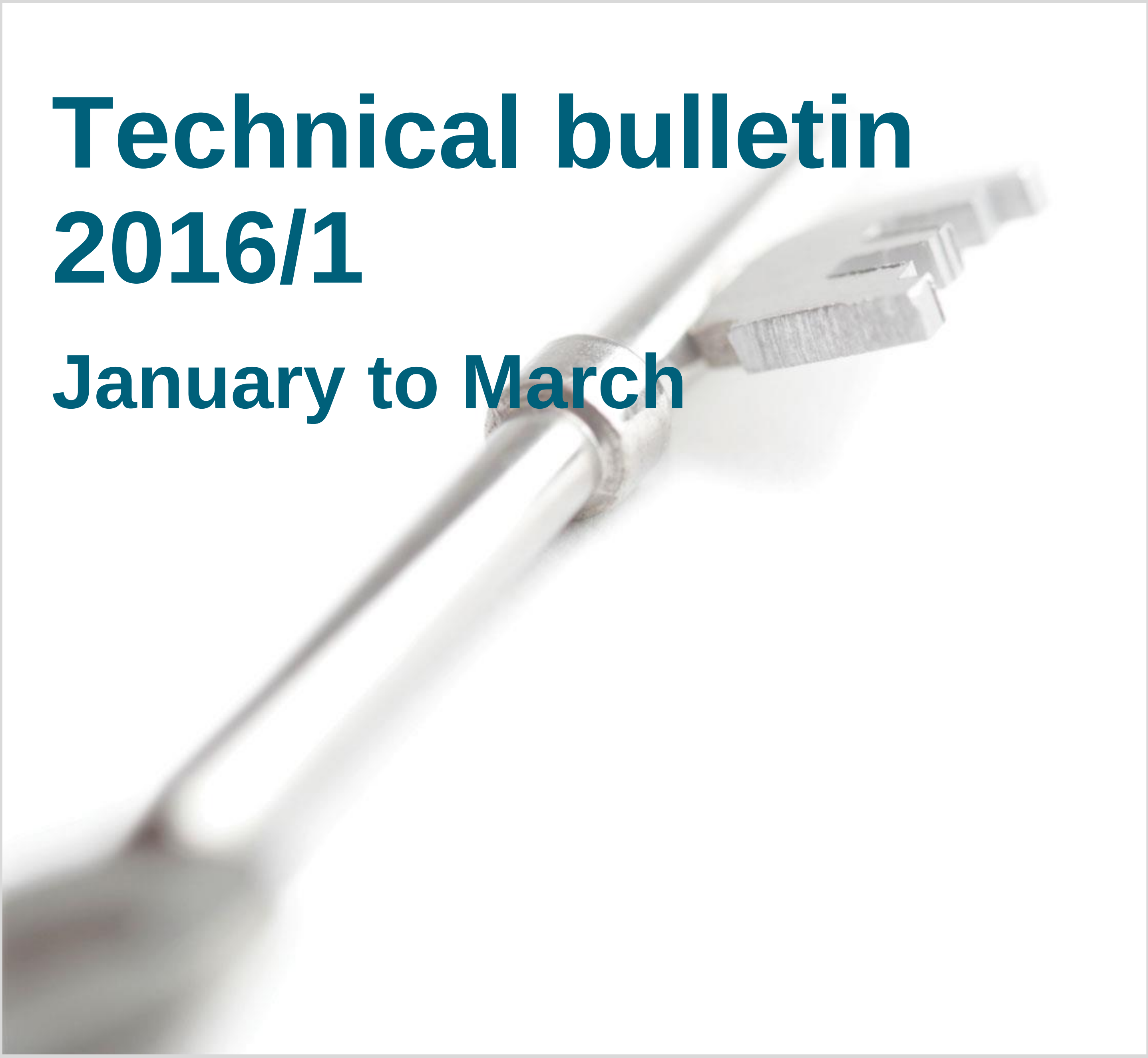
Technical bulletin 2016/1

January to March



AUDIT SCOTLAND

Prepared by the Technical Services Unit
7 March 2016

Audit Scotland is a statutory body set up in April 2000 under the Public Finance and Accountability (Scotland) Act 2000. We help the Auditor General for Scotland and the Accounts Commission check that organisations spending public money use it properly, efficiently and effectively.

Contents

Foreword

Technical bulletins are prepared by Audit Scotland's Technical Services Unit (TSU), and approved by the Assistant Auditor General, to provide external auditors appointed by the Accounts Commission and Auditor General for Scotland with

- information on the main public sector technical developments in the quarter that are relevant to their audit appointment
- guidance from the TSU on any emerging risks identified in the quarter.

Technical bulletins are available to external auditors from Audit Scotland's *Technical reference library,* and published on the Audit Scotland website so that audited bodies and other stakeholders can access them.

It is important that auditors read this technical bulletin promptly so they are familiar with the information and guidance provided. The auditor action checklist section at the end of each chapter should be completed by a senior member of the audit team.

The articles on technical developments are intended to highlight the key points that the TSU considers external auditors require to be aware of. It may still be necessary for auditors to read the source material where greater detail is required. The documents referred to in the articles can be obtained by using the hyperlinks, where available. They are also available to external auditors from Audit Scotland's *Technical reference library*.

While auditors act independently, and are responsible for their own conclusions and opinions, the TSU has a role in ensuring that those conclusions and opinions are reached on the basis of informed judgement. Consistency in similar circumstances is important and **Audit Scotland's *Code of audit practice* therefore states that auditors should normally follow TSU guidance.** Auditors should advise the TSU promptly if they intend not to follow guidance provided in this technical bulletin on an emerging risk.

The TSU encourages feedback on this technical bulletin. Comments should be sent to pobrien@audit-scotland.gov.uk.

More in-depth and extensive guidance is provided in separate technical guidance notes published by the TSU. Technical guidance notes published in the quarter are referred to in this technical bulletin, and can be obtained by using the hyperlinks to the Audit Scotland website.

Headlines

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Cross-sectoral chapter

Introduction

This chapter contains technical developments and guidance from the TSU on emerging risks in the quarter that are relevant to all sectors.

It should be read by all external auditors. Information on developments and guidance from the TSU in the quarter that are relevant to only one sector are covered in the relevant sector-specific chapter.

Accounting developments

Management commentary

New report on clear and concise reporting

1. The Financial Reporting Council (FRC) has issued a report on the steps that companies have taken towards clear and concise reporting. Clear and concise – developments in narrative reporting has been issued under the FRC's *Clear & concise* initiative which is a programme of activities aimed at ensuring that annual reports provide relevant and easily understandable information. The objectives of the initiative are to encourage
   - communication that is focused on the needs of the audience
   - greater emphasis on the application of materiality
   - improvement in the relevance and readability of annual reports
   - consideration of other channels for reporting information.
2. The report highlights emerging best practice in narrative reporting following the introduction of the strategic report and considers developments in the reporting framework. Auditors may wish to refer to this report when considering the clarity and conciseness of an audited body's annual report and accounts.
3. Section 1 of the report
   - provides an overview of the current reporting landscape
   - considers feedback from investors and companies on the impact of recent developments
   - examines how communication can be improved
   - considers how some of the perceived barriers can be overcome.
4. For example, page 4 lists actions that can help achieve clear and concise reporting. They include
   - using a reduction in page count as a benchmark in order to streamline the annual report

- starting the planning process with a blank sheet of paper which enables organisations to be less constrained by how the annual report has been structured in previous years, enabling a fresh and more innovative approach
- bringing together teams across the organisation with responsibility for different parts of the annual report
- engaging with the Board early in the process of planning the annual report as Board support for driving innovative improvements in the annual report is key
- seeing the annual reporting process as a continuous improvement cycle rather than a one-off exercise.

5. Section 2 sets out the findings from a study on the impact of the strategic report The study consists of an analysis of recent research into the quality of strategic reports, supplemented by a detailed review of a small sample. Some key findings are summarised in the following paragraphs.

6. A fair, balanced and understandable strategic report
    - truly reflects the business
    - is comprehensive but concise
    - strikes an appropriate balance between positive and negative aspects
    - is cohesive, with different components of the annual report being consistent
    - is written in clear language.

7. A clear and sufficiently detailed contents page helps users locate specific components of the annual report and pieces of information that they wish to review.

8. Good linkages between related disclosures are essential for the annual report to communicate a holistic story, whereas insufficient linkage can make it appear disjointed. Cross-referencing and signposting are useful techniques that can assist organisations in highlighting linkages as follows
    - An item of required information set out in one component of the annual report can be included in another by cross-reference. This allows statutory disclosure requirements to be met while avoiding duplication. Cross-referencing can improve the narrative flow of the strategic report because information that is material, but not of strategic importance, can be provided elsewhere in the annual report.
    - Signposting can be used to direct users to complementary information outside the annual report.

9. Many organisations use diagrams to depict their business model. However, it is also important to provide sufficient narrative explanation to enable users to understand what the organisation does. Good examples of clear business model disclosures explained how the organisation generates long-term value, identifies its main revenue streams and highlights its key relationships, resources and other inputs that enable its successful operation. The

clearest disclosures explained explicitly how the business model will achieve the strategic objectives and how it is linked to the principal risks.

Auditing developments

Review of audit quality monitoring programmes

10. The FRC has issued a report to set out the principal findings of a thematic review undertaken on audit quality control monitoring programmes. Monitoring programmes evaluate the effectiveness of firms' quality control systems and the quality of completed audits, identifying where improvements can be made.

11. The review considered the monitoring performed by nine audit firms over their quality control systems. Audit quality thematic review – Firms' audit quality monitoring is intended to promote a better understanding of the firms' quality control monitoring programmes and how these can improve justifiable confidence in audit.

12. The FRC believes the report will be a valuable tool for audit firms in developing, enhancing, and evolving their policies on audit quality control monitoring and contributing to their own processes of continuous improvement. The key messages in respect of required improvements include the following

    - Audit firms should allocate sufficient and appropriate staff to undertake their monitoring and provide them with adequate training and guidance to ensure consistency between reviewers.
    - Firms should assess whether individuals involved in the quality control processes should have identified the issues arising and required them to be addressed prior to completion of the audit.
    - A greater element of unpredictability to the selection of audits for review should be introduced such that individuals subject to monitoring are unable to predict when they will be reviewed or the audit which will be selected. The audit team should be notified of the audits selected for review no longer than ten days prior to the review starting.

13. The report also makes recommendations where good practices were observed. Good practice includes

    - communicating failures in the application of the firm's quality control procedures to the individuals concerned and reflecting these in their performance appraisal and remuneration decisions
    - undertaking root cause analysis on issues identified. This involves questioning why a problem arose until the cause is identified, so actions address the underlying cause rather than the symptoms
    - moving away from completing procedural type checklists towards a risk focused review
    - ensuring that relevant findings are discussed with both the training and the ethics and independence teams

- undertaking in depth thematic reviews of specific aspects of audits where there are recurring issues.

Other developments

Charities

Changes to charities SORPs

14. The Office of the Scottish Charity Regulator (OSCR) has withdrawn the statement of recommended practice based on the *Financial reporting standard for smaller entities* with effect from reporting periods beginning on or after 1 January 2016. This is as a result of the FRC withdrawing the FRSSE.

15. All charities will therefore be required to follow the Charities SORP (FRS 102) from 2016/17. OSCR has issued a bulletin to reflect that change. Regulations have been issued to make consequent amendments to *The Charities Accounts (Scotland) Regulations 2006*.

TSU contact for cross-sector chapter

16. The contact in the TSU for this chapter is Paul O'Brien, Senior Manager (Technical) - 0131 625 1795 or pobrien@audit-scotland.gov.uk.

Local authority sector

Introduction

This chapter contains information on the main technical developments, and guidance from the TSU on any emerging risks, in the quarter that are relevant to the local authority sector.

It should be read by external auditors with appointments in the local authority sector. Auditors should also read the cross-sectoral chapter.

Accounting developments

General accounting

2015/16 Code guidance notes

17. The Chartered Institute of Public Finance and Accountancy (CIPFA) has published *the Code of practice on local authority accounting in the UK 2015/16 – guidance notes for practitioners* which are intended to assist in understanding the accounting requirements set out in the *Code of practice on local authority accounting in the UK* (the Code).

18. The main changes to the guidance notes are to reflect the Code's adoption of *IFRS 13 Fair value measurement*. Section J has been added to Module 2 and explains that local authorities are required to measure their assets and liabilities and provide disclosures in accordance with IFRS 13 where another section of the Code requires or permits fair value measurement.

19. The Code confirms that the measurement bases used for operational property, plant and equipment should focus on valuing their service potential. The Code does not directly adapt IFRS 13 but instead adapts IAS 16 and introduces the concept and definition of current value for the measurement of property, plant and equipment. This new definition of current value does not change the measurement requirements for operational property, plant and equipment.)

20. Only those property, plant and equipment assets that are classified as surplus are required to be measured at fair value in accordance with section 2.10 of the Code, representing a measure of the financial capacity and the opportunity cost of holding such surplus assets. IFRS 13 is also particularly relevant to financial instruments and investment properties.

21. Paragraph 2.10.2.5 of the Code defines fair value as 'the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date'. This definition emphasises that fair value is a market-based measurement. When measuring fair value, authorities are required to use the assumptions that market participants would use when pricing an asset or liability under current market

conditions. Therefore, an authority's reasons for holding an asset, for example, are not relevant when measuring its fair value.

22. A diagram at paragraph J13 summarises the fair value measurement approach required to achieve the objectives of the Code, which is further described in the table at paragraph J14.

23. IFRS 13 adopted by the Code introduces a comprehensive disclosure framework for fair value measurement, the objective of which is to provide users of financial statements with information about the valuation techniques and inputs used to develop fair value measurements. The disclosure requirements of the Code also apply to each class of asset and liability not measured at fair value but for which another section of the Code requires fair value disclosure. For example, IFRS 7 already requires disclosure of the fair value of financial instruments even if they are not measured at fair value.

24. A diagram at paragraph J76 sets out the main disclosure requirements for recurring fair value measurements. An appendix to section J presents example notes to the accounts for the 2015/16 year to assist authorities in making fair value disclosures for assets and liabilities consistent with the requirements of the Code.

25. In addition, module 4 and the example financial statements have been substantially updated to reflect the Code's introduction of the concept of current value in respect of the measurement of operational property, plant and equipment assets and the changed measurement requirements for assets classified as surplus assets.

26. Auditors may wish to refer to these guidance notes when auditing the 2015/16 local authority annual accounts.

Highways network asset

Update to 2015/16 accounting code

27. The CIPFA/LASAAC Local Authority Code Board has issued an update to the 2015/16 accounting Code in respect of the highways network asset. Auditors will be aware that the 2016/17 edition of the Code is introducing the requirement to measure the highways network asset at depreciated replacement cost in accordance with the methodologies specified in CIPFA's *Code of practice on transport infrastructure assets*.

28. The update to the 2015/16 accounting Code reflects the decision that the change in accounting policy will be applied from 1 April 2016, with no requirement to restate the information in the preceding year (i.e. from 1 April 2015). The change is to be accounted for as an adjustment to opening balances as at 1 April 2016. Auditors should therefore note that the change in accounting policy for measuring the highways network asset from 1 April 2016 will not require a retrospective restatement.

29. Paragraph D.1.5 which set out disclosure requirements for 2015/16 relating to the impact of the change in accounting policy has been deleted. The requirement to disclose in 2015/16 information on the change therefore no longer applies. This update means that paragraphs 231, 233, 239 and 240 of module 7 of technical guidance note 2015/8(LA) no longer apply.

Other developments

Borrowing and lending

New regulations

30. Regulations have been approved by the Scottish Parliament which provide, with effect from 1 April 2016, for the powers of local authorities to borrow money, to incur debt through borrowing by way of credit arrangements, and to maintain loans funds.

31. The Local Authority (Capital Finance and Accounting)(Scotland) Regulations 2016 are made under the *Local Government etc. (Scotland) Act 1994* and will replace much of the provision in relation to local authority borrowing that is contained in Schedule 3 to the *Local Government (Scotland) Act 1975*. Existing provisions are being repealed by The Local Government etc. (Scotland) Act 1994 (Commencement No. 9) Order 2016.

32. Regulations 2 to 4 are on the borrowing of money by local authorities
    - Regulation 2(1) sets out the purposes for which a local authority may borrow.
    - Regulation 2(1)(a) retains the existing power to borrow to finance capital expenditure but capital expenditure is now defined by reference to proper accounting practices.
    - Regulation 2(1)(b) includes a new purpose which will allow local authorities to borrow to give grants to a third party towards expenditure that would be capital expenditure if incurred by the authority.
    - Regulation 2(1)(c) allows borrowing for expenditure on third party land and buildings which would be capital if the authority had an interest in that land or building.
    - Regulation 2(1)(d) permits a local authority to borrow for treasury management activities. This provides a slightly wider power than Schedule 3 reflecting the treasury needs of an authority to refinance existing borrowing, use of internal cash reserves, borrowing in advance or after capital expenditure is incurred and for general liquidity purposes.
    - Regulation 4 requires a local authority, when exercising its borrowing powers, to have regard to recognised codes of practice and guidance in relation to treasury management, e.g. the *Prudential code* and *Treasury management code*.

33. Regulation 5 recognises credit arrangements (e.g. leases and private finance initiatives) for the purposes of financing capital expenditure of the local authority.

34. Regulation 6 requires a local authority to determine, before the start of each financial year, how much external debt it can afford (known as the authorised limit) during that financial year and each of the subsequent two financial years. The *Prudential code* includes long-term liabilities in the authorised limit, but the Regulations also include short term liabilities. As a supplemental measure, Regulation 17 requires the authorised limit for 2016/17 to be determined no later than 30 June 2016.

35. Regulation 6(2) requires an authority to set a single authorised limit for external debt and to separately identify the amount of borrowing and the amount of credit arrangements. These

are defined as the authority's 'debt amounts'. Regulation 6(3) allows a local authority to exceed either of its debt amounts (borrowing or credit arrangements) provided its authorised limit is not exceeded. Regulation 6(6)(a) requires the section 95 officer to report any debt amounts which have been exceeded.

36. Under Regulation 6(4), the determination of the authorised limit and any variation of that limit is a function of the authority itself and may not be delegated. This takes precedence over the *Prudential code*, which requires the setting or revising of prudential indicators to follow the same route as the budget of the local authority.

37. Regulation 7 sets out the arrangements for the security of money borrowed. As a new provision, local government pension funds do not form part of the revenues of the authority in terms of providing security for borrowing. Similarly, under Regulation 9(1), money borrowed by a local authority for a pension fund is not to be treated as borrowing of the local authority. The temporary use by a local authority of money forming part of pension funds (other than for the purposes of the fund) is to be treated as borrowing by the authority under Regulation 9(3).

38. Regulation 11 provides local authorities with the new power to borrow and advance funds to a common good fund. However, this is only in respect of expenditure by the fund which would be capital expenditure of the local authority if incurred directly by the authority.

39. Regulation 12 requires local authorities to maintain a loans fund and to administer it in accordance with proper accounting practices and prudent financial management. Regulation 13 requires a local authority to make loans fund advances in respect of the amount of expenditure and lending that the authority has determined is to be financed by borrowing. Regulation 14(1) requires a local authority to determine, for each loans fund advance

- the period over which the advance is to be repaid
- the amount of repayment in each financial year in that period.

40. Regulation 15 also amends provision in paragraphs 22 and 25 of Schedule 3 to the 1975 Act about the use of money in certain funds that is not immediately needed for fund purposes. There is no longer a requirement to recognise the internal borrowing of these funds by advancing them to the loans fund. Instead these funds can be used for any purpose that may be funded by borrowing. Paragraph 22 of the Schedule continues to allow these funds to be invested externally.

