist*](#) for the 2019/20 financial statements. The checklist is intended for use as an aide-memoire to ensure that the requirements of the 2019/20 accounting code are met. It is in the form of a series of questions:

- If the answer to a question is 'yes', the accounting code is being complied with.
- If the answer is 'no', a justification for departing from the code should be given.

27. It should be noted that required disclosures can be excluded if the information resulting from that disclosure is not considered to be material. This is the case even if the accounting code or a standard contains a list of specific requirements or describes them as minimum requirements.

28. Auditors should:

- request that the body completes the disclosure checklist
- investigate the reasons for any non-compliance that the checklist highlights
- evaluate whether the body's responses in the checklist are consistent with auditor's knowledge.

29. Where the body declines to complete the checklist, auditors should establish the alternative means by which the body satisfies itself regarding the completeness of disclosures, and evaluate whether the arrangements are adequate. Auditors may wish to consider completing the checklist themselves.

Auditor action
Auditors should carry out the actions at paragraphs 28 and 29

Discussion papers on improving local government financial reporting

30. The [CIPFA/LASAAC Local Authority Code Board](#) has issued a [discussion paper](#) on improving local government financial reporting. The paper discusses the requirements for local government accounts, particularly in respect of identifying users, focusing on their needs, presenting information and addressing issues relating to specific topics.
31. Some of the key issues are summarised in the following paragraphs.

The discussion paper sets out options for improving financial reporting

Primary users

32. The discussion paper suggests that the accounting code should more explicitly identify primary users of the accounts as those who have an interest in local government's accountability for public resources. This would clearly recognise the stewardship role of elected members in administering public resources, on behalf of current and future taxpayers and service users.
33. The accounting code could also include a specific requirement to assess relevance and faithful representation, including materiality, based on the needs of such primary users. Potentially, the accounting code could require the provision of additional information for other significant user groups, provided this does not obscure the information for the primary users.
34. A requirement to disclose the judgements made regarding the relevant user groups, and their needs, may be appropriate.

Primary users have an interest in accountability for public resources

Statutory adjustments

35. Primary users need clear information concerning the receipt and application of taxation funding. The discussion paper suggests that a specific section of the financial statements could therefore be developed relating to taxpayer funding. Examples of possible content are:
- taxpayer funds used to provide services in the reporting year
 - commitments of future taxpayer funding streams arising from statutory adjustments
 - the stewardship of taxpayer funds under the statutory adjustment framework
 - financial risks related to the commitment of future taxpayer funding arising from statutory mitigation arrangements.
36. The discussion paper also considers whether the accounting code's adaptations and interpretations are appropriate alternatives to statutory adjustments in some instances.

A separate section on taxpayer funding is suggested

Comprehensive Income and Expenditure Statement

37. The adaptation of normal accounting presentation requirements should be considered so that the Comprehensive Income and Expenditure Statement (CIES) reflects the expenditure supported by taxation. One option could be to split the Surplus or Deficit on Provision of Services (SDPS) section between statutory cost (to clearly show the expenditure charged to taxpayer funds), and the adjustments made to reflect accounting standards. Examples of presentation are illustrated in Appendix A of the paper.
38. A further question is whether a service analysis is required for the CIES if such an analysis is provided in a separate section related to taxpayer funds. This could allow an analysis in the CIES based on type, rather than purpose, of expenditure (e.g. by employee costs, property costs etc).

CIES could focus on statutory costs

Service analysis in CIES could be replaced with analysis by type of expenditure

Capital

39. The paper considers the cost of assets valuation and the maintenance of the detailed accounting information required. It challenges the relevance and role of precise market-based valuation for primary users, and suggests a change in focus and direction relating to the application of current value.
40. In particular, the level of accuracy required could be more appropriately balanced with the costs incurred. Adaptations could specify that current value information is provided to meet primary user needs, not for the purposes of

valuing a local government body nor for an assessment of the security available to lenders. The specification could support an appropriate degree of estimation which better reflects the costs and benefits arising from current value information.

