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

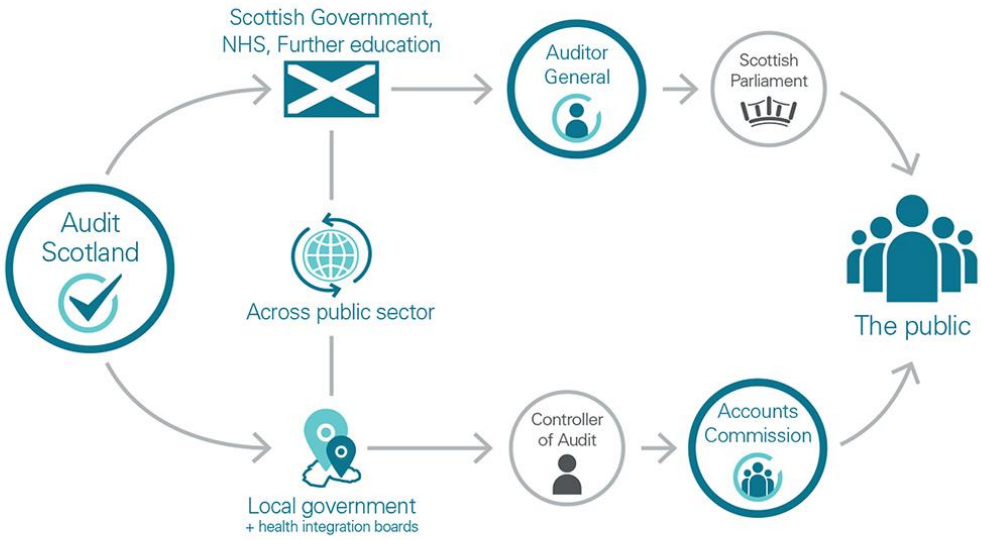
Who we are

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.

Contents

Introduction

Purpose

Technical bulletins provide information on developments and guidance on emerging risks

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.

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

Feedback on this technical bulletin is welcome

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.

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

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

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.

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.

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

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.

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.

As an interim solution, pension schemes fund GMP annual increases

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 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.

Preferred permanent solution is to convert GMP to benefit

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.

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.

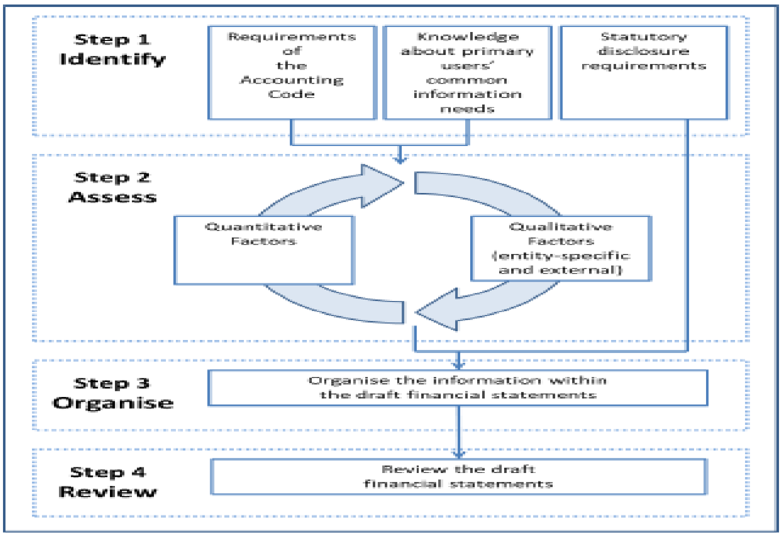
Materiality

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.

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

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.

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.

The 2016 regulations apply to advances made from 1 April 2016

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*

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).

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

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

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 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.

The statutory mitigation for equal pay provisions has been extended

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.

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.

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

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.

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.

Draft guidance proposes that an element of the general fund 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 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.

Previous guidance on insurance funds has been 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.

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).

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

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 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.

Negative reserves should be avoided

Direct reserve accounting is prohibited

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.

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.

HBCOUNT has been replaced by HBAP

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.