Housing benefit

2014/15 subsidy claims

41. The Department for Work and Pensions (DWP) has issued *Notes on completion of form MPF720B - final subsidy claim 2015/16* and a letter relating to the completion of the housing benefit subsidy claim for 2015/16.

42. The deadlines for receipt of the

- pre-certified claim to the DWP and external auditors is 30 April 2016

- the certified claim by the DWP is 30 November 2016.

2015/16 HB COUNT modules

43. The Public Sector Audit Appointments Limited (PSAA) has issued the following modules of the 2015/16 HB COUNT approach
    - Module 2 contains a checklist to help auditors ensure that the authority's system is using the correct benefit parameters to calculate benefit entitlement and for the authority to claim the correct amount of subsidy.
    - Module 3 comprises workbooks to be completed for detailed testing, incorporating step-by-step guidance and a test result summary.

44. Module 1 has also been issued and provides an overview of the approach, but this is superseded in Scotland by guidance from the TSU.

45. For 2015/16, the key changes to HB COUNT are
    - to reflect changes to the regulations and subsidy order, including the merger of *Electronic transfers of data* (ETDs) into *Automatic transfers to local authority system* (ATLAS) notifications and the implementation of *Real time information* (RTI) referrals
    - the introduction of an observations section into the covering letter template
    - errors which do not affect the amount of subsidy claimed no longer require additional testing (other than for overpayments)
    - rounding differences between the subsidy claim form’s in-year reconciliation cells and the HB system outturn reports no longer require a qualification to the auditor's conclusion.

46. An e-learning package setting out the principles of the HB COUNT approach to the certification of HB subsidy claims for 2015/16 has also been issued.

Miscellaneous 2016/17 circulars

47. The DWP has issued the following circulars
    - HB circular A13/2015 Housing benefit uprating 2016/17 advises of the benefits rates from April 2016.
    - HB circular S10/2015: 2016/17 Housing benefit administration subsidy arrangements for Scottish local authorities provides details of the provisional HB administration subsidy for each local authority for 2016/17.
    - HB circular S1/2016 Discretionary housing payments government contribution for 2016/17 confirming UK government funding for discretionary housing payments in 2016/17.
    - HB circulars S2/2016 and A2/2016 Extension of fraud & error reduction incentive scheme 2016/17 set out the arrangements for *Fraud and error incentive reduction scheme* in 2016/17.

TSU contacts for local authority chapter

48. The contacts in the TSU for this chapter are

- Paul O'Brien, Senior Manager (Technical) - 0131 625 1795 or pobrien@audit-scotland.gov.uk.
- Tim Bridle, Manager - Local Government (Technical) - 0131 625 1793 or tbridle@audit-scotland.gov.uk.
- Anne Cairns, Manager – Benefits (Technical) - 0131 625 1926 or acairns@audit-scotland.gov.uk (for housing benefit).

Central government sector

Introduction

This chapter contains information on the main technical developments, and guidance on any emerging risks, in the quarter that are relevant to central government bodies.

It should be read by external auditors with appointments in the central government sector. It should also be read by auditors with appointments in the health sector and further education sector as most of the articles also apply to those sectors. Auditors should also read the cross-sectoral chapter.

Accounting developments

Amendments to the 2015/16 FReM

49. HM Treasury has issued a revised version of the 2015/16 Government financial reporting manual (the FReM). The changes from the previous version are minor and include the following

- Paragraph 5.4.20 has been amended to highlight the need to consider the disclosure requirements in the relevant accounting standard, subject to any adaptations and interpretations.
- Paragraph 5.4.28 has been amended to remove the requirement to deduct the interest element in the disclosure of total commitments for service concession arrangements.

50. Auditors should ensure their audited bodies are aware of these further changes in 2015/16 and are making preparations to implement them.

2015/16 disclosure guides

51. The National Audit Office (NAO) has issued the 2015/16 FReM disclosure guide for financial statements, 2015/16 Charities SORP disclosure guide and the 2015/16 FReM disclosure guide for annual reports which are designed to ensure that entities covered by the FReM have prepared their 2015/16 annual report and accounts in the appropriate form and have complied with all disclosure requirements.

52. The guides are cross-referenced to the 2015/16 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.

53. While the guides are designed primarily for the NAO's internal use, auditors in Scotland may also find them helpful.

2016/17 FReM

54. Treasury has issued the 2016/17 FReM. It applies EU adopted IFRS and Interpretations in effect for accounting periods commencing on or after 1 January 2016.

55. There are no significant changes from 2015/16.

Auditing developments

Technical guidance note on auditing 2015/16 annual accounts

56. The TSU has published Audit of 2015/16 annual report and accounts (central government) - technical guidance note 2016/1(CG) to provide auditors with guidance on planning and performing the audit of the 2015/16 central government annual accounts.

57. The technical guidance note comprises a number of modules that

- highlight the main risks of misstatement in each financial statement area, explains the correct treatment, and sets out actions for auditors to assess whether the body has followed the required treatment
- provide guidance on auditors' responsibilities in respect of the performance and accountability reports, including the remuneration and staff report and governance statement.

58. 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 plan and perform the audit of 2015/16 central government annual accounts.

59. Auditors should read the technical guidance note so they are familiar with the guidance provided. It is important that auditors follow the actions set out to ensure that all auditors adopt a consistent approach to common risks.

2015/16 Government Banking Service account information

60. The TSU will obtain information on account balances at 31 March 2016 for central government bodies from the Government Banking Service (GBS) and distribute them to relevant auditors. The GBS has recently awarded the contract for banking services to NatWest who will operate accounts under the GBS contract. A single NatWest account will replace the previous Citibank and RBS accounts.

61. The GBS has confirmed that the arrangements for obtaining 2015/16 account balances are unchanged. The GBS have informed the TSU that *Auditor authorisation forms* to allow disclosure of account balances are not required for accounts which have transferred to NatWest.

Auditor action checklist

	Yes/No/N/A	Initials/date	W/P ref
1 Have you carried out the action recommended at paragraph 50 in respect of the 2015/16 FReM?			
2 Have you carried out the action required by paragraph 59 in respect of technical guidance note 2016/1(CG)?			

TSU contacts for central government chapter

62. The contacts in the TSU for this chapter are

- Neil Cameron, Manager - Central Government and Health (Technical) - 0131 625 1797 or ncameron@audit-scotland.gov.uk.
- Helen Cobb, Technical Adviser (Central Government, Health and Further Education) - 0131 625 1901 or hcobb@audit-scotland.gov.uk.

Health sector

Introduction

This chapter contains information on the main technical developments, and guidance on any emerging risks, in the quarter that are relevant to health bodies.

It should be read by external auditors with appointments in the health sector. Auditors should also read the central government chapter and cross-sectoral chapter.

Accounting developments

2015/16 accounts manual

63. The Scottish Government Health and Social Care Directorates (SGHSCD) has issued the 2015/16 *NHS board manual for annual report and accounts* to complement the guidance contained in the 2015/16 FReM for health boards. The main changes from the previous year's accounts manual are summarised in the following paragraphs.

64. In accordance with the FReM, the accounts manual has been revised to require the annual report portion of the annual report and accounts to comprise a performance report and accountability report.

65. Pages 8 to 10 explain that the performance report is to provide information on the board, its main objectives and strategies and the principal risks that it faces. The report is required to provide a fair, balanced and understandable analysis of the board's performance, in line with the overarching requirement for the annual report and accounts as a whole. The report is required to have the following two sections

    - An overview to give the user a short summary that provides sufficient information to understand the board, its purpose, the key risks to the achievement of its objectives and how it has performed during the year
    - A performance analysis to report the most important performance measures and provide longer term trend analysis, where appropriate.

66. Pages 11 to 31 cover the accountability report, which is required to include a

    - Corporate governance report which should explain the composition and organisation of the board's governance structures and how they support the achievement of the board's objectives. It is required to include a directors' report, statement of accountable officer's responsibilities, statement of board members' responsibilities, and the governance statement. Guidance on the governance statement (previously available separately) has been added to page 15 with a proforma at Annex A.
    - Remuneration and staff report which has new disclosures set out on pages 26 to 31.

67. As a result of the FReM's adoption of IFRS 13, there have been changes on pages 56 and 57 (i.e. note 1 on accounting policies) to the measurement requirements of property, plant and equipment. In summary

- operational assets which are in use delivering front line services or back office functions, and surplus assets with restrictions on disposal which would prevent access to the market, are required to be valued at current value in existing use (rather than fair value). An asset is surplus where there is no clear plan to bring it back into operational use
- all assets that are not held for their service potential (i.e. investment properties and assets held for sale), including operational assets which are surplus to requirements where there are no restrictions on disposal, continue to be measured at fair value.

68. The wording of the accounting policy on clinical and medical negligence costs (on page 64) has been amended to reflect guidance issued in 2014/15 on the requirement for a board to recognise a provision in respect of its participation in the *Clinical negligence and other risks indemnity scheme*.

69. Note 33 (pages 135 and 136) has been amended to reflect the disclosure of a board's interest in an integration joint board (IJB). The manual assumes that the nature of the arrangement is such that it should be accounted for as a joint venture, but notes that boards should satisfy themselves that this applies to their own particular circumstances. Under *IFRS 11 Joint arrangements*, a joint venturer should recognise its interest in a joint venture as an investment and account for it using the equity method in accordance with *IAS 28 Investments in associates and joint ventures*.

70. The manual explains that

- IFRS 12 sets out the disclosure requirements, and requires the disclosure of information on significant judgements and assumptions made by the board in determining whether or not it has joint control over another entity
- a board's contributions to IJBs and subsequent expenditure in delivering services should be treated as distinct and separate from the commissioning income that will be received
- consolidated gross expenditure and consolidated gross income will increase but the impact on net expenditure should remain relatively stable
- the interest in the IJB should be reversed in the summary of resource outturn to provide figures for total core expenditure to be compared to core revenue resource limits.

71. Auditors should confirm that audited bodies are aware of the changes to the 2015/16 accounts manual and are taking the necessary steps to comply

2015/16 capital accounting manual

72. The SGHSCD issued the 2015/16 *Capital accounting manual* (CAM) which interprets the accounting guidance contained in the 2015/16 FReM on capital accounting issues in the NHS.

73. The main changes from the previous year's version are at paragraphs 6.19.13 and 6.19.14 as a result of the adoption of IFRS 13.

74. Auditors should confirm that audited bodies are aware of the changes to the 2015/16 CAM and are taking the necessary steps to comply

Auditing developments

Technical guidance notes

Audit of 2015/16 annual accounts

75. The TSU has published Audit of 2015/16 annual report and accounts (health boards) - technical guidance note 2016/2(H) to provide auditors with guidance on planning and performing the audit of the 2015/16 health board annual accounts.

76. The technical guidance note comprises a number of modules that

- highlight the main risks of misstatement in each financial statement area, explains the correct treatment, and sets out actions for auditors to assess whether the board has followed the required treatment
- provide guidance on auditors' responsibilities in respect of the performance and accountability reports, including the remuneration and staff report and governance statement.

77. 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 plan and perform the audit of 2015/16 health board annual accounts.

78. Auditors should read the technical guidance note so they are familiar with the guidance provided. It is important that auditors follow the actions set out to ensure that all auditors adopt a consistent approach to common risks.

Auditor action checklist

	Yes/No/N/A	Initials/date	W/P ref
1 Have you carried out the action recommended at paragraph 71 in respect of the 2015/16 annual report and accounts?			
2 Have you carried out the action recommended at paragraph 74 in respect of the 2015/16 capital accounting manual?			
3 Have you carried out the action recommended at paragraph 78 in respect of the 2015/16 technical guidance note?			

Further education sector

Introduction

This chapter contains information on the main technical developments, and guidance on any emerging risks, in the quarter that are relevant to further education colleges.

It should be read by external auditors with appointments in the further education sector. Auditors should also read the central government chapter and cross-sectoral chapter.

Corporate governance developments

New guidance on severance schemes

79. The Scottish Funding Council (the SFC) has issued further guidance to colleges and regional strategic bodies on meeting the requirements in the *Scottish public finance manual* in relation to severance schemes and settlement agreements.

80. Paragraph 19 of SFC/CG/01/2016 Guidance on seeking approval for severance schemes and settlement agreements sets out the key principles colleges must observe when considering any severance. These include

- where appropriate, ex-gratia severance or redundancy packages must be based on the arrangements set out within relevant extant terms and conditions of employment
- special payments must be transparent and negotiated in a way which avoids conflicts of interest
- offers of subsequent employment or consultancy work must be exceptional and only made where they represent value for money
- any undertakings about confidentiality must leave transactions open to proper public scrutiny.

81. The guidance requires that policies and procedures are established and applied including ensuring a business case is prepared, decisions are fully documented, and evidence is retained. It also requires clear governance oversight, e.g. the Remuneration Committee must undertake robust scrutiny of proposed severance schemes and settlement agreements before recommending approval to the Board.

82. A flowchart at Annex A shows the processes for obtaining approval for severance schemes and settlement agreements from the SFC

- Colleges should complete the template at Annex B setting out details of any proposed voluntary severance scheme or changes to an existing scheme.
- Individual approval is required for each settlement agreement or proposal to secure a voluntary resignation and colleges are required to request approval by completing the template at Annex C. There should always be a presumption against the use of

settlement agreements except in exceptional circumstances and colleges will have to justify their use.

83. Any confidentiality clause within a settlement agreement should not restrict an individual's right to make a protected disclosure under the Public Interest Disclosures Act 1998. Where a confidentiality clause is included in a settlement agreement, the text should be included in the business case submission to SFC.

TSU contacts for further education chapter

84. The contacts in the TSU for this chapter are

- Neil Cameron, Manager - Central Government and Health (Technical) - 0131 625 1797 or ncameron@audit-scotland.gov.uk.
- Helen Cobb, Technical Adviser (Central Government, Health and Further Education) - 0131 625 1901 or hcobb@audit-scotland.gov.uk.

Fraud cases

This chapter contains a summary of fraud cases arising at audited bodies that have recently been reported by auditors to the TSU.

Auditors should consider whether the weaknesses in internal control that facilitated each fraud may apply at their audited bodies and take the appropriate action.

Income

Council tax refunds

85. A council tax officer defrauded over £17,000 from a council by processing inappropriate council tax reliefs and exemptions prior to processing refunds to his own bank account.

Key features

The fraud was perpetrated by the officer

- transferring historical council tax credits from unrelated dormant accounts into his own council tax account to offset his liability
- creating inappropriate exemptions and reliefs to re-create credits in the dormant accounts
- transferring credits into the accounts of council tax payers with similar names to himself
- processing refunds, authorised unwittingly by fellow officers, to his own bank account.

The fraud was identified when a member of staff identified a mismatch between a council tax account payer's name and the name on a bank account refund.

Procedures have been reviewed and controls have been strengthened including the introduction of monitoring of historical dormant accounts, an annual audit of officers' council tax accounts and random quality checking.

The officer concerned has been dismissed and a police investigation is underway.

TSU contact for fraud chapter

86. The contact in the TSU for this chapter is Anne Cairns, Manager – Benefits (Technical) - 0131 625 1926 or acairns@audit-scotland.gov.uk.

Technical Services Unit

Audit Scotland's Technical Services Unit (TSU) informs the professional judgement of appointed external auditors on technical matters and encourages the proper exercise of professional scepticism to improve the quality of the audit delivered to the Accounts Commission and Auditor General for Scotland. The TSU provides authoritative guidance and practical assistance to support appointed auditors in carrying out their responsibilities under the *Code of audit practice* to

- provide an opinion on audited bodies' financial statements and, where required, the regularity of transactions
- review and report on other information published with the financial statements, including governance statements and remuneration reports
- examine and report on approved grant claims and other returns submitted by local authorities
- review and report on whole of government accounts returns.

Contact details for relevant TSU staff are included at the end of each chapter.

Feedback on technical bulletins is encouraged and should be sent to

pobrien@audit-scotland.gov.uk

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Technical bulletin 2016/2

April to June 2016

Prepared by the Technical Services Unit
7 June 2016

Audit Scotland is a statutory body set up in April 2000 under the Public Finance and Accountability (Scotland) Act 2000. We help the Auditor General for Scotland and the Accounts Commission check that organisations spending public money use it properly, efficiently and effectively.

Contents

Foreword

Technical bulletins are prepared by Audit Scotland's Technical Services Unit (TSU), and approved by the Assistant Auditor General, to provide external auditors appointed by the Accounts Commission and Auditor General for Scotland with

- information on the main public sector technical developments in the quarter that are relevant to their audit appointment
- guidance from the TSU on any emerging risks identified in the quarter.

Technical bulletins are available to external auditors from Audit Scotland's *Technical reference library,* and published on the Audit Scotland website so that audited bodies and other stakeholders can access them.

It is important that auditors read this technical bulletin promptly so they are familiar with the information and guidance provided. The auditor action checklist section at the end of each chapter should be completed by a senior member of the audit team.

The articles on technical developments are intended to highlight the key points that the TSU considers external auditors require to be aware of. It may still be necessary for auditors to read the source material where greater detail is required. The documents referred to in the articles can be obtained by using the hyperlinks, where available. They are also available to external auditors from Audit Scotland's *Technical reference library*.

While auditors act independently, and are responsible for their own conclusions and opinions, the TSU has a role in ensuring that those conclusions and opinions are reached on the basis of informed judgement. Consistency in similar circumstances is important and **Audit Scotland's *Code of audit practice* therefore states that auditors should normally follow TSU guidance.** Auditors should advise the TSU promptly if they intend not to follow guidance provided in this technical bulletin on an emerging risk.

The TSU encourages feedback on this technical bulletin. Comments should be sent to pobrien@audit-scotland.gov.uk.

More in-depth and extensive guidance is provided in separate technical guidance notes published by the TSU. Technical guidance notes published in the quarter are referred to in this technical bulletin, and can be obtained by using the hyperlinks to the Audit Scotland website.

Headlines

This chapter provides brief headlines for the articles on technical developments and guidance in this technical bulletin, classified by the audit year to which it relates, and referenced to the paragraphs containing the main article.

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Cross-sectoral chapter

Introduction

This chapter contains technical developments and guidance from the TSU on emerging risks in the quarter that are relevant to all sectors.

It should be read by all external auditors. Information on developments and guidance from the TSU in the quarter that are relevant to only one sector are covered in the relevant sector-specific chapter.

Auditing developments

New code of audit practice

1. Audit Scotland has issued a new Code of audit practice that will apply from the new audit appointments starting in 2016/17. The code
   - outlines the responsibilities of external auditors appointed by the Auditor General for Scotland and the Accounts Commission and it is a condition of their appointment that they follow it
   - describes the scope of public audit in Scotland where audit work is undertaken by appointed auditors, staff from Audit Scotland or jointly depending on the nature and timing of the work.
2. A significant change in this edition of the code is a requirement for appointed auditors to provide conclusions on the four dimensions of wider-scope public audit, i.e.
   - financial sustainability
   - financial management
   - governance and transparency
   - value for money.
3. The audit work on the dimensions will help meet stakeholder expectations and also help to focus auditors' work in support of the new approach to auditing best value. This involves an increasingly integrated approach that will make more use of the work that auditors carry out so that they add value for audited bodies and are better placed to address the challenges that they face.
4. The code is a high-level document and will be supplemented by more detailed guidance which will reflect changing priorities and auditing developments and support auditors to provide consistently high quality audits.