Appropriate
estimating of
asset values

41. The paper also raises the potential to:

- replace the historical cost element of depreciation charges with the statutory repayment of debt; or
- move towards statutory charges being replaced by, or made equivalent to, the depreciation charge.

Pensions

42. The paper explores the option of the financial statements of employers ceasing to recognise pension liabilities. Instead, there could be suitable disclosures in the financial statements of the employer and the LGPS pension fund. For example:

- LGPS fund accounts could include an analysis of the pension liability by employer.
- Employer financial statements could provide a note disclosing, but not recognising, the liability.
- The full cost of pensions would not appear in the CIES.
- The need for a pensions statutory adjustment would be negated.

Pension liabilities in
the Balance Sheet
could be replaced
with disclosures

43. The paper also suggests that the triennial funding valuation could be used to measure employer liabilities in employer accounts. Consideration would be required as to whether (and if so how) the funding valuation liability should be updated in intervening years.

Financial instruments

44. The paper suggest that the accounting code could follow the approach of FRS 102 and draw a distinction between basic and complex financial instruments. This would reduce the reporting burden for bodies which do not have complex or risk-sensitive instruments.

45. The paper challenges the appropriateness of fair value measurement, especially the Fair Value through Profit or Loss (FVPL) classification, for some instruments. It questions whether a historical cost measurement for the Balance Sheet with additional disclosure of fair value would be sufficient.

46. It also suggests that the accounting code could apply more adaptations and interpretations, thus negating the need for specific statutory adjustments.

Fair value in the
Balance Sheet
could be
replaced with
historical cost
and disclosures

Group

47. The paper suggests that a specific disclosure section for group arrangements, as part of the single entity statements, could replace a requirement for group financial statements.

48. Alternatively, there is a suggestion that only group financial statements would be presented.

Differential reporting

49. CIPFA/LASAAC has also issued a related [discussion paper](#) on the concept of differential reporting.

50. A differential reporting framework allows entities to apply specified financial reporting requirements and accounting practices depending on their circumstances, e.g. size, industry, structure, nature or other differentiating feature. This approach contrasts with the current uniform reporting framework in local government, where the same requirements and accounting standards are prescribed for all entities.

Bodies could apply
different financial
reporting requirements
depending on their size

51. The paper describes how a differential approach has been adopted in other sectors including companies, charities and the public sector in other countries. The two main methods of achieving differentiation in a reporting framework are:

- allowing reduced disclosures to be made by smaller entities; or
- specifying different recognition and measurement requirements as well as different disclosure requirements.

- 52.** A differential reporting framework could be a potential solution where the volume and complexity of accounting standards mean the cost of producing financial statements outweigh their benefits.
- 53.** The paper presents a number of options for a differential reporting framework in local government, and highlights some of the challenges.

Options are discussed for differential reporting in local government

Wider audit scope developments

New financial management code

- 54.** CIPFA has published a [Financial Management \(FM\) Code*](#) which is designed to support good practice in financial management and to assist local government bodies in demonstrating their financial sustainability.
- 55.** Local government bodies are required to apply the requirements of the FM Code with effect from 1 April 2020 on a 'shadow year' basis. The first full year of compliance will therefore be 2021/22, with earlier adoption encouraged. Bodies will be required to demonstrate that the requirements of the FM code are being satisfied.
- 56.** The principles that underlie the FM Code are summarised in the following table:

The code supports good practice in financial management and applies from 2021/22

Principle	Explanation
Leadership	Demonstrating a clear strategic direction based on a vision in which financial management is embedded into organisational culture
Accountability	Based on medium-term financial planning that drives the annual budget process supported by effective risk management, quality supporting data and whole life costs
Transparency	Financial management is undertaken with transparency at its core using consistent, meaningful and understandable data, reported frequently with evidence of periodic officer action and elected member decision making
Standards	Adherence to professional standards is promoted by the leadership team and is evidenced
Assurance	Sources of assurance are recognised as an effective tool mainstreamed into financial management, including political scrutiny and the results of external audit, internal audit and inspection
Sustainability	The long-term sustainability of local services is at the heart of all financial management processes and is evidenced by prudent use of public resources

57. The underlying principles are supported by explicit standards of financial management which have different practical applications according to the different circumstances of each body. The financial management standards are summarised on page 15 of the FM Code, while page 16 groups the standards with the corresponding principle.

