

Technical bulletin 2018/1

January to March 2018



Prepared for appointed auditors in all sectors

19 March 2018

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

Extracts from the code of audit practice

Technical support

40. Auditors appointed by the Auditor General for Scotland or the Accounts Commission are responsible for giving an opinion on the financial statements and reporting on other related matters. Audit Scotland provides technical support to appointed auditors in respect of these responsibilities to inform their professional judgement.

108. Audit Scotland provides technical support and guidance to all appointed auditors. While appointed auditors act independently, and are responsible for their own conclusions and opinions, Audit Scotland has a role in ensuring that those conclusions and opinions are reached on the basis of informed judgement.

An element of the technical support and guidance to appointed auditors referred to in the above extracts from the [Code of audit practice](#) is technical bulletins provided by Audit Scotland's Professional Support.

The purpose of technical bulletins is to provide appointed auditors with

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

This technical bulletin applies to appointed auditors in all sectors, though some sections apply to a particular sector.

Technical bulletins are available to appointed 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.

The articles on technical developments are intended to highlight the key points that Audit Scotland's Professional Support considers appointed auditors require to be aware of. It may still be necessary for auditors to read the source material if greater detail is required. 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*.

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

Audit Scotland makes no representation as to the completeness or accuracy of the contents of technical bulletins or that legal or technical guidance is correct. Points of law, in particular, can ultimately be decided only by the Courts. Audit Scotland accepts no responsibility for any loss or damage caused as a result of any person relying upon anything contained in this technical bulletin.

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 they relate, and referenced to the paragraphs containing the main article.

| Cross sector chapter | | Paragraphs |
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| 2017/18 audit year | | |
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| Local authority chapter | | Paragraphs |
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| CIPFA has issued a bulletin on closing the 2017/18 financial statements. | | 15 - 28 |
| SGLGFD has issued revised guidance on the untaken holiday accrual. | | 29 - 31 |
| SGLGFD has issued revised guidance on capital grants. | | 32 - 38 |
| SGLGFD has issued revised guidance on the pension fund annual report. | | 39 - 40 |
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| Professional Support will obtain information on GBS account balances at 31 March 2018. | 78 |
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| NAO has issued a disclosure guide for the financial statements. | 84 - 87 |
| Cabinet Office has issued guidance on the remuneration and staff report. | 98 - 100 |
| Treasury has announced the discount rates as at 31 March 2018. | 101 - 105 |
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| Health chapter | Paragraphs |
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| <i>Guidance from Professional Support</i> | |
| Professional Support has published a technical guidance note on performing the audit of 2017/18 health board annual report and accounts. | 107 - 112 |
| Professional Support has published a technical guidance note on model 2017/18 independent auditors reports for health boards. | 113 - 118 |
| Professional Support will shortly issue the results of a review of the work carried out by CLO on CNORIS. | 119 - 121 |
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| Fraud and irregularity chapter | Paragraphs |
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| Professional Support has provided a summary of reported fraud cases. | 141 - 142 |

Cross-sectoral chapter

Introduction

This chapter contains information on the main technical developments in the quarter that are relevant to all sectors.

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

Auditing developments

Updated review on materiality

1. The [Financial Reporting Council](#) (FRC) has issued an updated [audit quality thematic review on materiality](#). The review explains the concept of audit materiality and how the major accountancy firms determine it in practice.
2. International standards on auditing in the UK (ISAs (UK)) define information to be material if its misstatement could influence the economic decisions of users. Materiality is therefore assessed by auditors quantitatively and qualitatively, and that assessment drives the scope, nature and extent of the auditor's work.
3. The majority of the key messages in the previous 2013 report have been addressed by the firms. These include an increased emphasis on the application of judgment when determining overall materiality, and demonstrating the consideration of risk in setting performance materiality.
4. Some key messages from this most recent review include the following
 - Three firms have introduced guidance to reduce performance materiality in the first year of audits to reflect the increased risk.
 - Where adjusted profit is used as the benchmark for setting overall materiality, auditors should explain why they have made the adjustments and how that benchmark responds to the needs of the users of the financial statements.
 - Some audit teams base materiality benchmarks on a rolling average basis to eliminate volatility.
 - Guidance on setting component materiality and how it relates to overall materiality would be helpful.
 - Firms should consider how they can better explain the concept of performance materiality in their reports.