New and revised auditing standards

5. The [Financial Reporting Council] (FRC) has issued new and revised [international standards on auditing] (ISAs) that apply in the UK and Ireland [ISAs (UK&I)] for accounting periods commencing on or after 17 June 2016. However, earlier adoption is permitted, and the TSU is considering the merit in adopting them from the first year of the new audit appointments, i.e. from 2016/17.

6. The main source for the changes are new and revised standards from the International Auditing and Assurance Standards Board (IAASB) arising from projects on auditor reporting, responsibilities for other information, and financial statement disclosures. As auditing standards in the UK are based on international standards, the consequent revisions have been made to the UK standards. The standards have also been updated to reflect a new EU audit directive (Directive 2014/56/EU).

7. The following paragraphs provide more information on these changes. The TSU has also provided auditors with a technical briefing note that provides more detail of the main changes to each standard.

Auditor reporting

8. In January 2015, the IAASB revised its *ISA 700 Forming an opinion and reporting on financial statements*. The FRC had not previously adopted ISA 700 as it had significant concerns with that standard, and instead had issued *ISA 700 (UK&I) Independent auditor's reports on the financial statements*. However, the FRC believes that the changes to the revised ISA 700 has addressed these concerns and therefore has decided to adopt that standard.

9. The IAASB also issued *ISA 701 Key audit matters* which requires auditors of listed entities' financial statements to communicate those matters that the auditor views as most significant, with an explanation of how they were addressed in the audit. The FRC has also adopted ISA 701, but has extended the definition of key audit matters used by the IAASB to include the requirements for enhanced auditor reporting that already apply in the UK, i.e. those assessed risks of material misstatement which had the greatest effect on the overall audit strategy, the allocation of resources in the audit, and directing the efforts of the audit team.

10. The IAASB has also taken steps to increase the auditor's focus on the going concern basis of accounting by enhancing the auditor's reporting responsibilities, including requiring greater focus on the related disclosures in the financial statements, and adding more transparency in the auditor's report about the auditor's work in this respect. The FRC has also amended ISA (*UK&I) 570 Going concern* as follows

    - Where the auditor concludes that the use of the going concern basis of accounting is appropriate and no material uncertainty has been identified, the auditor is required to report that they have no matters to report in this regard i.e. reporting by exception.
    - Where a material uncertainty exists, the auditor highlights it in a separate section of the auditor's report, provided that the circumstances are fully explained in the financial statements.

- If the auditor concludes that the disclosures are not adequate to meet the requirements of accounting standards, or that the financial statements do not include adequate disclosures to give a true and fair view, the auditor should modify the audit opinion and provide the reasons for doing so.

Responsibility for other information

11. The IAASB issued a revised *ISA 720 The auditor's responsibilities relating to other information* to clarify and enhance the auditor's responsibilities in relation to 'other information" (i.e. financial and non-financial information, other than the audited financial statements, that is included in or accompanies entities' annual reports).

12. This revision enhances the auditor's work effort with respect to other information by requiring the auditor to consider whether there is a material inconsistency not only between the other information and the financial statements but also between the other information and the auditor's knowledge obtained in the audit. It also requires the auditor to address the outcome of the auditor's work relating to other information in the auditor's report.

13. The FRC has adopted the IAASB's revised ISA 720. The existing ISA (UK&I) 720 section B is therefore being withdrawn and section A is being dropped from the title.

14. The EU Directive requires the auditor to give an opinion on certain of the other information (e.g. the strategic report and corporate governance statement) described in the standard as 'statutory other information'. Under existing legislation, the auditor is required to give an opinion on whether the statutory other information is consistent with the financial statements. However the Directive goes further, and requires auditors, based on the work undertaken as part of the audit, to
    - express an opinion on the compliance of the statutory other information with the applicable legal requirements
    - state whether any material misstatement in the statutory other information has been identified by the auditor in light of the knowledge obtained, in the context of the evidence obtained during the course of the audit.

15. The FRC has addressed this by incorporating requirements in ISA (UK&I) 720 to require the auditor to
    - obtain an understanding of the applicable reporting framework used to prepare the statutory other information
    - consider whether there are material misstatements between the other statutory information and that framework
    - report on the statutory other information in accordance with the legislation.

Auditing disclosures

16. Following the IAASB's project on the audit of financial statement disclosures, the ISAs have been revised in order to enhance the auditor's focus on disclosures by introducing or enhancing certain requirements and application and other explanatory material.

17. ISA 200 has been amended to define disclosures as comprising explanatory or descriptive information that is required or permitted by the financial reporting framework to be set out on the face of a financial statement, or in the notes, or incorporated therein by cross-reference.

18. The revisions to the standards address risk assessment, evaluating misstatements and forming an opinion on the financial statements relevant for the purposes of auditing quantitative and qualitative disclosures.

New ethical standard

19. The FRC has issued a revised ethical standard that applies to audit engagements. In implementing the revisions, the existing five separate standards have been consolidated into one standard with sub-sections. This is intended to help avoid a situation where the current standards 2 to 5 may be considered in isolation without regard to the overarching principles in standard 1.

20. It is effective for accounting periods commencing on or after 17 June 2016, with earlier adoption permitted.

21. The ethical standard has been revised to make the overarching principles and supporting ethical provisions more prominent and more clearly outcome based, and to place them at the front of the standard.

    - Part A sets out the overarching principles of integrity, objectivity and independence, together with supporting ethical provisions. These establish a framework of ethical outcomes that are required to be met by the auditor.
    - Part B sets out specific requirements relevant to certain circumstances that may arise in audit engagements. These specific requirements are designed to assist in meeting the ethical outcomes required by the overarching principles and supporting ethical provisions. However, the standard has been amended to clarify that compliance with the specific requirements may not always be sufficient to achieve this as Part B does not address all possible circumstances. Accordingly auditors need to be alert for other circumstances that create threats to meeting the ethical outcomes.

22. As the ethical standard includes detailed requirements, there is still a risk that this can lead to a rules-based mind-set on the part of the auditor. This can result in an approach which considers whether actions are ‘specifically prohibited’ rather than ‘appropriate’ which can lead to behaviour which third parties perceive as likely to compromise integrity, objectivity and independence. Therefore, the standard has been amended to clarify in the requirements that safeguards have to reduce threats to ‘a level at which it is probable that an objective, reasonable and informed third party would not conclude that independence would be compromised’ (rather than simply reducing them to an ‘acceptable level’).

Accounting developments

Guidance on going concern basis of accounting

23. The FRC has issued guidance on the disclosures

- on the going concern basis of accounting and material uncertainties in their financial statements
- regarding principal risks and uncertainties within their strategic report.

24. *Guidance on the going concern basis of accounting and reporting on solvency and liquidity risks* is intended to assist organisation that do not apply the *UK Corporate governance code.* It explains that the assessment of the going concern basis of accounting should

- be proportionate to the size, complexity and the particular circumstances of the organisation
- take into account the relevant facts and circumstances at the date of approval of the financial statements
- be documented in sufficient detail to explain the basis of the directors' conclusion.

25. In determining whether there are material uncertainties relating to events or conditions that may cast significant doubt upon the continuing use of the going concern basis of accounting in future periods, the guidance advises senior management to consider

- the magnitude of the potential impacts of the uncertain future events or changes in conditions on the organisation and the likelihood of their occurrence
- the realistic availability and likely effectiveness of actions that senior management could take to avoid, or reduce the impact or likelihood of, the events or changes
- whether the events or changes are unusual, rather than occurring with sufficient regularity for senior management to make predictions about them with a high degree of confidence.

26. In making their assessment of the organisation's ability to continue to adopt the going concern basis of accounting and material uncertainties, IAS 1 specifies that the period to be considered should be at least 12 months from the reporting date. The guidance recommends at paragraph 3.5 that directors should consider a period of at least 12 months from the date the financial statements are authorised for issue.

27. When assessing which principal risks and uncertainties to include in the strategic report, senior management should identify those matters that could significantly affect the development, performance, position and future prospects of the organisation. They should consider the full range of business risks including those that are non-financial in nature. These will generally be matters that senior management regularly monitors and discusses because of their likelihood or the magnitude of their potential effect.

28. Senior management should consider threats to solvency and liquidity as part of their assessment of the principal risks and uncertainties faced by the organisation

- Solvency risk is the risk that an organisation will be unable to meet its liabilities in full. Insolvency is likely to be preceded by a lack of liquidity.
- Liquidity risk is the risk that an organisation will be unable to meet its liabilities as they fall due.

29. Where senior management considers that solvency or liquidity risks are material, they should explain the particular economic or operational conditions that give rise to those principal risks and uncertainties, and the potential impact on specific aspects of the business. Issues that may require disclosure will depend upon individual facts and circumstances.

Corporate governance developments

Revised public sector internal audit standard

30. The Chartered Institute of Public Finance and Accountancy (CIPFA) has issued a revised Public sector internal auditing standard which applies across the public sector (PSIAS). The PSIAS encompasses the mandatory elements of the Institute of Internal Auditors *International professional practices framework* with additional requirements and interpretations for the UK public sector.

31. The revised PSIAS applies from 1 April 2016 and comprises the following main sections
    - Section 3, which is new to this revised edition, states that the mission of internal audit is to enhance and protect organisational value by providing risk-based and objective assurance, advice and insight.
    - Section 4 defines internal auditing as an independent, objective assurance and consulting activity designed to add value and improve an organisation's operations
    - Section 5, which is new to this revised edition, sets out the core principles which articulate internal audit effectiveness. For an internal audit function to be considered effective, all principles should be present and operating effectively. They include demonstrating competence and due professional care; being objective and free from undue influence; aligning with the strategies, objectives, and risks of the organisation; and being appropriately positioned and adequately resourced.
    - Section 6 sets out the code of ethics
    - Section 7 sets out the standards for the professional practice of internal auditing.

TSU contact for cross-sector chapter

32. The contact in the TSU for this chapter is Paul O'Brien, Senior Manager (Technical) - 0131 625 1795 or pobrien@audit-scotland.gov.uk.

Local authority sector

Introduction

This chapter contains information on the main technical developments, and guidance from the TSU on any emerging risks, in the quarter that are relevant to the local authority sector.

It should be read by external auditors with appointments in the local authority sector. Auditors should also read the cross-sectoral chapter.

Accounting developments

General accounting

2016/17 accounting code

33. The CIPFA/LASAAC Local Authority Code Board has issued the *Code of practice on local authority accounting in the UK 2016/17* (accounting code) which sets out local authority accounting requirements for 2016/17.

34. The accounting code's financial reporting framework is based on international financial reporting standards (IFRS) as adopted by the European Union, adapted for the local authority context where necessary. The 2016/17 accounting code has been prepared on the basis of accounting standards and other pronouncements in effect for accounting periods commencing on or before 1 January 2016.

35. The main changes in this edition of the Code are as follows

- The new requirement in section 3.1 for an expenditure and funding analysis.
- Revised formats and reporting requirements in section 3.1 for the comprehensive income and expenditure statement and movement in reserves statement.
- A new section 4.11 on measuring the highways network asset.
- Amendments to section 6.5 in respect of accounting and reporting by pension funds.
- Other changes relate to amendments to IFRS, the annual governance statement, and the new conceptual framework for public bodies.

36. Auditors should confirm that their local authorities are making the necessary arrangements to ensure they can comply with the new requirements.

New expenditure and funding analysis

37. Paragraphs 3.4.2.96 to 3.4.2.98 of the accounting code set out the requirements for a new expenditure and funding analysis. The expenditure and funding analysis provides a reconciliation of the statutory adjustments between the authority's financial performance on a

funding basis and the surplus or deficit on the provision of services in the comprehensive income and expenditure statement.

38. The expenditure and funding analysis is required to include the following three columns

- Column I) should show the income and expenditure chargeable to the general fund. Lines are required for
  - Net expenditure chargeable on a statutory funding provisions, analysed by segments based on the organisational structure under which the authority operates
  - Other income and expenditure not charged to services and chargeable to the general fund.
  - Surplus or deficit for the general fund.
- Column II) should show adjustments that add expenditure or income not chargeable to council tax or rents and remove transactions which are only chargeable under statutory provisions. A note is required to describe the material items in this column.
- Column III) should show the amounts for each line in column I after the adjustments in column II, which equal the net expenditure in the equivalent lines in the comprehensive income and expenditure statement.

39. The foot of the expenditure and funding analysis is required to show the movement for the period, including opening and closing balances on the general fund.

40. A description of the purpose of the expenditure and funding analysis requires to be provided in the financial statements or the management commentary.

41. Paragraph 3.1.4.2 has been added to recommend that the management commentary cross refers to the outturn provided in the expenditure and funding analysis and include additional narrative context for the performance presented in the analysis. It also states that a local authority may wish to include appropriate budgetary information to provide additional context.

Revised financial statement formats

42. Paragraph 3.4.2.38 of the accounting code sets out the line items for the comprehensive income and expenditure statement. It has been amended to require authorities to present the service analysis on the basis of the organisational structure (including, where relevant, corporate support services) under which they operate. Authorities are therefore no longer required to follow the service expenditure analysis in the *Service expenditure reporting code of practice* (SeRCOP).

43. Paragraph 3.4.2.39 clarifies that income and expenditure allocation to services should reflect the way in which an authority operates or manages its services. Each service segment should include appropriate charges for the use of its non-current assets and for accrued employee benefit costs.

44. Paragraph 3.4.2.53 has been amended to remove the requirements for

- the columnar analysis of reserves on the face of the movements in reserves statement

- separate lines for the surplus or deficit on the provision of services and other comprehensive income and expenditure.

Highways network asset

45. Section 4.11 has been added to the accounting code to introduce the new measurement requirements for the highways network asset to be measured at depreciated replacement cost (DRC) in accordance with the measurement methodologies specified in the *Code of practice on transport infrastructure assets* (the transport code).

46. The change to DRC is a change in accounting policy. However, paragraph 4.11.2.14 refers to an adaption to IAS 1 so that there is no requirement to restate the preceding year information or for an opening balance as at 1 April 2015. The changes should instead be accounted for as an adjustment to opening balances at 1 April 2016.

47. The highways network asset should be treated as a single asset for financial reporting purposes, and presented as a separate class of assets on the face of the balance sheet. Paragraph 4.11.2.1 explains that the highways network asset comprises
    - carriageways including urban roads and rural roads
    - footways and cycletracks
    - structures including bridges, signs, retaining walls, and subways
    - street lighting
    - street furniture including traffic signs, safety fences, bollards, and bus shelters
    - traffic management systems including traffic signals, pedestrian signals, zebra crossings, and safety cameras
    - land, including freehold land and other land where the economic benefits and service potential are controlled by the authority.

48. Annual depreciation of the highways network asset requires to be measured in accordance with the transport code. The transport code requires annual depreciation to be calculated by estimating the aggregate cost of all the capital replacements/reinstatements needed to restore service potential over the life cycle, spread over the estimated number of years in the cycle.

49. Any accumulated depreciation and impairment at the date of valuation should follow the option in IAS 16 where the gross carrying amount is adjusted in a manner that is consistent with the revaluation of the carrying amount of the asset. The accumulated depreciation at the date of the revaluation is adjusted to equal the difference between the gross carrying amount and the carrying amount of the asset after taking into account accumulated impairment losses.

50. Derecognition is covered at paragraph 4.11.2.13 and follows the normal requirements of the accounting code. In addition, the cost of the replacement component shouldl be used as a proxy for the carrying amount of the component replaced for derecognition purposes. If a local authority has more detailed information on the gross replacement cost or accumulated depreciation relating to the components to be derecognised, it may use it. A local authority should presume that the component has reached the end of its useful life and/or has been

fully utilised. This presumption may be rebutted if the authority has evidence that there is a measureable carrying value remaining for the component.

51. A further transitional provision at paragraph 4.11.2.16 allows authorities to use any reasonable estimation process to split the depreciated historical cost of the original infrastructure class of assets between the residual infrastructure assets and the highways network asset.

Pension funds reporting

52. The amendments to section 6.5 of the accounting arise from a review by CIPFA/LASAAC of the reporting requirements for pension funds. The review was timed to coincide with the issue of the new *Financial reports of pension schemes - a statement of recommended practice 2015* (the 2015 pension SORP).

53. The amendments include the following

- Changes have been made to paragraph 6.5.3.6 in respect of the format of the fund account and net assets statement to reflect changes in the 2015 pension SORP including an updated analysis of investment income and investment assets, and new classifications for transfers from other pension funds and payments to and account of leavers.
- Further changes to paragraph 6.5.3.6 in respect of the fund account to
  - remove management expenses from the subtotal for dealings with members
  - require rents from properties to be presented gross.
- The application of the disclosure requirements of *IFRS 13 Fair value measurement* to pension fund investments (covered by section 2.10 of the code).
- New recommended disclosure requirements at paragraph 6.5.5.2 in respect of management expenses. The disclosures are
  - the total amount of direct transaction costs of all significant asset classes (i.e. investment types)
  - an explanation of the nature of the transaction costs and how they arise for different types of investment.
- An annex that provides an overview of how the other sections of the accounting code apply to pension funds.

Amendments to IFRS

54. There have been a number of amendments to the accounting code arising from narrow scope amendments to IFRS. They include those amendments summarised in the following paragraphs.

55. An amendment to paragraph 3.4.2.26 clarifies that an authority must not reduce the understandability of its financial statements by

- obscuring material information with immaterial information
- aggregating material items that have different natures or functions.

56. An amendment to paragraph 3.4.2.27 clarifies that materiality considerations still apply when a standard requires a specific disclosure including cases where the standard uses the term ‘as a minimum’.

57. Paragraph 3.4.2.84 gives examples of ordering the notes to the financial statements systematically. These include

- giving prominence to the areas of its activities that the authority considers to be most relevant to an understanding of its financial performance and financial position, such as grouping together information about particular activities
- grouping together information about items measured similarly such as assets measured at current value
- following the order of the line items in the comprehensive income and expenditure statements and the balance sheet.

58. Paragraph 3.4.2.61 has been amended to clarify that line items in the balance sheet may be disaggregated. It also been amended to require that any sub-totals should be presented in accordance with paragraph 55A of *IAS 1 Presentation of financial statements*, i.e. the subtotals should

- be comprised of line items made up of amounts recognised and measured in accordance with IFRS
- be presented and labelled in a manner that makes the line items that constitute the subtotal clear and understandable
- be consistent from period to period
- not be displayed with more prominence than the sub-totals and totals required in IFRS.

59. Paragraph 3.4.2.92 has been amended to require authorities to disclose the factors that are used to identify the reportable operating segments when they have been aggregated.

60. Paragraph 4.1.2.33 has been amended to remove the option to proportionately restate any accumulated depreciation or impairment at the date of valuing property, plant and equipment (other than for the highways network asset).

61. Paragraph 3.9.2.7 has been amended to clarify that an entity that provides key management personal services to an authority is deemed to be a related party. The disclosure requirements for the amounts incurred by an authority for key management personnel services have been inserted in new paragraph 3.9.4.2.

Annual governance statement

62. Paragraph 3.7.4.4 has been amended to reflect changes in the *Delivering good governance in local government: framework (2016)*. The amended paragraph sets out the information that the annual governance statement should include which is taken from the revised good governance framework (see paragraph 68).

Conceptual framework

63. The amendments arising from the issue of the conceptual framework include those at paragraph 2.1.2.18 which states that

- some complex economic phenomena are difficult to represent in local authority financial statements
- all efforts should be undertaken to represent economic phenomena in a manner that is understandable to a wide range of users.
- some users may need to seek the aid of an advisor to assist in understanding them
- information should not be excluded from financial statements solely because it may be too complex or difficult for some users to understand without assistance.