58. The financial management standards are explained in sections 1 to 7 of the FM Code:

- Sections 1 and 2 address important contextual factors which need to be addressed in the first instance if sound financial management is to be possible. The first deals with the responsibilities of the section 95 officer and leadership team, and the second with the body's governance and financial management style.
- Sections 3 to 7 address the requirements of the financial management cycle:
 - Section 3 states the need for a long-term approach to the evaluation of financial sustainability.
 - The body's annual budget setting process (Section 4), stakeholder engagement and business cases (Section 5) and performance monitoring arrangements (Section 6) are also covered.

Principles are supported by standards which require to be complied with

- The cycle is completed by section 7, which shows how high-quality financial reporting supports the financial management cycle by ensuring that it rests on sound financial information.

59. CIPFA's expectation is that local government bodies will have to comply with all the financial management standards if they are to demonstrate compliance with the FM Code. However, the code is not prescriptive about how this is achieved.

Summary of auditor actions in this section

Paragraphs	Auditor actions
12 - 17	Pay due regard to TGN 2019/9(LG) when planning and performing the audit of the 2019/20 annual accounts
26 - 29	Carry out the actions set out at paragraphs 28 and 29 in respect of the 2019/20 disclosure checklist

Contact point for this section

60. The contact point for this section of the Technical Bulletin is Paul O'Brien, Senior Manager (Professional Support) - pobrien@audit-scotland.gov.uk

Section 3

Central government sector

Accounting developments

Consultation on 2020/21 FReM

61. [HM Treasury](#) has issued an [exposure draft](#) of proposed revisions to the Government Financial Reporting Manual (FReM) for 2020/21. The revisions have been proposed in light of the [Government Financial Reporting Review](#) and are intended to improve reporting in the annual reports and accounts as well as supporting guidance for preparers.

Proposal to restructure FReM

62. It is proposed to structure the FReM into four parts which are summarised, along with the related chapters, in the following table:

Part	Chapters
A Principles, purposes and best practice of government financial reporting	2 on financial reporting principles and 3 on best practice in narrative reporting
B The form and content of Government annual reports and accounts	4 on the annual report and accounts, 5 on the performance report, 6 on the accountability report, and 7 on the financial statements
C Applying accounting standards to government annual reports and accounts	8 on adapting and interpreting standards
D further guidance for government annual reports and accounts,	9 to 12 provides further guidance on specific areas and 13 on whole of government accounts

63. Paragraph 2.4.1 introduces the concept that the four purposes of government financial reporting are to:

- maintain and ensure parliamentary control of government spending, enabling Parliament to hold the Government accountable for its spending
- enable the public and researchers to understand and consider the value for money offered by public spending so that they can make decisions about the effectiveness, efficiency, and economy of particular policies or programmes
- provide a credible and accurate record which can be relied upon
- provide managers with the information they require to run bodies efficiently and effectively.

64. Each of the four purposes relates to the needs of a different report user. Chapter 2 therefore discusses the importance of user engagement. It also clarifies that the needs of Parliament as the primary user take precedence.

65. Chapter 3 is new and reflects lessons learned from the Government Financial Reporting Review which found a wide range of examples of good practice in narrative reporting. The new chapter provides guidance to help preparers improve reporting.

66. Chapter 5 on the Performance Report has been extensively revised and contains substantive changes to reporting requirements. The guidance on the performance analysis section is split into:

- mandatory requirements (paragraph 5.4.4)
- comply or explain requirements (paragraph 5.4.5)
- best practice recommendations (paragraph 5.4.6).