Other developments

Financial management

Revised treasury management code

5. The [Chartered Institute of Public Finance and Accountancy](#) (CIPFA) has issued a revised [Treasury management in the public services: Code of practice and cross-sectoral guidance notes](#) (treasury management code) to apply from 2018/19. The treasury management code provides a framework for effective treasury management in public sector bodies. It defines treasury management as
 - the management of a body's investments and cash flows, banking, money market and capital market transactions
 - the effective control of the risks associated with those activities
 - the pursuit of optimum performance consistent with those risks.
6. The main changes in this edition are
 - the extension to include non-financial asset investments that are not part of treasury management activity, e.g. investment property
 - clarification in the guidance notes that approval and ongoing monitoring of the detail of the treasury management strategy should be permitted where this facilitates more active discussion of the strategy. It should be performed by those with the most appropriate skills and knowledge, but overall responsibility for treasury management remains with the full board/council and a compliant capital strategy must be approved by them.

Professional Support contact for cross-sectoral chapter

7. The contact in Audit Scotland's Professional Support for this chapter is Paul O'Brien, Senior Manager (Professional Support) - 0131 625 1795 or pobrien@audit-scotland.gov.uk.

Local authority chapter

Introduction

This chapter contains information on the main technical developments, and guidance from Audit Scotland's Professional Support on an emerging risk, 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.

Guidance from Professional Support

Technical guidance notes

Audit of 2017/18 annual accounts

8. Audit Scotland's Professional Support has published a [module](#) of technical guidance note 2017/10(LA) to provide guidance to all appointed external auditors on performing the audit of 2017/18 integration joint board (IJB) annual accounts.
9. The module provides guidance on applying the other modules of the technical guidance note to IJB accounts, including further supplementary guidance.
10. Auditors should use the module when auditing the 2017/18 IJB annual accounts.

Guidance on emerging risks

Treatment of grant funding

11. [Finance circular 4/2018](#) advises that the total overall funding package for 2018/19 includes an additional £159.5 million of general revenue grant. £34.5 million of this sum is being paid as a redetermination of the 2017/18 funding to be paid on 28 March 2018.
12. Audit Scotland is aware of uncertainty and differing views over whether the £34.5 million should be recognised as
 - income in 2017/18; or
 - grant received in advance (i.e. a liability) at 31 March 2018, with recognition as income deferred to 2018/19.
13. Auditors should assess whether the grant has been accounted for in accordance with the *Code of practice on local authority accounting in the UK* (accounting code). In making this assessment, auditors should note that the accounting code adapts *IAS 20 Accounting for government grants* and requires grants to be recognised immediately as income, unless there are any conditions relating to initial recognition that the authority has not satisfied.

14. Finance circular 4/2018 does not include any such conditions or stipulate that the grant may only be spent in 2018/19. Professional Support has confirmed with the Scottish Government that there are no conditions attached to the grant set out elsewhere, and authorities are free to spend it from the date of receipt. On that basis, Professional Support considers that the accounting code requires the £34.5 million grant to be recognised as income in 2017/18.

Accounting developments

General accounting

Guidance on closing 2017/18 financial statements

15. CIPFA has issued [Bulletin 01 Closure of the 2017/18 financial statements](#) to
 - provide further guidance and clarification to complement the guidance notes on the 2017/18 accounting code
 - look further ahead to some future developments.
16. Auditors may wish to refer to this bulletin when auditing the 2017/18 local authority annual accounts. The main subjects applicable to Scottish local authorities on which the bulletin provides guidance are
 - the new *Apprenticeship levy*
 - accounting standards issued but not yet adopted
 - the going concern basis of accounting
 - a review of *Telling the story* changes
 - the application of new international financial reporting standards (i.e. IFRSs 9, 15 and 16).

Apprenticeship levy

17. Paragraphs 7 and 8 of the bulletin explain that the *Apprenticeship levy*, introduced by the UK Government from 1 April 2017, is payable through the pay as you earn system along with income tax and national insurance and should therefore be accounted for in a similar manner. It is therefore an employee expense and should be recognised as such in accordance with the requirements of section 6.2 of the accounting code.
18. Paragraph 9 does not apply to Scottish bodies as the method of disbursing the income in Scotland is different to England.

Accounting standards issued but not yet adopted

19. The bulletin lists the following standards that have been issued (but not adopted until the 2018/19 accounting code) that may be relevant for additional disclosures in the 2017/18 financial statements
 - *IFRS 9 Financial instruments*
 - *IFRS 15 Revenue from contracts with customers*

- *Amendments to IAS 12 Income taxes: Recognition of deferred tax assets for unrealised losses*
- *Amendments to IAS 7 Statement of cash flows: disclosure initiative.*

20. The bulletin highlights that comparative amounts are not to be restated on the introduction of IFRS 9 and IFRS 15 and therefore there is no requirement to provide financial information relating to their impact for the 2017/18 year in the 2017/18 financial statements.