2016/17 SeRCOP

64. CIPFA has issued a revised edition of SeRCOP which sets out proper accounting practice for financial reporting below the level of the financial statements in 2016/17. SeRCOP provides guidance on financial reporting to stakeholders (e.g. performance indicators) in order to achieve data consistency and comparability.

65. The structure of SeRCOP is as follows

- Section 1 gives an overview of SeRCOP's framework and status.
- Section 2 defines total cost, and includes best practice guidance to provide a commentary on the mandatory requirements.
- Section 3 sets out the service expenditure analysis (SEA).
- Section 4 provides a recommended standard subjective analysis.

66. Changes have been made to the social work SEA in respect of the integration of health and social care. There is a new division of service for the contribution to integration joint boards that should be separately presented on the face of the comprehensive income and expenditure statement.

67. SeRCOP does not provide guidance on the financial statements but is intended to be consistent with the accounting code. However, paragraph 1.22 indicates that the SEA in Section 3 is used to provide the service analysis in the comprehensive income and expenditure statement. As stated at paragraph 42 of this technical bulletin, the accounting code has been amended to instead require the analysis to be based on the authority's organisation structure.

Governance statements

Revised good governance framework

68. CIPFA and Solace have issued a revised framework for good governance in local government from 2016/17. *Delivering good governance in local government framework 2016* defines the

principles that should underpin the governance of each local government organisation. It provides a structure to help individual authorities with their approach to governance.

69. The framework advises authorities to test their governance structures against the principles contained in it by

- reviewing existing governance arrangements
- developing and maintaining an up-to-date local code of governance (i.e. the local governance structure in place which in practice may consist of a number of local codes or documents)
- reporting publicly on compliance with their own local code on an annual basis and on how they have monitored the effectiveness of their governance arrangements in the year and on planned changes.

70. The framework sets out the principles and sub-principles of good governance on pages 13 to 22. In a change from the previous edition, they are based on the *International framework: good governance in the public sector* interpreted for a local government context. The core principles are the following

- Behaving with integrity, demonstrating strong commitment to ethical values, and respecting the rule of law.
- Ensuring openness and comprehensive stakeholder engagement.
- Defining outcomes in terms of sustainable economic, social, and environmental benefits.
- Determining the interventions necessary to optimize the achievement of the intended outcomes.
- Developing the authority's capacity, including the capability of its leadership and the individuals within it.
- Managing risks and performance through robust internal control and strong public financial management.
- Implementing good practices in transparency, reporting, and audit to deliver effective accountability.

71. To achieve good governance, each local authority should be able to demonstrate that its governance structures comply with the core and sub-principles contained in the framework. It should therefore develop and maintain a local code of governance/governance arrangements reflecting the principles set out.

72. Local authorities are required to prepare an annual governance statement in order to report publicly on the extent to which they comply with their own code of governance, which in turn is consistent with the good governance principles in the framework. Paragraph 7.5 requires the annual governance statement to include

- an acknowledgement of responsibility for ensuring that there is a sound system of governance (incorporating the system of internal control) and reference to the authority's code of governance

- reference to and assessment of the effectiveness of key elements of the governance framework and the role of those responsible for the development and maintenance of the governance environment
- an opinion on the level of assurance that the governance arrangements can provide and that the arrangements continue to be regarded as fit for purpose in accordance with the governance framework
- an agreed action plan showing actions taken, or proposed, to deal with significant governance issues
- reference to how issues raised in the previous year's annual governance statement have been resolved
- conclusion – a commitment to monitoring implementation as part of the next annual review.

Revised statement on CFO role in local government

73. CIPFA has issued a revised statement on The role of the chief financial officer in local government which aims to give detailed advice on how to apply within local government the overarching statement on the role of the public service chief finance officer (CFO).

74. The statement sets out five principles that define the core activities and behaviours that belong to the role of the CFO. They are that the CFO in a local authority

    - is a key member of the leadership team, helping it to develop and implement strategy and to resource and deliver the authority's strategic objectives sustainably and in the public interest
    - must be actively involved in, and able to bring influence to bear on, all material business decisions to ensure immediate and longer term implications, opportunities and risks are fully considered, and alignment with the authority's financial strategy
    - must lead the promotion and delivery by the whole authority of good financial management so that public money is safeguarded at all times and used appropriately, economically, efficiently and effectively
    - must lead and direct a finance function that is resourced to be fit for purpose
    - must be professionally qualified and suitably experienced.

75. For each principle, the statement sets out the governance arrangements required within an authority to ensure that CFOs are able to operate effectively and perform their core duties. The arrangements in this statement have been revised to bring them uptodate but there are no significant changes.

76. The *Delivering good governance in local government framework* requires authorities to ensure that their financial management arrangements conform with this statement, or explain why they do not and how they deliver the same impact.

Retirement benefits

Statutory guidance on accounting for pensions

77. The Scottish Government has issued statutory guidance setting out the adjustments to be made to local authority accounts in respect of pension awarded under *The Local Government Pension Scheme (Scotland) Regulations 2014* (the 2014 regulations).

78. The statutory guidance issued with Finance circular 4/2016 - Accounting for pension and other post-employment benefits is necessary because *The Local Government Pension Reserve Fund (Scotland) Regulations 2003* (the 2003 regulations), which require a statutory adjustment for pension costs, apply only to schemes arising under the *Superannuation 1972*. They therefore do not apply to pension under the 2014 regulations which are issued under the *Public Services Pensions Act 2013*.

79. Paragraph 3 of the statutory guidance states that the amount to be charged to the general fund for pension payments is the amount set out in the 2014 regulations. The difference between that amount charged to the surplus or deficit on the provision of services in accordance with proper accounting practice requires to be taken to the pension reserve fund established under the 2003 regulations.

80. There is no requirement to separate the adjustments under the 2003 regulations from adjustments under the statutory guidance.

81. Auditors should refer to this guidance when considering whether authorities have properly accounted for retirement benefits in 2015/16.

2015/16 report on actuarial information

82. PricewaterhouseCoopers 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 2016.

83. 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.

84. The main findings in respect of the assumptions and approach are as follows

- The actuarial assumptions proposed by the actuaries are considered to be reasonable for most employers.
- For some actuaries individual assumptions may fall outside the expected range but when all assumptions are taken together a reasonable liability figure will be produced.
- The report recommends further investigation where an employer has requested different assumptions than those proposed by the actuary.

85. However, there is concern that accurate cash flows and details of significant events may not always be communicated to the actuaries. The report recommends that auditors consider extra tests on the cash flow data provided by employers, and satisfy themselves that any special events that they are aware of have been communicated to the actuaries.

86. Most actuaries follow a process of requesting redundancy and exit data in advance of the year end to allow more time for their calculations and reporting. This approach is reasonable provided there is a procedure to check for significant movements or employer decisions. If auditors are aware of material volumes of redundancies, particularly in the last few months, they should ensure that details of these have been passed onto the relevant actuary.

87. Auditors should use this report in relation to IAS 19 amounts and the work of the actuary in relation to 2015/16.

Non-domestic rates

Information on BRIS

88. The Scottish Government has issued a circular to provide information on the *Business rates incentivisation scheme* (BRIS). Finance circular 3/2016 Business rates incentivisation scheme 2014-17 details

- the outcome for 2014/15 in Annex A. The table shows the sums to be retained by each of the local authorities listed which represent the 50% share of the additional rates income generated in 2014/15. The local authorities listed should exclude the sums involved in returning their future non domestic rates returns until the individual local targets have been rebased
- the revised individual local authority BRIS targets for 2015/16 in Annex B
- the provisional targets for 2016/17 in Annex C.

89. Auditors should refer to this guidance when considering whether authorities have properly accounted for income retained in respect of BRIS in 2015/16.

Auditing developments

2015/16 model independent auditor's report

90. The TSU has issued 2015/16 Independent auditor's report (local authorities) - technical guidance note 2016/5(LA) to provide auditors with the model independent auditor's reports which should be used for the 2015/16 annual accounts of local authorities. The technical guidance note also provides application guidance on their use.

91. The main changes to the guidance and models for 2015/16 from last year are as follows

- Separate models have been provided to be used depending on whether a council prepares group financial statements. Appendix 1 should be used when group financial statements are prepared, and Appendix 2 when they are not.
- Appendix 2 encompasses integration joint boards.

- Additional clarification has been added in some areas as a result of the findings from a review of the 2014/15 reports.

92. In the interests of consistency, auditors are required to use the model wording in the appendices to the technical guidance note as a condition of their audit appointment. The only exception is any amendments required to tailor the terminology to reflect local circumstances.

93. Any proposed modifications to any audit opinion or conclusion in the model reports, or the inclusion of 'emphasis of matter' or 'other matter' paragraphs, should be discussed with the TSU in advance of finalising the report.

94. Auditors should use this technical guidance note when reporting on 2015/16 audits. They should complete the checklist at Appendix 5 which provides a list of the key auditor actions.

Other developments

Housing benefit

Guidance on 2015/16 subsidy claims

95. The Department for Work and Pensions (DWP) has issued a letter providing information and guidance on the housing benefit (HB) subsidy claim for 2015/16. The letter is available to auditors from the *Technical reference library* and contains details of the amounts paid for 2015/16 in respect of administration subsidy and interim benefit subsidy received.

96. The TSU has published Auditor certification of the 2015/16 housing benefit subsidy claim- technical guidance note TGN/HBS/16 to provide guidance to auditors on certifying 2015/16 HB subsidy claims. Auditors should follow this technical guidance note when reviewing and reporting on 2015/16 HB subsidy claims.

97. Module 5 of the 2015/16 HB COUNT has been issued. This is the software diagnostic tool. The module contains a control matrix that requires to be completed by auditors when certifying 2015/16 HB subsidy claims.

Miscellaneous funding circulars

98. The DWP has issued the following circulars on funding allocations

- HB circular S3/2016 Final new burdens payment 2015/16 for the real time information bulk data matching initiative, reduction in housing benefit backdating and removal of the family premium advises of funding allocated to local authorities in support of implementing welfare reform changes in 2015/16 as well as initial incentive payments for 2016/17.
- HB circular S4/2016 Additional new burdens funding to meet the costs of implementing welfare reform changes in 2016/17 advises of additional funding allocated to local authorities in support of implementing welfare reform changes in 2016/17.
- HB circular S5/2016 Payment of new burdens relating to the single fraud investigation Service project for 2016/17 advises of funding allocated to local authorities to help meet

costs incurred in respect of the impact of the introduction of the *Single fraud investigation* project.

- [HB circular S6/2016 New burdens payment 2016/17 for the pension credit assessed income period reform] advises of funding allocated to local authorities as a result of abolition of pension credit assessed income periods.

Section 106 charities

Review of 2014/15 accounts

99. The TSU has carried out a limited scope review of the 2014/15 statements of accounts of registered charities that fall within section 106 of the *Local Government (Scotland) Act 1973* (section 106 charities). The review was intended to establish progress in

- reducing the number of section 106 charities
- applying 'connected charities' provisions to reduce the number of separate statements of accounts.

100. A position report has been provided to auditors summarising the findings from the review and settings out some actions for them to take as part of 2015/16 audits. The following paragraphs provide a brief summary of the findings.

101. While there has been some progress in authorities reducing the number of section 106 charities they administer, it appears there remains considerable scope for further reductions. In 2014/15, there were 389 section 106 charities (five more than the 384 in 2013/14) administered by 29 councils. Only three of those councils have one section 106 charity each, while the other 26 councils can have as many as 55 charities.

102. While the long term aim is to reduce the number of section 106 charities, the overall number of separate sets of statements of accounts that are required can be reduced by the effective application of the connected charities provisions under *The Charities Accounts (Scotland) Regulations 2006*. Regulation 7 (as amended in 2010) permits a single set of accounts for charities if they have common or related purposes, or shared management (i.e. connected charities). This would be the case where charities have common trustees.

103. There were 126 sets of accounts in 2014/15 (up two from 124 in 2013/14). 13 councils applied the connected charities provisions but there appears to be scope for further application in two of those councils where charities have common trustees. 13 councils did not apply the connected charities provisions but there appears to be scope for ten of them to do so.

104. Auditors should consider the information in the report and encourage the relevant councils

- to rationalise the number of charities, particularly where there is a significant number and little or no progress was made in 2014/15
- to make full use of the connected charities provisions in 2015/16, so that the total number of accounts that requires to be audited is minimised.

Grant claims

2015/16 guidance for auditors

105. The TSU has issued Certification of 2015/16 approved local authority grant claims and returns - Technical guidance note TGN/GEN/16 to provide general guidance to auditors on the certification of 2015/16 local authority 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 2015/16 under their audit appointment
- considers the roles and responsibilities of grant-paying bodies, local authorities, the TSU and appointed auditors
- sets out the overall approach to be adopted by auditors
- provides guidance on auditor reporting.

106. The TSU also separately publishes a technical guidance note on each significant approved claim to provide auditors with specific guidance on certifying that claim. In addition to Auditor certification of the 2015/16 housing benefit subsidy claim - Technical guidance note TGN/HBS/16 referred to at paragraph 96, the following have been published for 2015/16

- Auditor certification of the 2015/16 education maintenance allowance grant claims - Technical guidance note TGN/EMA/16
- Auditor certification of the 2015/16 Bellwin scheme claims - Technical guidance note TGN/BEL/16.

107. Auditors should follow these technical guidance notes when reviewing and reporting on 2015/16 grant claims.

Auditor action checklist

	Yes/No/N/A	Initials/date	W/P ref
1 Have you carried out the action recommended at paragraph 36 in respect of the 2016/17 accounting code?			
2 Have you carried out the action recommended at paragraph 81 in respect of the statutory guidance on accounting for pensions?			
3 Have you carried out the action recommended at paragraph 87 in respect of the 2015/16 report on actuarial information?			
4 Have you carried out the action recommended at paragraph 89 in respect of the BRIS?			

	Yes/No/N/A	Initials/date	W/P ref
5 Have you carried out the action required at paragraph 94 in respect of the 2015/16 independent auditor's report?			
6 Have you carried out the action recommended at paragraph 104 in respect of section 106 charities?			
7 Have you carried out the action recommended at paragraphs 96 and 107 in respect of reviewing 2015/16 grant claims?			

TSU contacts for local authority chapter

108. The contacts in the TSU for this chapter are

- Paul O'Brien, Senior Manager (Technical) - 0131 625 1795 or pobrien@audit-scotland.gov.uk.
- Tim Bridle, Manager - Local Government (Technical) - 0131 625 1793 or tbridle@audit-scotland.gov.uk.
- Anne Cairns, Manager – Benefits (Technical) - 0131 625 1926 or acairns@audit-scotland.gov.uk (for housing benefit).

Central government sector

Introduction

This chapter contains information on the main technical developments, and guidance on any emerging risks, in the quarter that are relevant to central government bodies.

It should be read by external auditors with appointments in the central government sector. It should also be read by auditors with appointments in the health sector and further education sector as most of the articles also apply to those sectors. Auditors should also read the cross-sectoral chapter.

Accounting developments

Disclosure of new standards not yet effective

109. HM Treasury has issued a guide to new international financial reporting standards (IFRS) that have been issued but are not yet effective in 2015/16, and therefore require disclosure in accordance with *IAS 8 Accounting policies, changes in accounting estimates and errors*.

110. Review of new IFRS issued and/or effective during the 2015/16 clarifies that the standards that have been issued but not effective until 2016/17 include the following

- *IFRS 7 Financial instruments: disclosures: servicing contracts* is an amendment to IFRS 7 which requires disclosures for any 'continuing involvement' in an asset which has been transferred and fully derecognised. The amendment clarifies that, where a body has the right to earn a fee for servicing a financial asset, an assessment should be made regarding the nature of the fee to gauge whether the disclosures are required.
- *IAS 1 Disclosure initiative* encourages professional judgement to be used in determining what information to disclose in financial statements and where and in what order information is presented in the disclosures.
- *IAS 16 and IAS 38 Clarification of acceptable methods of depreciation and amortisation* prohibits revenue-based depreciation methods and generally presumes that such methods are an inappropriate basis for amortising intangible assets.
- *IFRS 11 Accounting for acquisitions of interests in joint operations* provides new guidance on how to account for the acquisition of an interest in a joint operation that constitutes a business.

111. Standards that are currently subject to analysis and review by HM Treasury and will apply, following due consultation, to future editions of the *Government financial reporting manual* (FReM) include

- *IFRS 15 Revenue from contracts with customers* which establishes the application principles required for bodies to report useful information on the nature, amount, timing and uncertainty of revenue and cash flows from contracts with customers

- *IFRS 9 Financial instruments* which applies a single classification and measurement approach to all financial assets
- *IFRS 16 Leases* which removes the distinction between operating and finance leases by introducing a single lessee accounting model that requires a lessee to recognise assets and liabilities for all leases with a term of more than 12 months.

112. Auditors should consider this guide when auditing the disclosure of standards issued but not yet effective in the 2015/16 annual report and accounts.

Remuneration and staff report

Preparation guidance for 2015/16

113. The Cabinet Office has issued EPN 452 (Revised) 2015/16 Disclosure of salary, pension and compensation information to provide guidance on the preparation of the remuneration and staff report for 2015/16. An example of the remuneration disclosures is provided at Annex 13C.

114. The remuneration disclosures include
    - information on the pay and pension packages of the senior management team
    - the median remuneration of all staff and the ratio between this and the mid-point of the banded remuneration of the highest paid director
    - the number of exit packages for all staff by cost band, broken down by the number of compulsory redundancies and the number of other departures agreed
    - compensation payments made to senior management.

115. There are no significant changes to the remuneration disclosures required from 2014/15.

116. Auditors should refer to this guidance when auditing the remuneration and staff report in the 2015/16 annual report and accounts.

Governance statement

SPFM change

117. The Scottish Government has amended the certificates of assurance section of the *Scottish public finance manual*. Amendments have been made to the guidance on the format of governance statements highlighting the requirement for reporting on controls in place for programme and project management including compliance with the ICT assurance framework (where applicable); and details of any significant lapses of data security.

118. The internal control checklist that underpins the assurances to Directors (or equivalents) in respect of the governance statement has been updated. The questions have been reviewed, amended and guidance notes have been further developed.

Auditing developments

2015/16 model independent auditor's reports

119. The TSU has issued 2015/16 Independent auditor's report (central government) - technical guidance note 2016/4(CG) to provide auditors with the model independent auditor's reports which should be used for the 2015/16 annual accounts. The technical guidance note also provides application guidance on their use.

120. In the interests of consistency, auditors are required to use the model wording in the appendices to the technical guidance note as a condition of their audit appointment. The only exceptions are where there are group accounts or any amendments required to tailor the terminology to reflect local circumstances.

121. The main changes to the models are

- to reflect changed requirements in chapter 5 of the 2015/16 FReM in respect of the annual report
- additional clarification in some areas as a result of the findings from a review of the 2014/15 reports
- guidance on the positioning of the independent auditor's report has been provided
- wording changes in relevant models to reflect the FReM's change in terminology from net operating cost to net expenditure.

122. Any proposed modifications to any audit opinion or conclusion in the model reports, or the inclusion of 'emphasis of matter' or 'other matter' paragraphs, should be discussed with the TSU in advance of finalising the report.

123. Auditors should use this technical guidance note when reporting on 2015/16 audits. They should complete the checklist at Appendix 6 which provides a list of the key auditor actions.