New Performance Report requirements

67. There are a few changes in chapter 6 on the Accountability Report including a new requirement to disclose staff turnover in the Remuneration and Staff Report.

Wider scope developments

Changes in severance policy

68. The Scottish Government has issued [Finance Guidance Note 2019/6](#) to announce amendments to the [Settlement Agreements, Severance, Early Retirement and Redundancy Terms](#) chapter of Scottish Public Finance Manual to reflect changes in the severance policy.
69. The key features of the new policy are summarised in the following table:

Feature	Limit	
Cap on severance payments	95,000	£95,000 cap on payments
Minimum period individual can return to same employer	12 months	
Maximum payback period	2 years	
Maximum pay in lieu of notice for new contracts	6 months	

Contact point for this section

70. The main contact point for this section of the Technical Bulletin is Neil Cameron – ncameron@audit-scotland.gov.uk.

Section 4

Professional matters

Auditing developments

Revised standard on going concern

- 71.** The [Financial Reporting Council](#) (FRC) has issued a revised version of [ISA \(UK\) 570 Going Concern](#).
- 72.** The ISA is closely related to IAS 1 Presentation of Financial Statements which requires the adoption of the going concern basis of accounting in financial statements, except in circumstances where management intends to liquidate the entity or to cease trading, or has no realistic alternative than to do so.
- 73.** This requirement applies even when there are uncertainties about events or conditions that may cast significant doubt upon the entity's ability to continue as a going concern in the future.
- 74.** The term 'going concern' as used in the ISA applies to any entity unless its management intends to liquidate the entity or to cease trading, or has no realistic alternative. The term 'ability to continue as a going concern' is equivalent to the term 'ability to continue to adopt the going concern basis of accounting' in the future.
- 75.** The auditor's responsibilities are to obtain sufficient appropriate audit evidence regarding, and conclude on:
- whether a material uncertainty related to going concern exists; and
 - the appropriateness of management's use of the going concern basis of accounting in the preparation of the financial statements.
- 76.** A summary of the main changes in this revised version are set out in the following table:

The ISA is concerned with the going concern basis of accounting

Area	Proposed change
Linking to other ISAs	<p>Links from ISA (UK) 570 to important principles in other ISAs have been enhanced to:</p> <ul style="list-style-type: none"> • better demonstrate how they are applied in respect of going concern • provide an improved basis for the evaluation of management's assessment of the body's ability to continue to adopt the going concern basis of accounting.
Strengthening the objectives	The objectives of the ISA have been revised to require the auditor to obtain sufficient appropriate audit evidence about whether a material uncertainty related to going concern exists.
Enhancing risk assessment procedures	Clearer links have been drawn between the auditor's responsibilities in respect of going concern and the auditor's understanding of the body and its environment, the applicable financial reporting framework, and the body's system of internal control.
Evaluating management's assessment	The auditor's work effort in relation to the evaluation of management's assessment should be more robust including a more rigorous challenge of the method, information and assumptions.

Area	Proposed change
Professional scepticism and management bias	Additional requirements and application material have been added to enhance the auditor's application of professional scepticism and consideration of the potential for management bias. This includes a definition of management bias being added (i.e. a lack of neutrality by management in the preparation of information).
Enhanced auditor reporting	Where the going concern basis of accounting is appropriate, a new requirement for the auditor's report for listed entities has been added to include: <ul style="list-style-type: none"> an explanation of how the auditor evaluated management's assessment of the body's ability to continue as a going concern and where relevant, key observations arising with respect to that evaluation a conclusion that management's use of the going concern basis of accounting is appropriate where no material uncertainty has been identified, a statement that the auditor has not identified a material uncertainty related to going concern.
Strengthening communication with those charged with governance	A new requirement has been added to place more emphasis on communications with those charged with governance in situations where management is unwilling to make or extend its assessment when requested to do so by the auditor.
Communicating with regulators	A new requirement has been added for the auditor to consider whether there are any requirements beyond the ISAs which would require the auditor to report to a regulator.