Going concern basis of accounting

21. Paragraph 23 of the bulletin sets out CIPFA's view that, because the 2017/18 accounting code requires local authorities to use the going concern basis of accounting, authorities are not required to apply paragraph 25 of *IAS 1 Presentation of financial statements* which would otherwise require management to make an assessment of the authority's ability to continue as a going concern.
22. However, auditors should note that ISA (UK) 570 states that the preparation of the financial statements requires management to assess a body's ability to continue as a going concern even if the financial reporting framework does not include an explicit requirement to do so.

Review of Telling the story changes

23. Paragraph 36 of the bulletin draws attention to the following changes to the 2018/19 accounting code as a result of an early review of the *Telling the story* changes that were made to the 2016/17 accounting code
- The comprehensive income and expenditure statement (CIES) will no longer be required to meet the reporting requirements of *IFRS 8 Operating segments*.
 - Additional columns may be added to the expenditure and funding analysis note.
24. Paragraph 37 invites any comments on whether the *Telling the story* changes have achieved their objectives to be sent to financial.reporting@cipfa.org by 28 April 2018.

IFRS 9

25. The bulletin summarises the debate on the impact from 2018/19 of *IFRS 9 Financial instruments* on collective investment vehicles which are expected to be classified to fair value through profit or loss (i.e. fair value gains and losses will be chargeable to the surplus or deficit on the provision of services as they arise). The debate has centred on whether collective investment vehicles qualify for the presentation election under IFRS 9 to be reclassified to fair value through other comprehensive income (which would mean movements in fair value being charged to the financial instruments revaluation reserve).
26. In order to qualify for the presentation election, the investment would need to meet the definition of an equity instrument. This would not be case if the instrument is 'puttable' (i.e. the holder has the right to demand repurchase or repayment of the principal).

IFRS 15

27. In respect of the application of *IFRS 15 Revenue from contracts with customers* from 2018/19, the bulletin
- advises that the standard should not have a substantial effect for local authorities with relatively predictable income streams but it may have an impact on authorities where the consideration is variable or when income is recognised over time
 - encourages authorities to focus on the materiality of the information when meeting the standard's substantially increased disclosure framework.

IFRS 16

28. The bulletin explains that a consultation paper (referred to in technical bulletin 2017/4) on the application of *IFRS 16 Leases*, which is expected to be adopted by the 2019/20 accounting code, will be issued shortly. CIPFA is also considering other ways of assessing the impact of the standard.

Employee benefits**Revised guidance on untaken holiday accrual**

29. The [Scottish Government Local Government Finance Division](#) (SGLGFD) has issued [Finance circular 2/2018 Accounting for short term accumulating paid absences](#) which contains revised guidance on the untaken holiday accrual which replaces finance circular 3/2010 from 2017/18. Part 1 provides background and commentary, while part 2 sets out statutory guidance on proper accounting practices.
30. The revisions to the guidance are summarised in the following table:

| Revision | Timescale | Further comment |
|--|-------------------|--|
| Removal of the statutory adjustment for flexi-leave and time off in lieu | From 1 April 2021 | The statutory adjustment will be restricted to annual leave. Any balance on the employee statutory adjustment account at 31 March 2020 relating to flexi-leave or time of in lieu should be transferred to the general fund. |
| Allowing the statutory adjustment to be up to, rather than equal to, the accounting charge | From 1 April 2017 | A sum up to any accounting charge made to the CIES for untaken holiday at the year end may be transferred to the employee statutory adjustment account as a statutory adjustment. The amount should be transferred back in the following year. |

31. Auditors should refer to this guidance when auditing the untaken holiday accrual in the 2017/18 annual accounts.

Capital grants

Revised guidance on capital grants

32. The SGLGFD has issued [Finance circular 3/2018 Accounting for capital grants, contributions and donated assets](#) which contains revised guidance on accounting for capital grants, contributions and donated assets. Part 1 provides background and commentary, while part 2 sets out statutory guidance on proper accounting practices.
33. The finance circular from the Scottish Government setting out the guidance replaces finance circular 6/2010 from 2017/18. The guidance has been revised to
- include grants to third parties for capital projects
 - clarify how capital grants, contributions and donated assets should be reported in the annual accounts.
34. The guidance applies to capital grants, contributions and donated assets where the recognition criteria have been met, and they have been recognised in the CIES. The guidance distinguishes between a capital grant used to fund
- an authority's capital expenditure
 - a third party's capital expenditure.
35. The treatment for each type of grant, including where the grant has not been used by the year end, is summarised in the following table:

| Requirement | Used to fund authority's capital expenditure | Used to fund third party's capital expenditure | Unused by year end |
|---|---|--|---|
| CIES presentation (in current year) | Credit to taxation and non-specific grant income line | Credit grant received to service income Debit grant paid to service expenditure | Credit to taxation and non-specific grant income line |
| Statutory adjustment (in current year) | Debit general fund Credit capital adjustment account | N/A | Debit general fund Credit capital grants unapplied account |
| CIES presentation (in future year when unused grant finally used) | N/A | Debit grant paid to service expenditure | N/A |

| Requirement | Used to fund authority's capital expenditure | Used to fund third party's capital expenditure | Unused by year end |
|--|---|---|--------------------|
| Statutory adjustment (in future year when unused grant finally used) | Debit capital grants unapplied account Credit capital adjustment account | Debit capital grants unapplied account Credit general fund | N/A |

36. Donated assets should be treated in the same way as capital grants used to fund an authority's capital expenditure.
37. The statutory adjustments should be reported in the movement in reserves statement and analysed clearly either on the face of the statement or in a note.
38. Auditors should refer to this guidance when auditing capital grants, contributions and donated assets in the 2017/18 annual accounts.

Pension funds

Revised guidance on pension fund annual report

39. The SGLGFD has issued [Finance circular 1/2018 Local government pension fund annual report and accounts](#) which contains revised guidance on the local government pension fund annual report and accounts. Part 1 provides background and non-statutory guidance, while part 2 sets out statutory guidance on proper accounting practices.
40. The finance circular from the Scottish Government setting out the guidance replaces finance circular 6/2015 from 2017/18. The only change is that legislative references in the guidance have been updated to refer to *The Local Government Pension Scheme (Scotland) Regulations 2014*.

Financial instruments

New guide on IFRS 9

41. CIPFA has issued [IFRS 9 Financial instruments - an early guide for local authority practitioners](#) to provide application guidance on IFRS 9. The guide is intended to assist local authority practitioners in preparation for the adoption of this complex standard in 2018/19.
42. The guidance provides comprehensive coverage of the requirements of the forthcoming provisions, including recognition, measurement, treatment of gains and losses, derecognition and presentation and disclosure in the financial statements, and is intended to help practitioners determine the appropriate treatment for any instrument that they might originate or hold.
43. In addition to the ongoing accounting requirements, the guidance covers in particular

- the new classifications for financial assets and their accounting implications for measurement of fair value and the recognition of gains and losses
 - the impact of the change to an expected losses approach to impairment of financial assets (covering all types of investments and debtors)
 - the mechanics of making the transition in the 2018/19 financial statements (including the application of transitional provisions and the preparation of relevant disclosure notes).
5. Each of these areas is supported by worked examples and illustrations.
44. Auditors should refer to this guidance when assessing local authorities' preparations for complying with IFRS 9 in 2018/19.

Proposed revisions to statutory guidance

45. The SGLGFD has issued *Accounting for financial instruments - statutory guidance – consultation draft* which contains proposed revisions to the statutory guidance in finance circular 4/2007 on accounting for financial instruments.
46. The statutory guidance allows a local authority to make a statutory adjustment involving the financial instruments adjustment account when accounting for financial instruments in accordance with the accounting code for
- premiums and discounts associated with the refinancing of loans
 - soft loans
 - stepped interest rate loans.
47. The proposed revisions do not impact on the statutory adjustments but they provide
- more detail on the application of capital receipts to fund premiums
 - guidance on how the statutory adjustments should be reported in the annual accounts.
48. The existing statutory guidance allows capital receipts to be used to meet the cost of premiums. If that does not extinguish the premium, local authorities are required to produce a proportionate reduction of all the outstanding annual charges for that premium.
49. The proposed further detail at paragraphs 42 to 46 of the draft statutory guidance includes the following points
- Capital receipts may fund the cost of premiums either as they are incurred or as they are recharged annually back to the general fund.
 - Where capital receipts are used to fund the annual charge, the annual charge for deferred premiums should still be made to the general fund as a statutory adjustment, with the capital receipt treated as a transfer between statutory usable reserves (i.e. debit capital receipts, and credit general fund).
 - Capital receipts may be used to fund additional charges to the general fund over and above the annual charge.

- Where capital receipts are used to fund a premium incurred when the loan is extinguished, the cost is not transferred to the financial instrument adjustment account. Instead the capital receipts are transferred to the general fund.
 - Where only part of the premium cost is funded from capital receipts, an authority may choose to defer the remaining amount by transferring it to the financial instrument adjustment account as a statutory adjustment.
 - The transfer from capital receipts requires to be reported in a 'Transfer to/from other statutory usable reserves' line in the movement in reserves statement.
50. All statutory adjustments require to be reported as adjustments between the accounting basis and funding basis in the movement in reserve statement. The analysis should clearly identify each statutory adjustment, and the draft guidance provides suggested descriptors for each one at paragraphs 56 to 60.