Auditor action checklist

	Yes/No/N/A	Initials/date	W/P ref
1 Have you carried out the action recommended at paragraph 112 in respect of the disclosure of standards issued but not yet adopted?			
2 Have you carried out the action recommended at paragraph 116 in respect of the remuneration and staff report?			
3 Have you carried out the action required at paragraph 123 in respect of the 2015/16 independent auditor's report?			

TSU contacts for central government chapter

124. The contacts in the TSU for this chapter are

- Neil Cameron, Manager - Central Government and Health (Technical) - 0131 625 1797 or ncameron@audit-scotland.gov.uk.
- Helen Cobb, Technical Adviser (Central Government, Health and Further Education) - 0131 625 1901 or hcobb@audit-scotland.gov.uk.

Health sector

Introduction

This chapter contains information on the main technical developments, and guidance on any emerging risks, in the quarter that are relevant to health bodies.

It should be read by external auditors with appointments in the health sector. Auditors should also read the central government chapter and cross-sectoral chapter.

Accounting developments

Provisions and accruals

2015/16 guidance on equal pay

125. The Scottish Government Health and Social Care Directorates (SGHSCD) has sent a letter to boards on the treatment of equal pay in the 2015/16 financial statements.

126. In view of the increased certainty over the timing and amount, the Scottish Government's advice is to reclassify the liability from a provision to an accrual. The letter sets out a form of wording that should be disclosed in the accounts. The Scottish Government are advising boards separately of the amount to be recognised, and will provide funding.

127. There are a smaller number of claims that are not as progressed and the letter advises that these should not be recognised as they would be immaterial.

128. Auditors should refer to this guidance when auditing the 2015/16 equal pay liability.

Governance statement

Good practice note

129. The TSU has issued a good practice note on improving the quality of governance statements. The note is based on the results of a review of the 2014/15 governance statements of all the territorial health boards to identify instances of good practice and areas for improvement.

130. Areas for improvement identified by the review included

- a better use of cross referencing, signposting and links to other documents, and more innovative methods of presentation
- achieving a better balance between avoiding excessive detail while providing all the required information
- ensuring all the significant risks facing the board were reported.

131. Auditors should refer to this good practice note when considering the 2015/16 governance statement.

Auditing developments

2014/15 model independent auditor's reports

132. The TSU has issued 2015/16 Independent auditor's report (health) - technical guidance note 2016/3(H) to provide auditors with the model independent auditor's reports which should be used for the 2015/16 annual accounts. The technical guidance note also provides application guidance on their use.

133. In the interests of consistency, auditors are required to use the model wording in the appendices to the technical guidance note as a condition of their audit appointment. The only exception is any amendments required to tailor the terminology to reflect local circumstances.

134. The main changes to the models are

- to reflect changed requirements in chapter 5 of the 2015/16 FReM and accounts manual in respect of the annual report
- additional clarification in some areas as a result of the findings from a review of the 2014/15 reports
- guidance added at paragraph 26 on the treatment of the summary of resource outturn
- guidance on the positioning of the independent auditor's report has been added at paragraph 93
- the model and guidance for a report on summary financial information has been dropped.

135. Any proposed modifications to any audit opinion or conclusion in the model reports, or the inclusion of 'emphasis of matter' or 'other matter' paragraphs, should be discussed with the TSU in advance of finalising the report.

136. Auditors should use this technical guidance note when reporting on the audit of the 2015/16 annual reports and accounts. They should complete the checklist at Appendix 3 which provides a list of the key auditor actions.

Auditor action checklist

	Yes/No/N/A	Initials/date	W/P ref
1 Have you carried out the action recommended at paragraph 128 in respect of the equal pay liability?			
2 Have you carried out the action recommended at paragraph 131 in respect of the governance statement?			
3 Have you carried out the action required at paragraph 136in respect of the 2015/16 independent auditor's report?			

Fraud and irregularities

Introduction

This chapter contains a summary of cases of fraud and other irregularities arising at audited bodies that have recently been reported by external auditors to the TSU.

Auditors should consider whether the weaknesses in internal control that facilitated each case may also exist at their audited bodies and take the appropriate action.

Income

Grant income

137. A council was required to repay £4.4 million of European funding due to the failure of an arm's length external organisation (ALEO) to comply with grant conditions.

Key features

> The council is the lead authority for European funding in the area and has ultimate responsibility for ensuring claims are for eligible expenditure and in line with funding terms and conditions. The council claimed £4.4 million of grant in respect of project expenditure incurred by the ALEO.
>
> A condition for the project was that employee costs were eligible only if they related to staff who either worked 100% of their time on the project or, if not, their allocated time was supported by formal signed timesheets at the time the work was undertaken.
>
> During an audit of the project, the Scottish Government identified that ALEO employees who claimed to have spent 100% of their time on the project were also working on other projects. The council's internal audit team then investigated the matter further, and confirmed that grant had been claimed for staff who had neither spent 100% of their time on the project nor had formal signed timesheets.
>
> Failure by the council to ensure the expenditure was eligible resulted in the council being liable to repay the £4.4 million as the ALEO did not have the funds to pay the money back.
>
> Four officers in the ALEO have been suspended and are subject to disciplinary proceedings. Details of the internal audit investigation have also been passed to Police Scotland.

Payroll

Payments to former employee

138. A council continued to make payroll payments totalling £12,500 over a nine month period to a former employee.

Key features

The employee continued to be paid after they had left the council's employment due to late notification from the service area of the date of termination to payroll. The overpayment was possible as control weaknesses that had previously been raised by the council's auditor had not been addressed.

The overpayment was identified when the procedures which should have been carried out at the time of the employee leaving were carried out nine months later.

The council is treating the former employee as a debtor but has not yet recovered the overpayment as they have been unable to contact the individual.

Expenditure

Contract procurement

139. Three council roads employees awarded contracts totalling £210,000 over a three year period which did not comply with the contract award framework.

Key features

The council framework for awarding work in respect of any minor roads works requires checks to be carried out to ensure that the contractor holds the necessary health and safety competence and insurance cover. The perpetrators awarded 47 items of work to a company that was not on the approved list.

The irregularity was identified after the council received an anonymous note alleging that a roads employee was awarding work to a contractor without going through the official procurement process.

After investigation, it transpired that three roads employees involved in awarding this work were aware that the company was not properly approved or included in the framework.

The practice went undetected for three years due to separation of duties requirements not being applied and existing procedural requirements for prospective companies being entered on to the framework not being followed.

One of the employees resigned; the second received a final written warning; and the third (who was the most senior of the three) was dismissed. The company is now in liquidation.

Education grants

140. A student record administrator in a council defaulted £15,000 of student bursary awards over a three year period.

Key features

The fraud was carried out by the perpetrator

- selecting students who were not eligible for student bursaries and changed their status to indicate that they were eligible
- changing the bank details for the students within the bursary system to their own personal bank details.

The fraud was discovered after a new IT system was implemented which automatically generated a letter to students when amendments to their status were made. A student subsequently queried why their bursary status had been changed and why the bank details were incorrect.

The fraud was possible due to a lack of internal checks and exception reports regarding changes to the student bursary master file. A new exception report is now being run on a monthly basis outlining any changes to student information all of which is checked by a team leader.

The matter has been reported to the police and the individual has been suspended.

TSU contact for fraud and irregularity chapter

141. The contact in the TSU for this chapter is Anne Cairns, Manager – Benefits (Technical) - 0131 625 1926 or acairns@audit-scotland.gov.uk.

Technical Services Unit

Audit Scotland's Technical Services Unit (TSU) informs the professional judgement of appointed external auditors on technical matters and encourages the proper exercise of professional scepticism to improve the quality of the audit delivered to the Accounts Commission and Auditor General for Scotland. The TSU provides authoritative guidance and practical assistance to support appointed auditors in carrying out their responsibilities under the *Code of audit practice* to

- provide an opinion on audited bodies' financial statements and, where required, the regularity of transactions
- review and report on other information published with the financial statements, including governance statements and remuneration reports
- examine and report on approved grant claims and other returns submitted by local authorities
- review and report on whole of government accounts returns.

Contact details for relevant TSU staff are included at the end of each chapter.

Feedback on technical bulletins is encouraged and should be sent to

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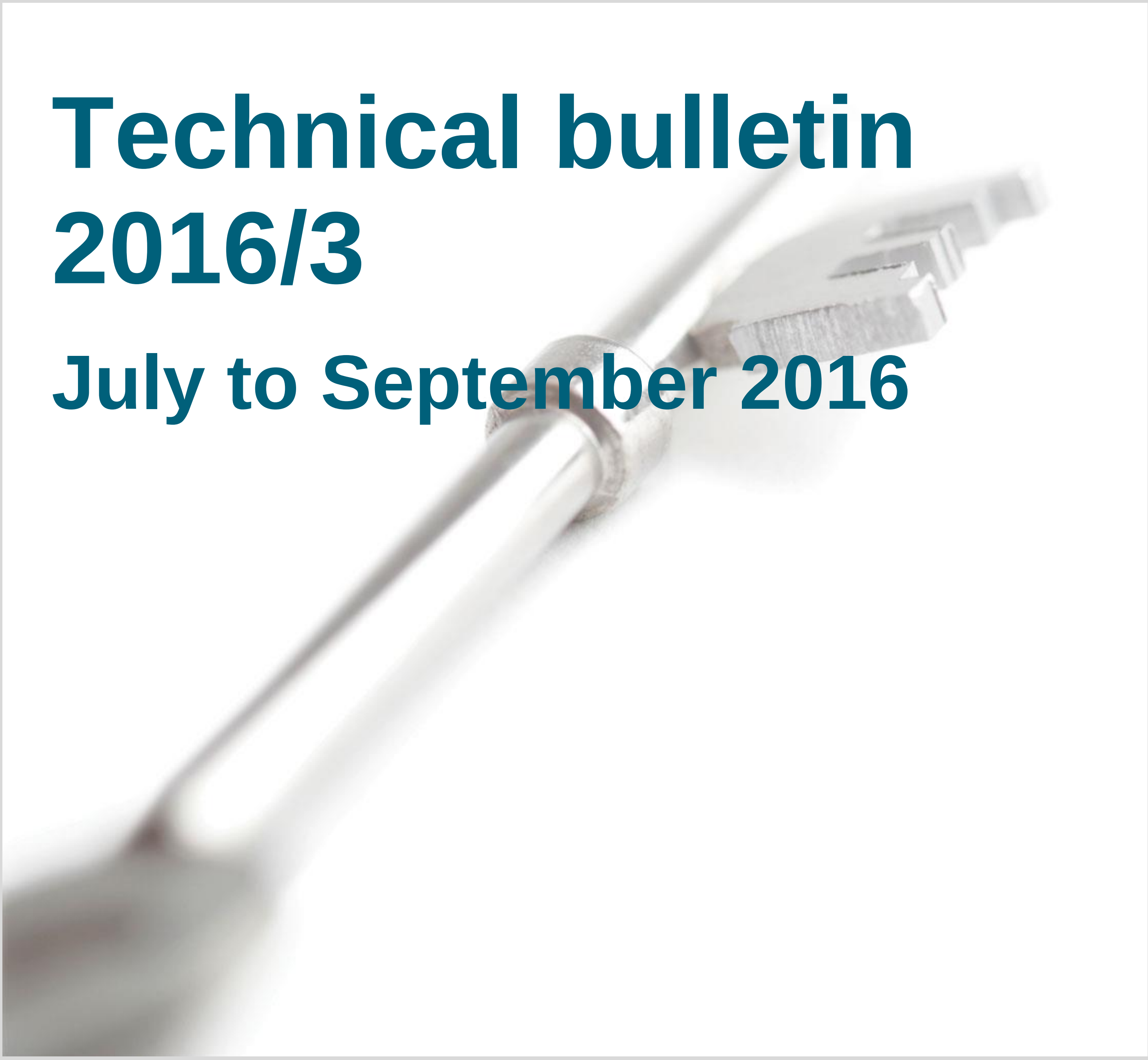

AUDIT SCOTLAND

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Audit Scotland is a statutory body set up in April 2000 under the Public Finance and Accountability (Scotland) Act 2000. We help the Auditor General for Scotland and the Accounts Commission check that organisations spending public money use it properly, efficiently and effectively.

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Foreword

Technical bulletins are prepared by Audit Scotland's Technical Services Unit (TSU), and approved by the Assistant Auditor General, to provide external auditors appointed by the Accounts Commission and Auditor General for Scotland with

- information on the main public sector technical developments in the quarter that are relevant to their audit appointment
- guidance from the TSU on any emerging risks identified in the quarter.

Technical bulletins are available to external auditors from Audit Scotland's *Technical reference library,* and published on the Audit Scotland website so that audited bodies and other stakeholders can access them.

It is important that auditors read this technical bulletin promptly so they are familiar with the information and guidance provided. The auditor action checklist section at the end of each chapter should be completed by a senior member of the audit team.

The articles on technical developments are intended to highlight the key points that the TSU considers external auditors require to be aware of. It may still be necessary for auditors to read the source material where greater detail is required. The documents referred to in the articles can be obtained by using the hyperlinks, where available. They are also available to external auditors from Audit Scotland's *Technical reference library*.

While auditors act independently, and are responsible for their own conclusions and opinions, the TSU has a role in ensuring that those conclusions and opinions are reached on the basis of informed judgement. Consistency in similar circumstances is important and **Audit Scotland's *Code of audit practice* therefore states that auditors should normally follow TSU guidance.** Auditors should advise the TSU promptly if they intend not to follow guidance provided in this technical bulletin on an emerging risk.

The TSU encourages feedback on this technical bulletin. Comments should be sent to pobrien@audit-scotland.gov.uk.

More in-depth and extensive guidance is provided in separate technical guidance notes published by the TSU. Technical guidance notes published in the quarter are referred to in this technical bulletin, and can be obtained by using the hyperlinks to the Audit Scotland website.

Headlines

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Cross-sectoral chapter

Introduction

This chapter contains technical developments and guidance from the TSU on emerging risks in the quarter that are relevant to all sectors.

It should be read by all external auditors. Information on developments and guidance from the TSU in the quarter that are relevant to only one sector are covered in the relevant sector-specific chapter.

Auditing developments

Proposed revisions to PN 10

1. The Public Audit Forum (PAF) has issued an exposure draft of proposed changes to the practice note on auditing financial statements of public sector bodies in the UK (PN 10).
2. PN 10 sets out how public sector auditors apply auditing standards to their work on financial statements. The aim of the PN is to support consistency in the application of auditing standards while also recognising the specific legislative and regulatory frameworks that apply to the audits of public sector bodies.
3. The exposure draft for the revised PN10 has two main parts
   - Part 1 on the application of auditing standards
   - Part 2 on the audit of regularity.
4. The annex to the invitation to comment includes a list of the revisions to PN 10 together with the rationale for the specific changes that are being proposed. In summary, the revised PN 10 has been amended to
   - make it more principles-based and applicable to all public sector auditors
   - reflect recent changes to auditing standards
   - reflect current practice across the UK in relation to auditors' work on regularity and the relevant legislative requirements that apply to this work
   - replace references to the Audit Commission with the new local audit arrangements that apply in England.
5. Comments should be sent to PracticeNote10@public-audit-forum.org.uk by 23 September 2016.

TSU contact for cross-sector chapter

6. The contact in the TSU for this chapter is Paul O'Brien, Senior Manager (Technical) - 0131 625 1795 or pobrien@audit-scotland.gov.uk.

Local authority sector

Introduction

This chapter contains information on the main technical developments, and guidance from the TSU on any emerging risks, in the quarter that are relevant to the local authority sector.

It should be read by external auditors with appointments in the local authority sector. Auditors should also read the cross-sectoral chapter.

Accounting developments

General accounting

Draft 2017/18 accounting code

7. The CIPFA/LASAAC Local Authority Code Board has issued an exposure draft of proposed changes to the *Code of practice on local authority accounting in the UK 2017/18* (the draft accounting code) which sets out local authority accounting requirements from 2017/18. It comprises an invitation to comment as well as extracts from the draft code with the proposed amendments set out.

8. There are few proposed changes applicable from 2017/18. However, the exposure draft proposes two new appendices (F and G) which contain the provisions for two new standards, i.e. *IFRS 9 Financial instruments* and *IFRS 15 Revenue from contracts with customers*. These standards will not apply until 2018/19 but they have been included in the 2017/18 code as they are likely to require substantial preparation.

9. Responses should be submitted to code.responses@cipfa.org by 7 October 2016.

Changes applicable from 2017/18

10. The main proposed changes applicable to Scottish local authorities that will apply from 2017/18 include the following

- Chapter one of the code has been restructured to separate the statutory requirements that apply in Scotland, England, Northern Ireland, and Wales.
- Paragraph 3.4.2.87 has been amended to encourage authorities to only include significant accounting policies in their financial statements. A local authority should consider whether disclosure would assist users in understanding how transactions, other events and conditions are reflected. It should also ensure that the accounting policies reflect those normally expected by the users of local authority financial statements. The listing of accounting policies has been moved from the main body of section 3.4 to an annex to provide examples of the accounting policies most likely to be significant.

- There is a proposed change at paragraph 3.4.4.1 to reflect an amendment to *IAS 7 Statement of cash flows (Disclosure initiative)* which requires disclosures that enable users of financial statements to evaluate changes in liabilities arising from financing activities.
- There is a proposal to change the disclosure for pension fund transaction costs in paragraph 6.5.5.2 from a recommendation to a requirement.

IFRS 9 Financial instruments

11. IFRS 9 applies a single classification and measurement approach to all types of financial asset. The existing classifications of held-to-maturity, loans and receivables and available-for-sale financial assets have been removed and replaced with the following
    - Financial assets measured at amortised cost applies where a financial asset meets the criterion that its contractual cash flows are solely payments of principal and interest (known as SPPI) and it is held to collect contractual cash flows.
    - Financial assets measured at fair value through other comprehensive income applies to financial assets that meet the criterion of SPPI and are held not only to collect cash flows but also to be sold.
    - Financial assets measured at fair value through profit or loss applies to all other financial assets.
12. IFRS 9 permits designations to a fair value through profit or loss classification in certain circumstances. There is therefore a proposal to remove the adaptation in the code that prohibits such designations. There are no proposed interpretations or adaptations to the general provisions of IFRS 9 for classification and measurement to reflect local government circumstances.
13. The new impairment requirements under IFRS 9 are intended to provide more useful information about an entity's expected credit losses on financial instruments. IFRS 9 replaces the incurred loss model under IAS 39 with the expected loss model. The guiding principle for the model is that it requires an authority to recognise expected credit losses at all times and to update the amount of expected credit losses recognised at each reporting date to reflect changes in the credit risk of financial instruments. The amount of expected credit losses recognised as a loss allowance or provision depends on the extent of credit deterioration since initial recognition.
14. IFRS 9 includes substantial new reporting requirements to disclose
    - the new classifications and resultant accounting treatments introduced by IFRS 9
    - the decisions that entities make under the standard
    - the impact of expected credit losses under the new impairment model in IFRS 9.
15. It is proposed that the option allowed by IFRS 9 to not restate comparatives information is adopted. However, restated information for 2017/18 will still need to be estimated for inclusion in the adjustments to reserves for the opening balance as at 1 April 2018. There are other

proposed detailed transitional requirements and practical expedients including exceptions on transition for undue cost or effort.

IFRS 15 Revenue from contracts with customers

16. IFRS 15 applies to all contracts with customers except those within the scope of other standards. The core principle in IFRS 15 is that entities should recognise revenue to depict the transfer of promised goods or services to the customer in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services.