77. The requirement in IAS 1 for the going concern basis of accounting is interpreted for the public sector so that it applies in all cases unless a body can be dissolved without statutory prescription or the functions of the body are to be discontinued or privatised. Going concern is therefore an issue for public sector auditors only if those circumstances apply.

Report on developments in audit during 2019

78. The FRC has issued its [Developments in Audit](#) report for 2019. The report focuses on the work the FRC undertook in its audit monitoring, supervision and policy functions for 2018/19 audits.

79. Insufficient challenge of management is the most frequent issue raised in audit quality inspections. This is most prevalent when auditors are evaluating management's estimates in areas of judgement, where information is often material to the financial statements.

80. Given the pivotal role that challenge of management plays in carrying out a high quality audit, the report urges firms to increase urgently their efforts to understand why they continue to underperform in this area. The report highlights the issues summarised in the following table in challenging management:

Insufficient challenge of management

Issue	Explanation
Auditor mindset	Familiarity with the audited entity can lead to the same audit approach, even when circumstances demand a different audit strategy, e.g. when an entity has problems with a major contract or wider economic difficulties.
Confirmation not challenge	Audit teams can be too ready to confirm what management tells them rather than questioning its plausibility. This lack of professional scepticism is especially prevalent where teams have to address significant management judgements.

Issue	Explanation
Audit is more than discussion	Audit teams have to discuss difficult accounting judgements with management to understand the assumptions underpinning key decisions. This should, however, be a starting point for the auditor not the main audit procedure. Challenge and corroboration are essential to test whether management's explanations are sound.
Insistence on realistic deadlines	Audit teams sometimes accept unrealistic deadlines which result in inadequate work and significant shortcomings.

81. Other inspection findings include:

- poorly performed substantive analytical procedures (comparing actual and estimated revenue), insufficient work over key sales reconciliations and a lack of evidence obtained over the occurrence of transactions
- audit teams not challenging management appropriately in key areas of judgement related to long term contracts and not obtaining sufficient evidence to support the judgements made on estimates of future costs and margins, forecast revenues for onerous contracts and revenue recognition for multiple-element and complex contracts
- concerns across a range of procedures related to fair value accounting including the review of model methodology, control testing, and issues with the risk assessment and scoping of work
- insufficient evidence of the audit team's understanding of processes and controls and/or evaluation of the design and implementation of controls relevant to the audit risks, and of the audit team's response to control deficiencies.

Accounting developments

Guide on selection accounting policies

82. The [International Accounting Standards Board](#) (IASB) has issued a [guide](#) that sets out a three step approach to selecting and applying accounting policies. The guide confirms that when a standard specifically applies, the accounting policy should be determined by following that standard.

83. In the absence of a specific standard, entities are required to use judgement in developing and applying an accounting policy that results in information that is reliable and relevant to the users of financial statements.

84. In making that judgement, entities should consider the:

- the requirements in standards dealing with similar and related issues; and then
- the definitions, recognition criteria and measurement concepts for assets, liabilities, income and expenses in the Conceptual Framework.

**Entities
should follow
three steps**

Review of impairment disclosures

85. The FRC has issued a [report](#) following a thematic review into disclosures made by a sample of companies related to the impairment of non-financial assets. The objective of the review is to encourage more transparent reporting of the:

- events and circumstances that led to the recognition or reversal of an impairment loss
- basis on which the directors concluded that the carrying amounts of non-financial assets are recoverable.

86. The review found instances of good practice such as:

- clear explanations of the events and circumstances that would trigger an impairment review
- the key assumptions used in the cashflow projections to estimate the recoverable amount, and how they were determined
- sensitivity analysis around the impact of changes in key assumptions.