Other developments

Financial management

Revised prudential code

51. CIPFA has issued a revised version of the [Prudential code for capital finance in local authorities](#) (prudential code) to apply from 2018/19. Local authorities are required by regulation to have regard to the prudential code when exercising their powers to borrow.
52. This revised version of the prudential code includes a new section on determining a capital strategy with a requirement for the section 95 proper officer to report formally on the capital strategy and associated risks. The capital strategy is required to
- demonstrate that the authority takes capital expenditure and investment decisions in line with service objectives and properly takes account of stewardship, value for money, prudence, sustainability and affordability
 - set out the long term context in which capital expenditure and investment decisions are made and gives due consideration to both risk and reward and impact on the achievement of priority outcomes.
53. The revised prudential code also includes a number of changes to the prudential indicators, including the following
- There is no longer an affordability indicator for the estimated incremental impact of capital investment decisions on the council tax.
 - The indicator for net debt and the capital financing requirement has been amended to refer to gross debt.
 - There is no longer a specific indicator relating to the treasury management code.

Housing benefit

Guidance on 2017/18 subsidy claims

54. [The Department for Work and Pensions](#) (DWP) has issued a letter and guidance notes on completing the 2017/18 subsidy claim.
55. The letter contains details of the amounts paid for 2017/18 in respect of administration subsidy and interim benefit subsidy received. The deadlines are
 - 30 April 2018 for authorities to submit the pre-certified claim to the DWP and external auditors
 - 30 November 2018 for the certified claim to be submitted to the DWP.

2017/18 HB COUNT modules

56. [Public Sector Audit Appointments](#) has issued the following modules of the 2017/18 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.
57. Module 1 has also been issued and provides an overview of the approach, but this is superseded in Scotland by guidance from Professional Support. Module 4 is an analytical review tool and module 5 is a software diagnostic tool but these have not yet been issued. Module 6 relates only to England.
58. For HB COUNT 2017/18, the key change is in respect of temporary accommodation management costs on which subsidy is no longer paid.
59. An e-learning package setting out the principles of the HB COUNT approach to the certification of HB subsidy claims for 2017/18 has also been issued.

Closure of universal credit live service

60. The DWP has issued [HB Urgent bulletin U4/2017: Closure of the gateway to new universal credit live service claims](#) to announce that universal credit live service ceased to take new claims from 1 January 2018.
61. Existing universal credit live service claimants are unaffected. New claimants are being directed to claim legacy benefits, including housing benefit, where appropriate.

2018/19 uprating

62. The DWP has issued HB circulars [A10/2017: Housing benefit: uprating 2018/19 \(revised\)](#) and [A1/2018 War pensions: uprating 2018/19](#) advising of the benefits rates from April 2018.

63. Circular A10/2017 also contains specific advice for local authorities that apply percentage increases to uprate income from other social security benefits. As some of the rates have been uprated by different indices, authorities should consider whether applying standard percentages will result in correct determinations.

Funding

64. The DWP has issued the following circulars in respect of HB funding
- [HB circular S2/2018 Universal credit live service closure new burdens payments](#)
 - [HB circular S3/2018: 2018/19 Housing benefit administration subsidy arrangements for English, Scottish and Welsh local authorities](#)

Auditor action checklist

| | Yes/No/N/A | Initials/date | W/P ref |
|--|------------|---------------|---------|
| 1 Have you carried out the action required at paragraph 10 in respect of module of technical guidance note 2017/10(LA) on IJB annual accounts? | | | |
| 2 Have you carried out the action recommended at paragraph 13 in respect of the treatment of additional general revenue grant? | | | |
| 3 Have you carried out the action recommended at paragraph 16 in respect of the CIPFA bulletin? | | | |
| 4 Have you carried out the action recommended at paragraph 31 in respect of the untaken holiday accrual | | | |
| 5 Have you carried out the action recommended at paragraph 38 in respect of capital grants, contributions and donated assets? | | | |
| 6 Have you carried out the action recommended at paragraph 44 in respect of financial instruments? | | | |

Professional Support contacts for local authority chapter

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

Central government chapter

Introduction

This chapter contains technical developments and guidance from Professional Support on emerging risks that are relevant to the central government sector.

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.