17. In order for a contract to be within the scope of IFRS 15, the criteria set out in paragraph 2.7.2.13 of the draft code requires to be met. The criteria includes
    - the contract has commercial substance and has been approved by the parties who are committed to perform their respective obligations
    - the authority can identify each party's rights and the payment terms
    - it is probable that the authority will collect the consideration to which it will be entitled.

18. To recognise revenue, IFRS 15 sets out the following five steps
    - Step 1 – identify the contract with the customer. It is proposed that references in the code should be to 'service recipients' rather than 'customers'. A service recipient is a party that has contracted with an authority to obtain goods or services in exchange for consideration.
    - Step 2 – identify the performance obligations in the contract. Performance obligations are promises to transfer to a service recipient goods or services that are distinct.
    - Step 3 – determine the transaction price. The transaction price is the amount of consideration to which an authority expects to be entitled in exchange for transferring promised goods or services to a service recipient, excluding amounts collected on behalf of third parties.
    - Step 4 – allocate the transaction price to performance obligations. The best evidence of the transaction price (a standalone selling price) is an observable price from standalone sales of that good or service separately in similar circumstances and to similar customers. If a standalone selling price is not observable, the authority is required to estimate it.
    - Step 5 – recognise revenue when a performance obligation is satisfied. An authority is required to recognise revenue when (or as) it satisfies a performance obligation by transferring a promised good or service (an asset) to a service recipient. A good or service is generally considered to be transferred when the service recipient obtains control. Control of an asset refers to the ability to direct the use of and obtain substantially all of the remaining benefits from the asset. This is different from the current approach which focuses on a transfer of risk and rewards.

19. There are no proposed adaptations or interpretations for the five step process for the local government context.

20. The disclosures under IFRS 15 are substantially more detailed than under IAS 18. It requires disclosures to help users understand the nature, amount, timing and uncertainty of revenue and cash flows arising from contracts with customers.

21. It is proposed that IFRS 15 should be applied retrospectively with adjustments made to the appropriate opening balances of the current period on transition. Contracts that were determined to be complete using previous revenue guidance would not need to be restated. It is still necessary to determine the transition adjustments in the opening balances in reserves/other components of equity, as appropriate.

Highways network asset

Revised code of practice

22. The Chartered Institute of Public Finance and Accountancy (CIPFA) has issued a revised *Code of practice on the highways network asset* to support an asset management-based approach to the provision of financial information about the local authority highways network asset (HNA) from 2016/17. This third edition of the HNA code, previously titled the *Code of practice on transport infrastructure assets*, has been updated to reflect changes to the 2016/17 accounting code.

23. The format of the HNA code has been revised so that
    - the paragraphs in bold purple font provide the principles to be applied in order to meet the financial reporting requirements of the accounting code
    - the grey shaded paragraphs represent key asset management principles
    - explanatory statements in standard type assist with interpreting the HNA code.

24. The HNA is a network and grouping of interconnected inalienable components, expenditure on which is only recoverable by continued use of the asset created, i.e. there is no prospect of sale or alternative use. The interconnected network is made up of carriageways, footways and cycletracks and the structures, street lighting and other components that are directly associated with them.

25. An authority's network needs to cover all the roads, and the components associated with them, that are included in the register kept in accordance with Section 1 of the *Roads (Scotland) Act 1984*. In Scotland, the term 'highway' should be interpreted as 'public road' as defined by the 1984 Act.

26. The HNA code uses depreciated replacement cost (DRC) to value the HNA. DRC is a method of valuation defined in the accounting code as the current cost of replacing an asset with its modern equivalent asset (MEA), less deductions for all physical deterioration and all relevant forms of obsolescence and optimisation. To estimate DRC, gross replacement cost (GRC) is based on the cost of constructing an MEA. The difference between the GRC and DRC is the value of the asset that has been consumed by the authority during its useful life. As it is not possible to estimate or quantify technical obsolescence in the GRC/MEA measurements, only physical obsolescence is taken into account.

27. The calculations for GRC are based on a combination of centrally provided rates with adjustment factors and locally derived rates, dependent on component type. For example, for carriageways, inventory data for the area of carriageway is multiplied by the rate and a regional adjustment to give the cost of calculating an MEA. Where rates are provided centrally they are indexed each year with a benchmark valuation every five years.

28. The GRC is not further split over some of the HNA components which are finite or indefinite (i.e. to identify depreciable components) and therefore it is not possible to calculate the amount consumed for each component. The HNA code therefore provides a methodology to estimate accumulated depreciation using the depreciable components. For example, for carriageways, an estimate is made of the value consumed of the depreciable surface layers of a carriageway with the underlying layers having an indefinite life.

29. For certain components of the HNA, in order to estimate the accumulated depreciation, it is necessary to establish the age of the component compared to its life, the size of the network and the current cost of renewal. Where age information is sparse, the HNA code permits the use of condition data to estimate the age of the asset, which enables an estimate to be made of the accumulated depreciation percentage to date. The methodology for carriageways has established a deterioration curve which plots the deterioration of surface layers over time using historical data gathered for asset management purposes. This deterioration curve is used to estimate age using condition which is then translated into an accumulated depreciation line.

30. The accumulated depreciation percentage is then multiplied by the network area and renewal rate in order to estimate the amount the asset has deteriorated and thus the amount that has been consumed, by using the costs of replacement as an estimation for the value of the accumulated depreciation.

31. The resulting accumulated depreciation is the total estimated for the finite life components. This, along with impairment, is then deducted from the GRC total to provide the DRC for carriageways.

32. This methodology of using the current replacement cost for the depreciable components in order to estimate the amount of an asset's value that has been consumed is also used for structures and footways.

33. Where an authority is using its own rates for calculating accumulated and annual depreciation, the rates must be updated annually using actual rates where available. If up-to-date rates are not available between revaluations, rates shall be indexed using an appropriate index.

34. Table 4.1 in the HNA code defines the components of the HNA in the accounting code. The overall classification has three levels defined as

- Level 1: component type – broad categories based on the general function of the components. They divide the HNA into categories of components and provide an appropriate basis for high-level management information.

- Level 2: component groups – used to distinguish between component types that have a similar function and form.
- Level 3: elements – distinguishes between components that, at least when systems become well developed, may require individual depreciation and impairment models, such as different service lives and/or rates of deterioration.

Revised guidance notes

35. CIPFA has also issued revised guidance notes to support the implementation of the HNA code. The guidance notes aim to
    - provide finance teams with an understanding of the valuation approaches required to be undertaken by engineers and the systems and processes involved
    - explain to engineers details of the information required by accountants to ensure that the accounting code requirements are met.

36. The guidance notes have been updated to reflect the changes to the 2016/17 accounting code.

New accounting guidance

37. CIPFA has issued accounting guidance which exemplifies the specifications of the 2016/17 accounting code and the HNA code where they relate specifically to the accounting requirements. It is intended to supplement the accounting code by providing practical assistance to enable authorities to comply with those accounting requirements.

38. Figure 2.1 on page 6 of the guidance provides an overview of the measurement process for the HNA while further discussion and guidance is provided throughout the publication.

Financial instruments

New statutory guidance on loans fund accounting

39. The Scottish Government has issued Finance circular 7/2016 The Local Authority (Capital Financing and Accounting)(Scotland) Regulations 2016 - loans fund accounting to provide statutory guidance on proper accounting practices in respect of the loans fund.

40. The guidance is in respect of *The Local Authority (Capital Finance and Accounting) (Scotland) Regulations 2016* which came into force on 1 April 2016 and replaced the statutory provisions for local authority borrowing, lending and loans funds as set out in Schedule 3 of the *Local Authority (Scotland) Act 1975.* The regulations contain the following provisions in respect of the loan fund
    - Regulation 12 places a duty on a local authority to maintain a loans fund, which is to be administered in accordance with the proper accounting practices and prudent financial management.

- Regulation 13 requires a local authority to make loans fund advances each year for expenditure of, or lending to third parties by, the local authority which it has determined should be met from borrowing.
- Regulation 14 requires a local authority to determine for each loans fund advance the period over which it will be repaid and the amount of each repayment. Both the period and the annual amounts must be considered by the authority to be prudent.

41. The change in the legislative basis from prescriptive under the 1975 Act to prudent represents a change in accounting policy. Local authorities should reflect this change in their accounting policies disclosure in the annual accounts. As the legislation is prospective from 1 April 2016, the change in accounting policy is also to be applied prospectively from that date.

42. From 1 April 2016, the statutory purpose of the loans fund is to

- recognise, by making advances from the loans fund, the expenditure incurred, or loans made, by the authority which it has determined are to be financed from borrowing
- record the opening balance, new advances, repayments, and closing balance
- record the annual repayment to be made to revenue for each loans fund advance. This will provide an authority with a profile of annual charges representing the amount of statutory repayment of debt to be charged to the general fund/housing revenue account (HRA) in any financial year.

43. Regulation 2 of the 2016 regulations sets out the purposes for which a local authority may borrow. Only expenditure on these purposes (excluding treasury management) may be the subject of a loans fund advance

- Capital expenditure of a local authority met from borrowing should be accounted for in accordance with the accounting code.
- Capital grants to third parties and expenditure on third party tangible assets should be accounted for in accordance with the accounting code as revenue expenditure. For statutory capital framework purposes, the expenditure is to be treated as capital expenditure. A statutory adjustment is required which involves a debit to the capital adjustment account and the general fund (or HRA) credited.
- Lending to third parties should be accounted for in accordance with the accounting code and recognised as a debtor. For statutory capital framework purposes, the loans are to be treated as a capital transaction.

44. Depreciation, revaluation and impairment movements charged to the surplus or deficit on the provision of services are not proper charges to the general fund. These amounts require to be transferred to the capital adjustment account. A local authority is required to debit the general fund and credit the capital adjustment account with the value of loans fund repayments.

45. Paragraphs 61 to 68 of the statutory guidance sets out reporting requirements that should be included in the annual strategy and annual report on capital investment, borrowing and the investment of money. This includes disclosing the policy for the repayment of loans fund advances, as well as information on the advances and repayments for the year, and an

analysis of the liability to make future repayments of loans fund advances. The management commentary in the annual accounts is required to direct the reader to this information in the annual strategy and annual report.

46. Paragraph 31 of the statutory guidance identifies that the broad aim of prudent repayment is to ensure that the repayments of a loans fund advance, in relation to repayment period and each year's repayment amount, are reasonably commensurate with the period and pattern of the benefits provided to the community from capital expenditure.

47. Paragraphs 63 to 96 of the statutory guidance identify four options that are considered prudent, though it is for each authority to decide what option to follow. A local authority need not select a single option but may select different options for different capital schemes or projects, though it should be consistent in applying options.

Option 1 – statutory method

48. Under the statutory method, all loans fund advances made prior to 1 April 2016 should continue to be repaid as if paragraph 15 of Schedule 3 of the 1975 Act had not been repealed.

49. The statutory method may continue to be used for a transition period of 5 years commencing on 1 April 2016. After calculation of the annuity, the principal amount of the annuity calculation is to be treated as fixed and should not to be changed in future years to reflect changes in actual interest costs.

Option 2 – depreciation method

50. Under the depreciation method, the annual loans fund repayment is equal to

- depreciation for the asset as charged to the surplus or deficit on the provision of services; less
- the difference between depreciation based on the revalued carrying amount of the asset and depreciation based on the asset's original cost; plus
- any impairment or decrease in the carrying amount required to be recognised in the surplus or deficit on the provision of services; less
- any reversal of a revaluation decrease or impairment previously recognised in the surplus or deficit on the provision of services.

Option 3 – asset life method

51. The asset life method differs from the depreciation method as the residual value of an asset is not taken into consideration. Repayments continue to be based on the initial life and value of an asset and do not change if the asset life is subsequently varied or is subject to impairment.

52. The annual repayments are calculated as either equal instalments or by the annuity method. The annuity method links the repayment of the borrowing to the flow of benefits from an asset where the benefits are expected to increase in later years. A local authority is required to use an appropriate interest rate to calculate the annual repayment of the loans fund advance. Once calculated it is only the principal element of the calculation that represents the annual

repayment of the loans fund advance. Interest is to be disregarded after calculation, the principal element being fixed at the time of the calculation.

Option 4 – funding/income profile method

53. Under option 4, the annual repayments of a loans fund advance are profiled to reflect a funding or other income stream that can reasonably be associated with the asset/loan to a third party. The repayment of the loans fund advance will therefore have a unique profile.

Pension funds

Revised guidance on accounting for management expenses

54. CIPFA has issued a revised version of *Accounting for local government pension scheme management expenses*. This revised guidance sets out a framework for the consistent reporting of data on local government pension scheme (LGPS) management expenses. It updates the guidance issued in 2014 in light of practitioners' experiences and to provide additional practical guidance on some of the more complex areas.

55. Administering authorities are required to account for the LGPS in accordance with the accounting code. The accounting code recommends that authorities have due regard to this guidance when preparing pension fund financial statements. This edition of the guidance applies from 2016/17, though the recommendations may be implemented earlier.

56. The guidance recommends that the total of management expenses reported on the face of the fund account should include the following three categories of expenditure supported by analysis in the notes

- Administration expenses.
- Oversight and governance costs.
- Investment management costs.

57. While many management expenses will be readily and directly attributable to LGPS administrative activity, some will be derived from internal recharges. It is important therefore that the recharge methodology is robust and fit for purpose.

58. Pension administration expenses consist of

- expenses related to members and pensioners, including all activities the pension scheme must perform to administer entitlements and provide members with scheme and benefit entitlement information
- expenses related to interaction with scheme employers, e.g. data collection and verification, contributions collection and reconciliation
- associated project expenses.

59. Administration expenses does not include any costs incurred by the administering authority in its role as an employer in the fund, nor does it include any costs associated with the administration of any other scheme with which the administering authority is associated.

60. Oversight and governance expenses are listed at paragraph 35 of the guidance and include

- the selection, appointment, performance management and monitoring of external fund managers
- investment advisory services
- the operation and support of the pensions committee
- internal or external reporting
- legal services in connection with investment management.

61. Investment management expenses are defined at paragraph 36 as any expenses incurred in relation to the management of pension fund assets and financial instruments entered into in relation to the management of fund assets. This includes expenses that are directly invoiced by investment fund managers and any fees that are payable to fund managers which are deducted from fund assets.

62. As a change from the 2014 edition, the guidance recommends that investment management expenses should be further analysed over the following

- Transaction costs which are all costs associated with the acquisition, issue or disposal of fund assets and associated financial instruments. They are usually a flat rate fee charged quarterly or half-yearly. They includes transaction costs on financial instruments as they are not capitalised under the accounting code (in contrast with the pension SORP) and should instead be reported gross in the fund account. However, they do not include transaction costs on investment property which the accounting code does require to be capitalised.
- Management fees which are calculated and charged periodically depending on contract terms and usually linked to fund value.
- Performance fees which become payable to a manager when a minimum level of performance is achieved.
- Custody fees are fees charged by a custodian.

63. The guidance covers some specific areas such as those in the following paragraphs.

64. It is common practice in pooled funds for fund management fees to be deducted from the pool at source, effectively through the redemption of units in the fund. The value of the pooled fund is then reported at the end of the reporting period net of the units redeemed. Paragraph 49 of the guidance advises that the value of the fees can usually be measured by applying the year end unit offer price to the units redeemed or by contacting the fund manager directly.

65. Certain types of investment (such as private equity and hedge funds) are commonly accessed through a fund of funds structure. Costs incurred at each tier in the investment structure should be reported. The 2014 edition of the guidance required costs to be reported up to the authority where the investments are actually made. The guidance in this revised edition has been amended to clarify that costs should be reported up to the level where the pension fund has

- contractual liability to pay; and
- control.

66. Authorities should avoid double-counting expenditure in relation to costs associated with sub-funds when fees charged directly by fund of fund managers already recharge a proportion of these costs.

67. Any significant judgements or estimates in adopting the appropriate accounting treatment should be disclosed in the statement of accounting policies, along with additional narrative disclosure.

68. It is common practice for fund managers to net off costs and fees against income, and therefore likely that not all fees are routinely reported back to the pension fund. Pension funds should request that the manager provides the necessary information. If it is not provided, reasonable estimation techniques should be used, with any limitations disclosed in the notes.

69. Management fees and profit shares paid to venture capitalists should be accounted for in the same way as other fees but require the use of more sophisticated estimation techniques and perhaps independent experts to arrive at year end valuations which cannot generally be calculated with certainty until the fund has been wound up.

70. Auditors should refer to this guidance when auditing management expenses in the 2016/17 pension fund financial statements and assess whether the authority has paid it due regard.

Other developments

Housing benefit

Guidance on 2015/16 subsidy claims

71. Module 4 of the 2015/16 HB COUNT has been issued. This is the analytical review tool component of the HB COUNT approach to the certification of 2015/16 housing benefit subsidy claims.

72. It provides a number of useful worksheets including the following two which require to be completed

    - The year-to-year worksheet where 2014/15 claim data is entered manually for comparison against 2015/16 data.
    - The key ratios worksheet that allows comparison with other authorities.

Data matching

73. The Department for Work and Pensions (DWP) has issued HB circular A5/2016: Optional real time information bulk data matching initiative advising that the DWP will start providing optional data matches between HM Revenue & Customs' *Real time information* (RTI) system and council housing benefit systems from June 2016.

74. Existing subsidy arrangements will continue to apply.

Changes to temporary absence rules

75. The DWP has issued HB Circular A7/2016: The Housing Benefit and State Pension Credit (Temporary Absence) (Amendment) Regulations 2016 to provide information about amendments to regulations which change the temporary absence rules.

76. The regulations introduce a distinction between temporary absences from the main home within Great Britain (GB) and outside GB for both working age and state pension credit age claims.

77. The allowable period of temporary absence outside of GB has been reduced from 13 weeks to 4 weeks, subject to some exceptions set out at paragraphs 11 to 17 of the circular.

Miscellaneous funding circulars

78. The DWP has issued the following circulars on funding allocations

- HB Circular S8/2016:New Burdens payment for the implementation of the 2016 benefit cap changes advises of funding allocated to local authorities to help meet costs incurred in implementing the 2016 benefit cap changes.
- HB Circular S9/2016 New burdens payment 2016/17: removal of temporary accommodation management fee in housing benefit subsidy advises of funding allocated to local authorities affected by the *Universal credit full service* during 2016/17.

TSU contacts for local authority chapter

79. The contacts in the TSU for this chapter are

- Paul O'Brien, Senior Manager (Technical) - 0131 625 1795 or pobrien@audit-scotland.gov.uk.
- Anne Cairns, Manager – Benefits (Technical) - 0131 625 1926 or acairns@audit-scotland.gov.uk (for housing benefit).

Further education chapter

Introduction

This chapter contains technical developments and guidance from the TSU on emerging risks that are relevant to the further education sector.

It should be read by external auditors with appointments in the further education sector. Auditors should also read the central government sector and cross-sectoral chapter.

Accounting developments

General accounting

2015/16 accounts direction

80. The Scottish Funding Council (SFC) has issued their accounts direction for colleges for 2015/16. 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, and to follow the additional disclosures required by the 2015/16 Government financial reporting manual (the FReM).

81. Specific mandatory disclosure requirements for colleges are set out in Appendix 2 to the direction. The most significant change is that colleges are required to include a performance report and accountability report in their annual report and accounts in accordance with the FReM.