**Some good
practice
examples but
also common
omissions**

87. However, the review also identified a number of common disclosure omissions (such as the recoverable amounts of the assets) and opportunities to clarify and enhance disclosures. The review also highlighted the need to comment on impairment in the strategic report.

Review of IFRS 16 disclosures

88. The FRC has issued a [report](#) following a thematic review of interim disclosures in respect of IFRS 16 Leases. The review identified a number of areas where disclosure could be improved, including the following:
- Information about key accounting judgments made on adopting the new standard which explains the specific judgements made and the effect on the financial statements, e.g. in respect of the lease term, and whether a contract contains a lease.
 - Clearer explanations of the specific transition choices made.
 - A detailed reconciliation between the operating lease commitment under the previous standard and the new lease liability, with clear explanations for reconciling items.
 - Alternative performance measures should be properly labelled, reconciled and explained, and not given more prominence than the IFRS-based measures.

Disclosures
should
explain
impact of
adopting
IFRS 16

Contact point for this section

89. The contact point for this section of the Technical Bulletin is Paul O'Brien, Senior Manager (Professional Support) - pobrien@audit-scotland.gov.uk.

Section 5

Fraud and irregularities

90. This chapter contains a summary of cases of fraud and other irregularities facilitated by weaknesses in internal control at audited bodies that have recently been reported by auditors to Professional Support.

Auditor action

Auditors should consider whether weaknesses in internal control which facilitated each fraud may exist in their bodies and take the appropriate action

Expenditure

Grant payments

91. A company fraudulently claimed £160,000 of grant funding from a central government body.

Key features

The grant was paid to a company to part-fund the purchase of machinery. The company used the grant for that purpose but the machinery was actually used by another party.

The fraud was not identified until the other party informed the central government body that they were using the machinery. The fraud was possible as a visit to the grant recipient's premises was not undertaken prior to payment of the final grant claim.

The case has been referred to Police Scotland and the company has agreed to repay the grant.

Invalid supplier

92. A third party defrauded £6,400 from a public sector body by requesting a fraudulent payment.

Key features

An email was received by the finance team purporting to be from the Chief Executive, requesting that an urgent payment be made to a new supplier. The finance team responded and made the payment.

It was subsequently identified that the email was fraudulent. The fraud was possible as the finance team did not spot tell-tale signs that the email was not genuine.

Staff training, awareness sessions and other communications have highlighted the risks of cybercrime. Three further similar emails have since been received but were not actioned.

The matter has been reported to Police Scotland.

Change of bank details

93. A third party defrauded over £5,000 from a council by re-directing salary payments.

Key features

An email was received by the payroll team, purporting to be from a senior officer of the council, advising of a change of bank account details. The payroll records were amended, and a salary payment was made.

It was not identified as fraud until the officer contacted the payroll team to query why they had not been paid. The fraud was possible as the procedures in place to check the validity of bank detail changes had not been followed.

Key features

Payroll staff have been reminded of the requirement to verify changes. They have also received information on how to spot fraudulent emails.

The case has been referred to Police Scotland.

Abuse of mobile telephone

- 94.** A social care customer defrauded almost £6,000 from a council through the misuse of a council mobile telephone.

Key features

The council had placed a mobile phone in a locked box at the customer's home for use by support workers. The customer managed to access the phone and used it to make calls to premium services over the period of a month.

The fraud was identified when the telephone bill was received by the council.

The fraud was possible as the telephone did not have a PIN authorisation code to prevent unauthorised access.

The case has been reported to Police Scotland and the customer charged.

Summary of auditor actions in this section

Paragraphs	Auditor action
91 - 94	Consider whether weaknesses in internal control which facilitated each fraud may exist in other bodies and take the appropriate action

Contact point

- 95.** The contact point for this section of the Technical Bulletin is Anne Cairns, Manager (Professional Support) – acairns@audit-scotland.gov.uk.

Technical Bulletin 2019/4

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Audit Scotland, 4th Floor, 102 West Port, Edinburgh, EH3 9DN
T: 0131 625 1500