Guidance from Professional Support

Technical guidance notes

Auditing 2017/18 annual report and accounts

66. Audit Scotland's Professional Support has published [Audit of 2017/18 annual report and accounts \(central government\) - technical guidance note 2018/1\(CG\)](#) to provide guidance to all appointed external auditors on performing the audit of 2017/18 central government annual report and accounts.
67. While appointed auditors act independently and are responsible for their own conclusions and opinions, paragraph 108 of the *Code of audit practice* states that Audit Scotland 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 therefore appointed auditors should consider such guidance.
68. The technical guidance note comprises a number of modules. The modules, along with a brief summary of the contents, are set out in the following table:

| Module | Content |
|--|---|
| Overview | Guidance on auditors' overall responsibilities for the annual report and accounts; financial reporting framework that bodies are required to follow; the application of ISAs (UK); presentation of financial statements; and accounting policies, estimates, and prior year errors |
| 1 Property, plant and equipment | Each module highlights the risks of misstatement in each financial statement area, explains the financial reporting requirements applying to that area, and sets out actions for each risk that auditors should undertake to assess whether the body has met those requirements. |
| 2 Provisions, creditors and accruals | |
| 3 Financial instruments | |
| 4 Group financial statements | |
| 5 Other financial statement areas | As for modules 1 to 4 but this module includes a number of financial statement areas including leases, grant in aid, and intangible assets etc |
| 6 Regularity of expenditure and income | This module provides guidance on auditor's responsibilities for the regularity of expenditure and income, and the risks of irregularities. It also sets out test procedures for auditors to carry out. |
| 7 Non-financial statements | This module covers the remuneration and staff report; performance report, governance statement and other non-financial statements. It explains auditors' responsibilities for these statements, sets out the different audit opinions required, highlights the main risks of misstatement, explains the financial reporting requirements applying to each statement, and sets out test procedures that auditors should undertake to assess whether the body has met those requirements. |
| 8 Charitable NDPBs | This module provides guidance on applying the other modules to charitable NDPBs, including further supplementary guidance. |

69. Following extensive consultation with all auditors, the technical guidance note represents an agreed position on a range of complex technical issues and is a key document as auditors perform the audit of central government 2017/18 annual report and accounts.
70. For the purposes of the Audit Scotland website, all the modules have been combined into one document. The individual modules are also available from the relevant subject pages on the central government site of the *Technical reference library*.
71. Auditors should use the technical guidance note when performing the audit of the 2017/18 central government annual report and accounts.

2017/18 model independent auditor's reports

72. Professional Support has issued [2017/18 Independent auditors report \(central government\) - Technical guidance note 2018/4\(CG\)](#) to provide auditors with the model independent auditor's reports which should be used for the 2017/18 annual report and accounts. The technical guidance note also provides application guidance on their use.
73. In the interests of consistency, auditors are required to use the relevant model report in appendices 1 to 4 of the technical guidance note as a condition of their audit appointment. The only exception to using the wording in each model is to tailor the terminology to reflect local circumstances.
74. The model independent auditor's reports have been revised to comply with the new *ISA (UK) 700 Forming an opinion and reporting on financial statements*.
75. 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 Professional Support in advance of finalising the report.
76. Auditors should use this technical guidance note when reporting on 2017/18 audits. They should complete for each report the checklist at Appendix 5 which provides a list of the key auditor actions.
77. The technical guidance note also provides a model auditors report for summary financial statements at Appendix 6.

2017/18 GBS account information

78. Professional Support will obtain information on account balances at 31 March 2018 for central government bodies from the Government Banking Service (GBS) and distribute them to relevant auditors. The GBS has confirmed that the arrangements for obtaining 2017/18 account balances are unchanged.

Accounting developments

General accounting

Revised 2017/18 FReM

79. [HM Treasury](#) has issued a revised version of the [2017/18 Government financial reporting manual](#) (the FReM).
80. The most significant changes from the previous version are to chapter 5 which has been amended to improve disclosure requirements and to reflect the introduction of *The Companies, Partnerships and Groups (Accounts and Non-Financial Reporting) Regulations 2016*. These regulations amend the Companies Act and therefore the FReM changes apply in Scotland.
81. The changes are summarised in the following table:

| Paragraph | Statement | Additional disclosure requirement |
|-----------|---|--|
| 5.2.8 | Performance report - overview | Brief description of the business model and environment, organisational structure, objectives and strategies in the statement of the purpose and activities of the organisation |
| 5.2.10 | Performance report – performance analysis | <p>Explanatory narrative on the link between key performance indicators, risk and uncertainty</p> <p>Explanation of the relationships and linkages between different pieces of information within the annual report and accounts</p> <p>Non-financial information pertaining to social matters, respect for human rights, anti-corruption and anti-bribery matters</p> <p>Environmental matters including the impact of the body's business on the environment</p> |
| 5.3.28(f) | Staff report | Information relating to employee matters such as other diversity issues, health and safety at work and trade union relationships |