82. The requirement for a performance report replaces the previous requirement for an operating and financial review, and the SFC has confirmed that it supersedes the 2015 SORP's requirement for a strategic report. In addition to the content required by the FReM, the direction requires the following additional specific disclosures

- An explanation of any deficit resulting from using cash-funding provided for depreciation on other purposes. An illustrative form of wording is provided at Appendix 5.
- Confirmation of compliance with the Scottish Government sustainability reporting requirements should be included.
- A statement describing the payment practice code or policy adopted regarding the payment of suppliers and the performance achieved, together with disclosure of any interest paid under the *Late Payment of Commercial Debts (Interest) Act 1998*, or a statement that there were no matters to disclose.
- Details of the college's financial position for the financial year including a statement of the outturn against resource and capital budgets with explanation of any variances.

83. The accounts direction requires the performance report to be signed by the College Principal.

84. In line with changes to the 2015/16 FReM, the remuneration report is part of the accountability report and has been renamed the remuneration and staff report. It has been expanded to include disclosures on, for example, sickness absence data and exit packages. An example report is provided at Appendix 4.

85. In preparing their governance statement, which is also within the accountability report, colleges are required to give due regard to the guidance contained in Appendix 3 and the specific requirements of the Scottish public finance manual.

86. Auditors should confirm that colleges have complied with the accounts direction.

Guidance on 2015/16 financial statements

87. The SFC has issued Detailed notes for guidance on completion of the 2015/16 financial statements which are designed to supplement the accounts direction for 2015/16. The guidance covers key disclosures in the financial statements, including model disclosure notes set out at Annexes A to E.

88. The guidance notes remain largely unchanged from 2014/15, although some of the guidance provided on account areas in 2014/15 has been removed (e.g. tangible fixed assets). They have also been updated to reflect that

- the comparative figures will be for the 16 months to 31 July 2015
- colleges should disclose in the notes the unitary charge for non-profit distributing projects split between the running cost and loan repayment elements.

Provisions and contingencies

Guidance for early retirement provision

89. The SFC has issued Guidance for early retirement provision spreadsheet completion to advise that the suggested net interest rate for early retirement pension calculations in 2015/16 has been changed to 0.50%.

90. 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.

Auditing developments

Technical guidance notes

Audit of 2015/16 annual report and accounts

91. The TSU has published Audit of 2015/16 annual report and accounts (further education) - technical guidance note 2016/8(FE) to provide auditors with guidance on performing the audit of the 2015/16 further education annual report and accounts.

92. The technical guidance note comprises a number of modules that

- highlight the main risks of misstatement in each financial statement area, and sets out actions for auditors to undertake to assess whether colleges have followed the required treatment
- provides guidance on auditors' responsibilities in respect of auditing the regularity of transactions, the performance report, the remuneration and staff report, and the governance statement.

93. Auditors should use the technical guidance note when performing the audit of the 2015/16 further education annual report and accounts.

2015/16 model independent auditor's reports

94. The TSU has issued 2015/16 Independent auditor's report (further education) - technical guidance note 2016/9(FE) to provide auditors with the model independent auditor's reports which should be used for the 2015/16 annual accounts. The technical guidance note also provides application guidance on their use.

95. In the interests of consistency, auditors are required to use the model wording in the appendices to the technical guidance note as a condition of their audit appointment. The only exception is any amendments required to tailor the terminology to reflect local circumstances. It should be noted that the requirement to follow the model wording in the appendices applies to the 'Bannerman' paragraph.

96. Any proposed modifications to any audit opinion or conclusion in the model reports, or the inclusion of 'emphasis of matter' or 'other matter' paragraphs, should be discussed with the TSU in advance of finalising the report.

97. Auditors should use this technical guidance note when reporting on the audit of the 2015/16 annual reports and accounts. They should complete the checklist at Appendix 3 which provides a list of the key auditor actions.

Report on sector

98. Audit Scotland has issued Scotland's colleges 2016 to provide the results of its annual review of the further education sector.

99. Part 3 of the report considers college finances. The sector reported an overall deficit of £28 million in 2014/15 in audited accounts. After adjustments to remove the effect of property asset valuation reductions, pension adjustments, and donations to arm's-length foundations, the deficit decreases to £3 million.

100. Paragraphs 69 to 71 of the report sets out the complex approach to funding colleges for depreciation. The report highlights that, while the SFC recommended that colleges disclose the impact of this on their operating position, this was not disclosed by all colleges.

Auditor action checklist

	Yes/No/N/A	Initials/date	W/P ref
1 Have you carried out the action recommended at paragraph 86 in respect of the accounts direction?			
2 Have you carried out the action recommended at paragraph 90 in respect of the early retirement provision?			
3 Have you carried out the action required at paragraph 93 in respect of performing the audit of the 2015/16 annual report and accounts?			
4 Have you carried out the action required at paragraph 97 in respect of reporting the audit of the 2015/16 annual report and accounts?			

Fraud and irregularities

Introduction

This chapter contains a summary of cases of fraud and other irregularities arising at audited bodies that have recently been reported by external auditors to the TSU.

Auditors should consider whether the weaknesses in internal control that facilitated each case may also exist at their audited bodies and take the appropriate action.

Expenditure

Procurement purchases for personal use

103. An employee in an NDPB used a corporate purchase card to make a variety of personal purchases totalling £8,000.

Key features

The employee used the purchase card to make a number of personal retail and internet purchases. The fraud was possible as the defaulter failed to submit the required list of invoices, receipts and other supporting documentation for the purchases and neither the line manager nor the procurement department chased them up.

The fraud was identified by the finance department during a regular VAT recovery audit when it was highlighted that there was a backlog of purchase card logs, and supporting documentation which had not been submitted by employees including the defaulter.

Upon questioning, the employee admitted misuse of the card. The employee was dismissed, and the matter reported to Police Scotland.

A review of expenditure on all purchase cards has since been completed with managers required to confirm that all expenditure is legitimate, and all cardholders reminded of the policy for the use of purchase cards.

Purchases for personal use

104. A council clerical assistant used a council procurement card to purchase goods valued at £16,000 for their personal use.

Key features

The clerical assistant used the procurement card to purchase additional goods for their personal use when purchasing goods for the council.

The fraud was identified when the manager responsible for authorising the transactions identified two specific transactions of which he had no knowledge and for which no supporting paperwork could be found.

The fraud was possible because transactions were approved without supporting documentation being available.

Officers have been reminded of the procedures to be followed and guidance has been updated to detail how to escalate potential fraudulent activity.

Invalid social care payments

105. In two separate cases, the relatives of care home resident's defrauded a total of £40,000 by failing to declare capital in an application for council funded care.

Key features

The defaulters held capital for the care home residents which they had not reported in the application for the council funded care in the care home.

The frauds were discovered during separate investigations by the council in respect of the defaulters' claims for other benefits after a match from the Department for Work and Pensions' Housing benefit matching service indicated that they had capital which had not been declared.

The debts are being repaid.

Contract procurement

107. Three council roads employees awarded contracts totalling £210,000 over a three year period which did not comply with the contract award framework.

Key features

The council framework for awarding work in respect of any minor roads works requires checks to be carried out to ensure that the contractor holds the necessary health and safety competence and insurance cover. The perpetrators awarded 47 items of work to a company that was not on the approved list.

The irregularity was identified after the council received an anonymous note alleging that a roads employee was awarding work to a contractor without going through the official procurement process.

After investigation, it transpired that three roads employees involved in awarding this work were aware that the company was not properly approved or included in the framework.

The practice went undetected for three years due to separation of duties requirements not being applied and existing procedural requirements for prospective companies being entered on to the framework not being followed.

One of the employees resigned; the second received a final written warning; and the third (who was the most senior of the three) was dismissed. The company is now in liquidation.

Income

School funds

108. A business support manager misappropriated over £20,000 of cash from a school fund.

Key features

The fraud was identified following receipt of an allegation made via the council's whistleblowing line.

Internal audit's subsequent investigations confirmed that funds were missing and identified that a lack of supervision and controls being overridden led to the theft.

The council has since introduced several controls including online payments across schools, proper accounting records for excursions, a revised daily cash sheet, restricted access to safes and restricted access to the procurement system. The matter has been reported to the police.

Personal funds

Social work client bank account

109. A council social work employee defrauded £130,600 from clients' bank accounts by taking money for her own use.

Key features

The fraud was identified after the social work team identified inconsistencies in the benefits income of one client and also that the client had failed to pay a number of their homecare invoices. Subsequent investigations identified that there was limited evidence to support the amounts being drawn from the client account.

A review of the employee's caseload identified that another client may also have suffered a similar financial loss.

The fraud was possible due to a lack of review and challenge of the work and actions of the employee.

An action plan is in the process of being agreed which addresses authorisation controls, client account monitoring processes and homecare invoice monitoring arrangements as well as reiterating the importance of implementing existing procedures.

The employee has been charged with embezzlement and is also subject to the council's internal disciplinary procedures.

Theft

Photographic equipment

111. An unknown defaulter stole photographic equipment worth £8,000 from an NDPB.

Key features

The equipment was discovered to be missing when the Digital Imaging Unit team were relocating to new premises.

The theft was possible as

- the equipment was not stored securely
- the room in which it was stored was unsecure, accessible by members of the public and not covered by CCTV
- the equipment was not asset tagged.

A review has been undertaken of the security arrangements in the new location. Entry is now via a coded keypad and an improved asset management receipting, recording and monitoring process is being implemented.

TSU contact for fraud and irregularity chapter

112. The contact in the TSU for this chapter is Anne Cairns, Manager – Benefits (Technical) - 0131 625 1926 or acairns@audit-scotland.gov.uk.

Technical Services Unit

Audit Scotland's Technical Services Unit (TSU) informs the professional judgement of appointed external auditors on technical matters and encourages the proper exercise of professional scepticism to improve the quality of the audit delivered to the Accounts Commission and Auditor General for Scotland. The TSU provides authoritative guidance and practical assistance to support appointed auditors in carrying out their responsibilities under the *Code of audit practice* to

- provide an opinion on audited bodies' financial statements and, where required, the regularity of transactions
- review and report on other information published with the financial statements, including governance statements and remuneration reports
- examine and report on approved grant claims and other returns submitted by local authorities
- review and report on whole of government accounts returns.

Contact details for relevant TSU staff are included at the end of each chapter.

Feedback on technical bulletins is encouraged and should be sent to

pobrien@audit-scotland.gov.uk

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Technical bulletin 2016/4

October to December 2016

AUDIT SCOTLAND

Prepared by the Technical Services Unit
12 December 2016

Contents

Foreword

Technical bulletins are prepared by Audit Scotland's Technical Services Unit (TSU), and approved by the Assistant Auditor General, to provide external auditors appointed by the Accounts Commission and Auditor General for Scotland with

- information on the main public sector technical developments in the quarter that are relevant to their audit appointment
- guidance from the TSU on any emerging risks identified in the quarter.

Technical bulletins are available to external auditors from Audit Scotland's *Technical reference library,* and published on the Audit Scotland website so that audited bodies and other stakeholders can access them.

It is important that auditors read this technical bulletin promptly so they are familiar with the information and guidance provided. The auditor action checklist section at the end of each chapter should be completed by a senior member of the audit team.

The articles on technical developments are intended to highlight the key points that the TSU considers external auditors require to be aware of. It may still be necessary for auditors to read the source material where greater detail is required. The documents referred to in the articles can be obtained by using the hyperlinks, where available. They are also available to external auditors from Audit Scotland's *Technical reference library*.

While auditors act independently, and are responsible for their own conclusions and opinions, the TSU has a role in ensuring that those conclusions and opinions are reached on the basis of informed judgement. Consistency in similar circumstances is important and **Audit Scotland's *Code of audit practice* therefore states that auditors should normally follow TSU guidance.** Auditors should advise the TSU promptly if they intend not to follow guidance provided in this technical bulletin on an emerging risk.

The TSU encourages feedback on this technical bulletin. Comments should be sent to pobrien@audit-scotland.gov.uk.

More in-depth and extensive guidance is provided in separate technical guidance notes published by the TSU. Technical guidance notes published in the quarter are referred to in this technical bulletin, and can be obtained by using the hyperlinks to the Audit Scotland website.

Headlines

This chapter provides brief headlines for the articles on technical developments and guidance in this technical bulletin, classified by the audit year to which it relates, and referenced to the paragraphs containing the main article.

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Cross-sectoral chapter

Introduction

This chapter contains technical developments and guidance from the TSU on emerging risks in the quarter that are relevant to all sectors.

It should be read by all external auditors. Information on developments and guidance from the TSU in the quarter that are relevant to only one sector are covered in the relevant sector-specific chapter.

Auditing developments

Application of revised auditing standards to Scottish public sector

1. Technical bulletin 2016/2 (paragraph 5) drew attention to the issue by the Financial Reporting Council (FRC) of revised international standards on auditing in the UK [ISAs (UK)] for periods commencing on or after 17 June 2016.
2. The TSU has carried out a consultation exercise with auditors on adopting the revised ISAs (UK) in the Scottish public sector. After some consideration, it was decided that Audit Scotland would not adopt the revised ISAs (UK) early. The effective dates of the revised ISAs (UK) is therefore
   - 2017/18 for the local authority, central government and health sectors
   - 2016/17 for the further education sector.
3. Although not formally adopting the revised ISAs (UK) in most sectors until 2017/18, model independent auditor's reports for 2016/17 in all sectors will be amended to reflect the requirements of *ISA (UK) 700 Forming an opinion and reporting on financial statements*. For example
   - the ‘opinion’ paragraph will be moved to the first section of the report followed by a ‘basis for opinion’ paragraph
   - the description of auditor’s responsibilities will be cross-referred to a significantly expanded description located on the Audit Scotland website
   - the opinion on the financial statements will be included in a separate section from other reporting responsibilities.
4. In addition, the reporting responsibilities will include new opinions required by an amendment to the Companies Act which requires opinions on whether the management commentary/performance report and governance statement have been prepared in accordance with applicable legal requirements. Although the Companies Act applies directly only to the private sector, Audit Scotland's approach is to apply equivalent requirements in the public sector as a matter of good practice.

Revised practice note on ISAs in the public sector

5. The Public Audit Forum (PAF) has issued a revised version of Practice note 10 Audit of financial statements of public sector bodies in the UK (PN 10) which provides guidance on the application of ISAs to the audit of public bodies' financial statements. The PAF has been designated by the FRC as a 'SORP-making body' for the purposes of maintaining and updating PN 10.

6. This revised PN 10 has been prepared by the PAF with advice and assistance from representatives from Audit Scotland and each of the UK national audit agencies. The Auditor General for Scotland and the other heads of the national audit agencies in the UK require auditors to have regard to PN 10.

7. The revised PN 10 is based on ISAs and legislation in effect at 1 September 2016, and therefore includes the revised ISAs (UK). PN 10 nevertheless applies to 2016/17 other than the guidance on the new ISAs (UK). PN 10 is supplementary to ISAs and sets out in

   - part 1 the special considerations relating to the audit of public sector bodies which arise from certain individual ISAs. A table on pages 4 to 6 lists the ISAs on which application guidance is provided
   - part 2 guidance on the audit of regularity.

8. PN 10 has also been revised to

   - reflect other changes since the previous version was published in 2010
   - make the guidance more principles-based and applicable to all public sector auditors
   - reflect current practice across the UK in relation to auditors' work on regularity and the relevant legislative requirements that apply to this work.

9. Particular examples of the application guidance on individual ISAs are included in the following paragraphs.

10. Paragraphs 45 to 47 refer to *ISA (UK) 240 The auditor's responsibilities relating to fraud in an audit of financial statements* which states that the auditor ordinarily presumes that there are risks of fraud in revenue recognition. In the public sector, auditors focus their consideration of the risk of fraud and error on expenditure. As most public bodies are net spending bodies, the risk of material misstatement due to fraud related to expenditure recognition may be greater than the risk related to revenue recognition.

11. Paragraph 86 provides illustrative examples of applying different benchmarks for setting materiality in accordance with *ISA (UK) 320 Materiality in planning and performing an audit*. One example is of an audited body with significant non-current assets where its main role is to provide services to the public. It suggests that it is more appropriate to use gross expenditure rather than non-current assets as a benchmark for setting materiality to reflect the entity's role and interest of the users of the financial statements.

12. Paragraphs 114 to 115 consider the risk of management bias in accounting estimates. In the public sector, factors outside the scope of the financial reporting framework can have a

significant influence on management's estimates. Auditors need to understand these influences when considering the appropriateness of accounting estimates and the assumptions applied by management. For example

- central government departments must adhere to HM Treasury budgetary controls, and estimates in the financial statements can be influenced by the impact they have on departmental expenditure limits or the administration budget
- in the health sector, statutory limits or targets can similarly influence management decisions.

13. Paragraphs 144 to 159 consider the application of *ISA (UK) 570 Going concern* to the public sector. In the public sector, bodies may have a deficit of income over expenditure or an excess of liabilities over assets. However, the operational existence of the 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. Where that is the case, the following may apply

- If the body's operational activities are likely to be transferred elsewhere in the public sector, the going concern basis of accounting is likely to remain appropriate.
- If not, the auditor may decide to request that the audited body secures from the sponsoring body a letter of financial support, confirming that the body continues to have financial backing to utilise its assets and meet liabilities as they fall due
  - Where the auditor judges that the going concern basis is appropriate substantially on the basis of a sponsoring body's confirmations, the auditor should considers whether this should be reported in an 'other matter' paragraph
  - If no appropriate confirmations can be obtained, the auditor should consider whether there is a material uncertainty that requires to be reported in the auditor's report.

14. Auditors should have regard to the revised practice note when applying auditing standards to the audit of public bodies' financial statements.

New professional judgement framework

15. The Institute of Chartered Accountants of Scotland (ICAS) has issued A professional judgement framework for financial reporting decision making which provides a structured process to guide decision-makers through how to make, assess and document significant judgements. It targets judgements across narrative and financial reporting including accounting treatment, materiality, estimates and disclosures.

16. The original framework in 2012 was primarily targeted at accountants (including auditors) when determining the appropriate accounting treatment for particular transactions. This new edition has been broadened to make it more universally applicable to decision-makers involved in financial reporting, including non-accountants. It also includes a new section on audit committees.

17. The framework is aimed at situations where the relevant standard does not provide sufficient detail, where significant judgement is required, or where there is no specific standard covering the transaction.

18. The framework identifies principles for preparers, auditors, audit committees, and regulators. For example, the principles in respect of auditors are that a professional auditing judgement can only be made

- once all relevant and determinable information has been collected and analysed
- in the context of the applicable accounting framework, accounting and auditing standards, and other relevant guidance/literature
- after undertaking appropriate due process to assess and challenge the client's judgement
- if the auditing judgement and the assessment and challenge of the client's judgement is suitably documented.

19. The framework also provides detailed guidance in the form of illustrative lists of actions that might be undertaken to apply the principles For example, the actions for principle 3 in respect of assessing and challenging the client's judgement include

- considering the uncertainties and range of possible outcomes of the transaction and comparing these with the client's assessment
- reviewing the client's assessment of alternative treatments and the reasons for rejection
- evaluating whether significant assumptions made by the client are reasonable
- assessing the client's proposed accounting treatment
- considering the interaction with other judgements and the cumulative impact
- obtaining appropriate advice from experts.

20. Auditors are encouraged to refer to this guidance when forming judgements on significant narrative and financial reporting matters.

Revised bulletin on illustrative auditor's report

21. The FRC has issued a bulletin that provides a compendium of illustrative auditor's reports applicable to periods commencing on or after 17 June 2016 for bodies in the private sector. The auditor's reports set out in the appendices to the bulletin illustrate how the requirements of the revised ISA (UK) 700, and other reporting requirements of the revised ISAs (UK), can be applied. The bulletin replaces the examples in bulletin 2010/2.