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.

Auditor action
Auditors should use the technical guidance note when planning and performing the audit of 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).

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

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.

Auditor action
Auditors should consider requesting that bodies complete this checklist

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

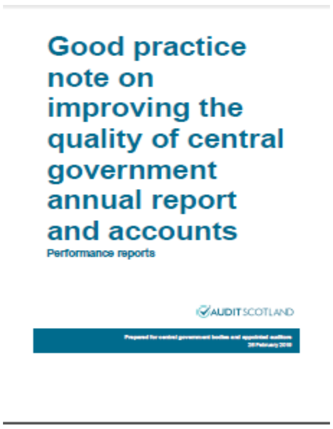
- assess whether the body's responses in the checklist are consistent with auditor's knowledge.

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:

Auditor action
Auditors should confirm that bodies have considered this good practice note

 Good practice note on improving the quality of central government annual report and accounts Performance reports AUDIT SCOTLAND	• 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

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 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.

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

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:

 2018/19 independent auditor's reports (health boards) Technical guidance note 2019/3(H)	• 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

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.

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

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 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 *IFRS 9 Financial instruments.*
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

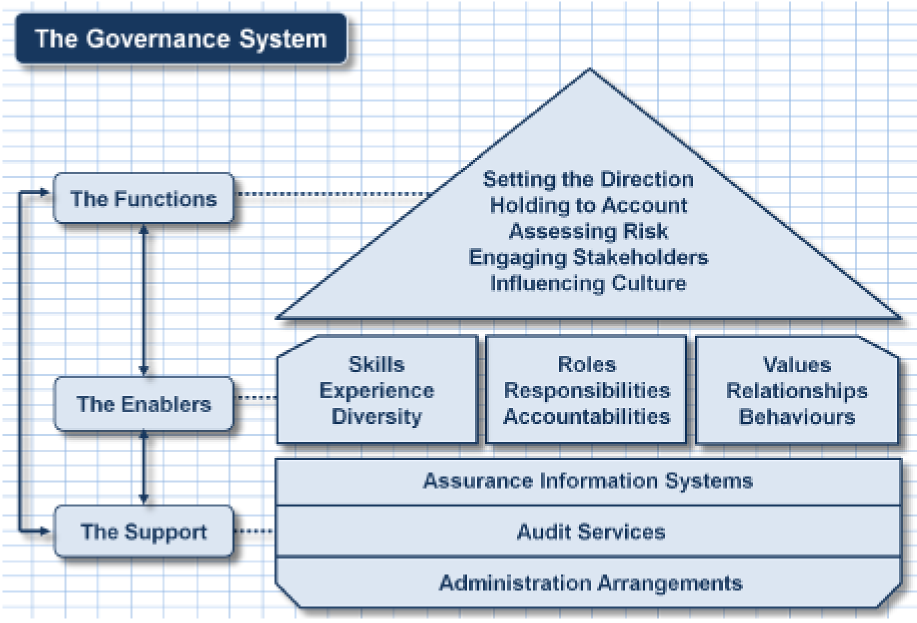
Blueprint for good governance

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.

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

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.

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.

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

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.

No concerns over auditing standards

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.

Proposal to publish audit quality reports to be progressed

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.

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: • 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.

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

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 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	Links from ISA (UK) 570 to important principles in other ISAs are to be enhanced to: • 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	Where the going concern basis of accounting is appropriate, a new requirement for the auditor's report has been added to include: • 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 charge 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.

A well-functioning market would produce high quality audits

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:

Concern	Proposed reform
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. 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.	**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: • 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.
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.	**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. 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. **Market share cap** - An alternative approach, but less favoured by the CMA, is imposing a market share cap on the Big Four.

Concern	Proposed reform
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: (a) Profit pooling means that audit partners directly benefit from the commercial success of the non-audit part of the business (b) The significant revenue derived from non-audit services means that governance and investment decisions are heavily driven by non-audit considerations. (c) There are underlying cultural concerns of the same firm providing audit and non-audit services.	**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. 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
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.	**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.

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.

The review will consider audit standards and requirements for the future

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.

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

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

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.

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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