82. There has also been a new section added on the *Apprenticeship levy* which was introduced from 1 April 2017. The new requirements are summarised in the following table:

| Paragraph | New requirement |
|-----------|---|
| 8.4.1 | Payment of the levy should be accounted for as a tax expense within staff costs. |
| 8.4.2 | Income received should be accounted for as grant income and recognised when the associated expense for training services is recognised. |

83. Auditors should refer to this version of the FReM when auditing the 2017/18 annual report and accounts.

2017/18 disclosure guide

84. The [National Audit Office](#) (NAO) has issued the [2017/18 FReM disclosure guide for financial statements](#) which is designed to ensure that bodies covered by the FReM have prepared their 2017/18 annual report and accounts in the appropriate form and have complied with all disclosure requirements.
85. The guides are cross-referenced to the 2017/18 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.

86. While the guide is designed primarily for the NAO's internal use, auditors in Scotland may also find it helpful. When checking that the FReM's disclosure requirements have been met, auditors should
- consider requesting that the body completes the NAO's 2017/18 disclosure guide for the financial statements
 - investigate the reasons for any non-compliance that the guide highlights
 - assess whether the body's responses in the checklist are consistent with auditor's knowledge..
87. The NAO has also issued the *2017/18 FReM disclosure guide for annual reports*. Professional Support has amended this guide for application to Scottish bodies, and the amended version is available from the *Technical reference library*. Auditors should consider requesting that the body completes the (amended) disclosure guide. However, auditors should use and complete the checklists in module 7 of technical guidance note 2018/1(CG) for the purposes of their opinions on the performance report and governance statement.

2018/19 FReM

88. Treasury has issued the [2018/19 FReM](#). It applies EU adopted IFRS and interpretations in effect for accounting periods commencing on or after 1 January 2018.
89. The two significant changes from 2017/18 are the adoption of
- *IFRS 9 Financial instruments*
 - *IFRS 15 Revenue from contracts with customers*.

Application guidance on IFRS 9

90. Treasury has issued [IFRS 9 Financial instruments: Public sector application guidance](#) to support the adoption of IFRS 9 in the 2018/19 FReM. IFRS 9 produces a more principles-based approach to the accounting for financial instruments, including their classification and measurement. Some key features are summarised in the following table:

| Feature | Commentary |
|---|---|
| Criteria for classifying financial assets | <p>IFRS 9 has moved away from IAS 39's reliance on the terms of an instrument (and whether it is traded or not) and applies a single classification and measurement approach to all types of financial assets based on the</p> <ul style="list-style-type: none"> • body's business model for managing financial assets • contractual cash flow characteristics of the financial asset. |
| New measurement categories for financial assets | <p>The new measurement categories for financial assets are as follows</p> <ul style="list-style-type: none"> • Financial assets measured at amortised cost. • Financial assets measured at fair value through other comprehensive income. |

| Feature | Commentary |
|---------------------------|--|
| | <ul style="list-style-type: none"> Financial assets measured at fair value through profit or loss. <p>Financial assets are reclassified between measurement categories only when the body's business model for managing them changes.</p> |
| Impairment | <p>IFRS 9 contains a forward looking expected loss impairment model and requires the same measurement basis for impairment for all items subject to its impairment requirements.</p> <p>The FReM requires the simplified approach allowed by IFRS 9 which removes the need for an entity to consider whether the credit quality of trade receivables, contract assets and lease receivables has deteriorated significantly since initial recognition. It may, however, result in a higher loss allowance recognised on 'day-1' than under the full impairment model.</p> |
| Financial liabilities | IFRS 9 carries forward unchanged almost all the accounting requirements in IAS 39 for financial liabilities. |
| Transitional arrangements | IFRS 9 has been interpreted so that bodies are required to recognise the difference between the carrying amount at 31 March 2018 and the carrying amount at 1 April 2018 in the opening general fund within taxpayers' equity. |

91. Auditors should refer to this application guidance when assessing the progress of central government bodies in preparing to comply with IFRS 9 in 2018/19.