22. The bulletin provides examples of unqualified opinions but paragraph 7 advises that, although the examples in the appendix of the revised ISA (UK) 705 have not been tailored for the UK, they illustrate the requirements where an opinion is qualified.

23. The illustrative examples in the bulletin include the two most common scenarios when reporting on going concern under the revised ISA (UK) 570, i.e.

- Appendices 1, 2, 3, 5 and 7B illustrate reporting by exception under the heading 'Conclusions relating to going concern' where the going concern basis of accounting is appropriate and no material uncertainty has been identified.
- Appendix 4 illustrates a 'Material uncertainty related to going concern' section for cases where a material uncertainty has been identified and adequately disclosed in the financial statements.

24. The appendices also include illustrative examples of 'Other information' sections as described in the revised ISA (UK) 720. Where the auditor concludes that there is an uncorrected material misstatement of the other information, paragraph 35 of the bulletin advises that, in addition to including a statement in the auditor's report that describes the material misstatement, the auditor should also consider the reporting implications for the specific opinions, conclusions or statements required by ISAs (UK), law or regulation. A table at paragraph 37 sets out example wording that the auditor should include in the auditor's report when a material misstatement of the other information, arising from an inconsistency between the other information and the financial statements, has been identified.

25. In the illustrative auditor's reports, the alternatives for including a description of the auditor's responsibilities are shown as follows:
    - Appendix 2 illustrates where the responsibilities are located within the body of the auditor's report.
    - Appendix 6 illustrates where the responsibilities are located within an appendix to the auditor's report.
    - Appendices 1, 3, 4, 5, 7A and 7B illustrate where a reference is included in the auditor's report to an appropriate website with a description of the responsibilities. As indicated at paragraph 3, this is the approach to be adopted by Audit Scotland.

26. The TSU will consider the illustrations in this bulletin when preparing model independent auditor's reports for public sector bodies under the revised ISAs (UK).

Audit quality review of root cause analysis

27. The FRC has issued a report to set out their findings of a thematic review on the subject of root cause analysis (RCA). RCA is a process for identifying the causes of problems or events in order to prevent them from recurring. It is a developing area in the audit profession, where it typically relates to understanding why deficiencies have occurred in audits.

28. The report is intended to provide an understanding of the RCA procedures of the six largest audit firms, including areas of good practice and how the procedures can be improved. The main types of root cause identified by the firms from the RCA reviews are
    - knowledge/skills of individuals, e.g. insufficient knowledge of the business or systems
    - behaviours of individuals, e.g. mind set, lack of professional scepticism, audit risks not identified

- care of individuals, e.g. insufficiently supported conclusions, responses to risks not sufficient
- direction by partners and senior team members, e.g. insufficient coaching and/or review
- resources/project management, e.g. not enough time, work performed too late
- firm's processes, e.g. gaps or lack of clarity in guidance.

29. The report notes that the nature of the root causes indicate that they may not have always been fully investigated in sufficient depth to establish, for example, why individuals had not exercised adequate professional scepticism.

30. The firms focus on training, guidance and communications to address the root causes identified, largely because these often relate to behaviours of individuals. Actions include delivering training within audit teams on the areas of recurring issues to supplement traditional classroom training and the use of practical workshops. While there is some evidence that firms are increasing the amount of behavioural related training, they could make more use of this.

31. There is also an increased focus on real time monitoring and use of central teams to directly support audit teams, improving the integration of internal experts and coaching related initiatives, such as providing practice aids in key areas of the audit.

Report on auditor skills

32. A joint FRC/ICAS Steering Committee has issued a report called Auditor skills in a changing business world which sets out the findings from research projects into auditor skills. The research assessed the attributes, competencies, professional skills and qualities that require to be combined in an audit team in order for it to perform a high quality public interest audit in a modern and complex global business environment.

33. The Steering Committee believes that an opportunity exists for the audit profession to be at the forefront of evolving the audit into a more holistic assessment of an entity's strategy, business model, risk profile, operations and performance. There is evidence that the audit of the future will need to provide
    - more transparency into what has been learned during the course of the audit
    - perspectives on key information generated by management
    - deeper insights on entity performance, operations and risks.

34. However, based on the findings from the research, it is doubtful whether the profession currently has the skill base necessary to deliver an audit beyond the traditional financial statement audit.

35. The report therefore highlights the Steering Committee's view of what needs to change to allow auditors to be able to deliver the audit of the future. It focusses on the three main skill areas that need to be developed to equip audit teams to undertake an audit that is more holistic and useful for stakeholders and society. These are categorised as

- advanced business acumen skills; if an auditor does not understand the dynamics of the business, they cannot challenge it effectively because they will not have the necessary understanding to assess the information or explanations provided. New methods of increasing business knowledge therefore needs to be adopted, including providing training that focuses on understanding business models
- technology and data interrogation skills; data analytics enable audit teams to interrogate entire populations of data, rather than relying on results of sampling a small part. Audit teams need to have the knowledge and experience to identify when to commission specialist services, to know what questions to ask the internal specialists, and to know how to decipher the answers they get back
- soft skills; the auditor will be expected to exercise judgement over a much greater range of professional issues and the Steering Committee questions whether professional judgement receives sufficient ranking in development and performance measurement procedures. To exercise professional judgement and professional scepticism more effectively, the Steering Committee believe that much greater emphasis should be given to the development of the psychological and behavioural skills that are key to successful auditing. Training auditors in how to evaluate corporate culture, behaviours and conscious and unconscious bias would help with the development of these skills.

36. The Steering Committee has identified that the main barriers to change include

- recruitment and development issues; while high quality talent is being recruited, some of the initiative and enthusiasm may be driven out of the trainees by the time they qualify, due to the routine nature of the work they undertake
- the implications of standardisation; the research identified a concern that the current levels of global standardisation, where an auditor needs to follow a firm's methodology through its audit software, may inhibit the exercise of professional judgement.

Auditor action checklist

	Yes/No/N/A	Initials/date	W/P ref
1 Have you carried out the action recommended at paragraph 14 in respect of practice note 10?			
2 Have you carried out the action recommended at paragraph 20 in respect of the new professional judgement framework?			

TSU contact for cross-sector chapter

37. The contact in the TSU for this chapter is Paul O'Brien, Senior Manager (Technical) - 0131 625 1795 or pobrien@audit-scotland.gov.uk.

Local authority sector

Introduction

This chapter contains information on the main technical developments, and guidance from the TSU on any emerging risks, in the quarter that are relevant to the local authority sector.

It should be read by external auditors with appointments in the local authority sector. Auditors should also read the cross-sectoral chapter.

Auditing developments

Technical guidance notes

Audit of 2016/17 annual accounts

38. The TSU has published Audit of 2016/17 annual accounts (local authorities) - technical guidance note 2016/10(LA) to provide auditors with guidance on planning and performing the audit of the 2016/17 local authority annual accounts. The technical guidance note comprises

- an overview module
- 8 modules on financial statement areas, e.g. property, plant and equipment, financial instruments, group financial statements
- module 9 on the management commentary, annual governance statement and remuneration report. This has been updated to reflect the new opinions explained at paragraph 4
- module 10 on local government pension scheme accounts
- module 11 on section 106 charity accounts
- module 12 on objections to accounts (to be published at a later date).

39. The modules highlight the main risks of misstatement in each area, explain the correct treatment, and set out actions for auditors to assess whether the authority has followed the required treatment. 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 plan and perform the audit of 2016/17 local authority annual accounts.

40. 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 local government site of the *Technical reference library*. There is also a module containing a summary of the risks of misstatement available as a word document which may be used as a checklist.

41. While auditors are responsible for their own conclusions and opinions, consistency in similar circumstances is important. Auditors should read the technical guidance note so they are

familiar with the guidance provided. It is important that auditors follow the actions set out, subject to local judgements on materiality, to ensure that all auditors adopt a consistent approach to common risks.

2015/16 financial overview

42. Audit Scotland has issued a report to provide a high-level, independent view of councils' financial performance and position in 2015/16. Financial overview 2015/16 is aimed primarily at councillors and senior council officers as a source of information and to support them in their roles. It is in two parts

- Part 1 focuses on the councils' income and expenditure in 2015/16 and trends over time.
- Part 2 comments on the financial outlook of councils at 31 March 2016 and outlines important factors to be considered in assessing future spending plans.

43. The primary sources of information for the report are councils' audited accounts and their 2015/16 annual audit reports, supplemented with other information supplied by auditors and councils.

Accounting developments

Property, plant and equipment

Revised property handbook

44. The Chartered Institute of Public Finance and Accountancy (CIPFA) has issued a revised *Property asset valuation handbook* which is intended to help authorities comply with the accounting requirements of the *Code of practice on local authority accounting in the UK* (accounting code) in relation to valuing property assets. The handbook

- examines issues surrounding local authority property assets including classification, valuation and component accounting
- provides examples based on situations that are likely to arise in practice
- explains the asset valuation process, the associated data requirements and how asset valuations can be used as a tool for good asset management.

45. The chapters of the handbook are as follows

- Chapter two explores in detail the reasons for asset valuations, the regulatory framework and the impact of asset valuation on both accounting and asset management.
- Chapter three outlines who needs to be involved in the valuation process and explores the various valuation methods and how the valuer applies these in practice; their applicability under the accounting code; the frequency of valuations; and how property assets should be classified. This chapter has significant changes from the previous edition of the handbook to reflect the adoption of *IFRS 13 Fair value measurement*.
- Chapter four explores the importance of accurate and reliable data for robust local authority property asset valuations and the effective management of those assets.

- Chapter five provides guidance on instructing internal and external valuers; the required skills and qualifications that property professionals should hold; the relationships that should exist between accountants and property professionals; and the form and content of valuation reports.
- Chapters six and seven give practical guidance on component accounting and depreciated replacement cost valuations, including worked examples to help illustrate approaches to be taken.

46. Auditors may find it helpful to refer to this handbook when auditing property, plant and equipment in the 2016/17 annual accounts.

Highways network asset

Update on implementation

47. The CIPFA/LASAAC Local Authority Code Board has issued an update which advises of their decision to postpone from 2016/17 the implementation of the move to measuring the highways network asset at current value.

48. A key part of moving to a current value basis is the provision of central gross replacement cost rates. The current rates were originally developed at the start of the project and are now over five years old. Revised rates are critical given the time frame since the last rates were produced.

49. However, it has become clear that revised rates will not be ready in good time for the 2016/17 financial statements. CIPFA/LASAAC has therefore decided to defer implementation for the 2016/17 financial year. They will review this position in March 2017 with a view to implementation in 2017/18. The restatement of prior year information will not be required.

50. Although there are no financial reporting requirements in respect of the highways network asset that apply in 2016/17, auditors should

    - assess local authorities' progress in ensuring they hold accurate inventory and condition data so they are in a position to comply with the accounting code's requirements from 2017/18
    - report findings from their assessment in their 2016/17 annual audit reports.

51. Guidance on the assessment is provided in module 2 of technical guidance note 2016/10(LA).

Governance statements

New guidance on governance framework

52. CIPFA has issued guidance notes for Scottish local authorities on the *Delivering good governance in local government: framework 2016*. The 2016 framework applies to annual governance statements prepared for the financial year 2016/17 onwards.

53. The guidance notes are intended to assist local authorities in reviewing the effectiveness of their own governance arrangements by reference to best practice and using self-assessment.

They are intended to be used in conjunction with the framework and are intended to assist Scottish authorities in

- reviewing and testing their governance arrangements against the principles for good governance
- interpreting the principles and terminology contained in the framework in a way that is appropriate for their governance structures, taking account of the legislative and constitutional arrangements that underpin them.

54. A comparison of the principles of the 2016 framework with those included in the previous 2007 framework is included for information at Appendix A to the guidance notes.

55. Auditors should refer to these guidance notes when auditing the annual governance statement in the 2016/17 annual accounts. Guidance on auditing the annual governance statement is provided in module 9 of technical guidance note 2016/10(LA).

Corporate costs

Guidance on corporate costs in 2016/17

56. CIPFA has issued guidance on reporting overheads and internal recharges in the 2016/17 comprehensive income and expenditure statement (CIES). This follows the changes to the 2016/17 accounting code which introduced the requirement for local authorities to report their service segments based on the way in which they operate and manage services. The change ends the requirement for the service analysis to be based on the definition of total cost and the service expenditure analysis in the *Service reporting code of practice* (SeRCOP).

57. The guidance confirms that there is no longer an absolute requirement to apportion support service overheads to services in the CIES. Instead, financial reporting requirements should follow the internal management processes as follows

- If an authority reports the financial performance of corporate departments and support services to management separately (e.g. as a service), their expenditure and income will be reported as segments rather than spread across other segments as overheads.
- Where financial effect is spread across services as overheads in the reports to management, the CIES should follow the same structure.

58. There is no requirement in the accounting code to include the line items required by SeRCOP for corporate and democratic core or non-distributed costs, though authorities may voluntarily continue to do so.

59. The same principle also applies to internal recharges as follows

- If the internal recharges do not feature in the monthly budget monitoring reports to management (e.g. because they are only made at the year end), they are not expected to feature in the segmental analysis in the CIES. Expenditure will be reported where it was originally debited.

- If the internal recharges are included in the monthly budget monitoring reports to management, they would need to be included in the segmental analysis in the CIES.

60. Where included in the segmental analysis in the CIES, the treatment depends on whether the recharges are
    - a means of allocating an authority's corporate expenditure to its other services in which case the recharge is eliminated and the expenditure is only shown in the service segment to which it is allocated. The service from which the expenditure is allocated would reduce its expenditure by the 'recharged' amount; or
    - effectively a business arrangement between the corporate departments and the other service segments in which case the CIES should include expenditure and income incurred for other segments within the corporate departments, and the (other) service segments should be charged for their use of the corporate departments' services.

Other developments

Housing benefit

Benefit cap

61. The Department for Work and Pensions (DWP) has issued HB circular A10/2016 (2nd Revision) Administration of the benefit cap 2016 to announce changes to the benefit cap from November 2016.

62. Households will generally no longer be entitled to receive more than £20,000 in benefits (£13,400 for single adults with no children), although those that meet certain qualifying conditions are exempt. The revised benefit cap will be implemented by local authorities as part of the administration of housing benefit (HB) payments.

63. Local authorities will administer a cap when they receive a notification from the DWP. Authorities then add the current weekly award of HB to the other benefits in payment, and reduce the amount of HB by the amount of benefit the claimant is entitled to over the cap level.

Annuities

64. The DWP has issued HB circular A8/2016 The secondary annuities market and housing benefit to confirm the action to be taken in respect of HB claimants who assign their annuity to a third party.

65. Local authorities will need to consider claimants' total weekly income taking into account any deemed income from a lump sum and any other capital as well as considering whether claimants have deliberately deprived themselves of income from annuities in order to obtain benefits.

Auditor action checklist

	Yes/No/N/A	Initials/date	W/P ref
1 Have you carried out the action recommended at paragraph 41 in respect of the technical guidance note on auditing the 2016/17 annual accounts?			

TSU contacts for local authority chapter

66. The contacts in the TSU for this chapter are

- Paul O'Brien, Senior Manager (Technical) - 0131 625 1795 or pobrien@audit-scotland.gov.uk.
- Anne Cairns, Manager – Benefits (Technical) - 0131 625 1926 or acairns@audit-scotland.gov.uk (for housing benefit).

Health chapter

Introduction

This chapter contains technical developments that are relevant to the health sector.

It should be read by external auditors with appointments in the health sector. Auditors should also read the central government sector and cross-sectoral chapter.

Auditing developments

2015/16 overview report

67. Audit Scotland has issued NHS in Scotland 2016 to provide the results of its annual review of how NHSScotland is performing. The report is in the following two parts

- Part 1 of the report considers the financial and wider service performance in the sector. An overall surplus of £4.5 million was reported against the revenue budget of £10.9 billion at the end of March 2016.
- Part 2 of the report focuses on the impact of some of the significant changes that the sector is undergoing, including health and social care integration.

68. There is evidence of boards increasingly using short-term approaches to meet the annual financial targets in 2015/16. Some boards only managed to achieve financial balance through one-off measures which included

- additional funding allocations from the Scottish Government late in the financial year
- making savings by delaying or under-spending on services or capital projects
- transferring capital funding to revenue funding to allow it to be used to cover increasing operational costs.

69. One auditor identified a prepayment for the cost of public holidays of over £1 million. The board corrected the entry after the auditor concluded it was contrary to proper accounting practice.

70. NHS Shetland was unable to locate assets included in its fixed asset register costing £1.4 million. The auditor qualified their conclusion regarding the maintenance of adequate accounting records.

TSU contact for health chapter

71. The contact in the TSU for this chapter is Neil Cameron, Manager - Central Government and Health (Technical) - 0131 625 1797 or ncameron@audit-scotland.gov.uk.

Further education chapter

Introduction

This chapter contains technical developments and guidance from the TSU on emerging risks that are relevant to the further education sector.

It should be read by external auditors with appointments in the further education sector. Auditors should also read the central government sector and cross-sectoral chapter.

Accounting developments

Governance statement

Revised good governance code

72. The Scottish Funding Council (SFC) issued SFC/GD/19/2016 Good practice in college governance to set out its determination of the principles of good governance for colleges. The guidance advises that the recently revised Code of good governance for Scotland's colleges issued by Colleges Scotland represents the SFC's view of good practice on governance. It is therefore a condition of grant that colleges comply with this code. It is expected that regional strategic bodies will also follow the code where relevant.

73. Each college is required to state its adoption of the code in the corporate governance statement. The chair is encouraged to report personally as to how the principles have been applied by the board.

74. Where a college's practice is not consistent with any principle of the code, it is required to make this known immediately to the SFC (or regional strategic body for assigned colleges). An explanation for that inconsistency requires to be clearly stated in its corporate governance statement.

75. Changes from the previous version of the code include the following

- Individual board members must ensure that they are aware of the provisions of the code and that they have a duty to act on concerns about the governance of the body.
- Guidance has been added on accountability and the ability to delegate responsibilities which include maintaining accurate and transparent minutes of board and committee business.
- The audit committee terms of reference should provide for the committee to meet in private.
- The members of the remuneration committee have a responsibility to understand their role and responsibilities.

- Expanded guidance on the roles and responsibilities of the Board Chair, members and the Board Secretary is provided.

76. Paragraph D.23 of the SFC guidance requires college boards to keep its effectiveness under annual review and have in place a robust self-evaluation process. Boards are required to send the self-evaluation and board development plan to the SFC as soon as they are available.

77. Auditors should refer to this guidance when auditing the corporate governance statement in the 2016/17 accounts.

TSU contact for further education chapter

78. The contact in the TSU for this chapter is Helen Cobb, Technical Adviser (Central Government, Health and Further Education) - 0131 625 1901 or hcobb@audit-scotland.gov.uk.

Technical Services Unit

Audit Scotland's Technical Services Unit (TSU) informs the professional judgement of appointed external auditors on technical matters and encourages the proper exercise of professional scepticism to improve the quality of the audit delivered to the Accounts Commission and Auditor General for Scotland. The TSU provides authoritative guidance and practical assistance to support appointed auditors in carrying out their responsibilities under the *Code of audit practice* to

- provide an opinion on audited bodies' financial statements and, where required, the regularity of transactions
- review and report on other information published with the financial statements, including governance statements and remuneration reports
- examine and report on approved grant claims and other returns submitted by local authorities
- review and report on whole of government accounts returns.

Contact details for relevant TSU staff are included at the end of each chapter.

Feedback on technical bulletins is encouraged and should be sent to

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