Application guidance on IFRS 15

92. Treasury has issued [IFRS 15 Revenue from contracts with customers: Public sector application guidance](#) to support the adoption of IFRS 15 in the 2018/19 FReM. IFRS 15 applies to revenue relating to the sale of goods and services.
93. The core principle of IFRS 15 is that a body should recognise revenue for the transfer of goods or services to customers at an amount that reflects the expected price. A body recognises revenue in accordance with that core principle by applying the five steps set out in the following table:

| Step | Action |
|------|--|
| 1 | Identify the contract(s) with a customer. The FReM has extended the definition of a contract to include legislation which enables a body to obtain revenue that is not classified as taxation. |
| 2 | Identify the performance obligations in the contract. |
| 3 | Determine the transaction price. |
| 4 | Allocate the transaction price to the performance obligations in the contract. |
| 5 | Recognise revenue when (or as) the entity satisfies a performance obligation. |

94. Application of this model will depend on the facts and circumstances presented in a contract with a customer and will require the exercise of judgement.
95. The standard also includes disclosure requirements regarding the nature, amount, timing and uncertainty of revenue and cash flows arising from the entity's contracts with customers.
96. On transition, bodies are required to recognise the difference between the carrying amount at 31 March 2018 and the carrying amount at 1 April 2018 in the opening general fund within taxpayers' equity.
97. Auditors should refer to this application guidance when assessing the progress of central government bodies in preparing for complying with this standard in 2018/19.

Remuneration and staff report

Preparation guidance for 2017/18

98. The [Cabinet Office](#) has issued [EPN 536 2017/18 Disclosure of salary, pension and compensation information](#) to provide guidance on the preparation of the pay pension and compensation disclosures in the remuneration and staff report for 2017/18. Example disclosures are provided at Annex 13C.
99. There are no significant changes to the remuneration disclosures set out from 2016/17. However, this guidance does not reflect the application of the FReM's requirements to Scottish bodies and therefore auditors should refer to module 7 of technical guidance note 2018/1(CG).
100. Auditors should refer to this guidance when auditing the remuneration and staff report in the 2017/18 annual report and accounts.

Provisions

2017/18 discount rates

101. Treasury has issued PES(2017)10 to announce the discount rate for post-employment benefits liabilities, general provisions and financial instruments as at 31 March 2018.

102. The discount rates for post employment benefits are set out in the following table:

| Use | Rate from 31 March 2018 |
|---|--|
| Real rate used for valuing unfunded pension scheme liabilities and early departure provisions | 0.10% |
| Nominal rate for unwinding discount on liabilities (interest costs) | 2.55% |
| Rate used for funded pension schemes | Based on returns from AA corporate bonds at 31 March |

103. The real discount rates to be applied to provisions recognised in accordance with IAS 37 as at 31 March 2018 are set out in the following table:

| Category | Period | Percentage |
|-------------|------------------------|-------------|
| Short term | Within 5 years | Minus 2.42% |
| Medium term | Between 5 and 10 years | Minus 1.85% |
| Long term | More than 10 years | Minus 1.56% |

104. The financial instrument discount rates to be applied at 31 March 2018 are set out in the following table:

| Type | Rate |
|---|------|
| Real rate when financial instrument indexed to RPI | 0.7% |
| Nominal rate when financial instrument is not linked to an inflationary index | 3.7% |

105. Auditors should refer to this paper when reviewing the discount rates applied to provisions in 2017/18 financial statements.

Auditor action checklist

| | Yes/No/N/A | Initials/date | W/P ref |
|---|------------|---------------|---------|
| 1 Have you carried out the action required by paragraph 71 in respect of technical guidance note 2018/1(CG)? | | | |
| 2 Have you carried out the action required by paragraph 76 in respect of 2017/18 model independent auditor's reports? | | | |
| 3 Have you carried out the action recommended at paragraph 83 in respect of the 2017/18 FReM? | | | |
| 4 Have you carried out the action recommended at paragraph 91 in respect of IFRS 9? | | | |
| 5 Have you carried out the action recommended at paragraph 97 in respect of IFRS 15? | | | |
| 6 Have you carried out the action recommended at paragraph 100 in respect of the remuneration and staff report? | | | |
| 7 Have you carried out the action recommended at paragraph 105 in respect of 2017/18 discount rates? | | | |

Professional Support contacts for central government chapter

106. The contacts in Professional Support for this chapter are

- Neil Cameron, Manager (Professional Support) - 0131 625 1797 or ncameron@audit-scotland.gov.uk.
- Helen Cobb, Senior Adviser (Professional Support) - 0131 625 1901 or hcobb@audit-scotland.gov.uk.

Health chapter

Introduction

This chapter contains information on the main technical developments, and guidance from Professional Support on any emerging risks, in the quarter 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 chapters.

Guidance from Professional Support

Technical guidance notes

Audit of 2017/18 annual report and accounts

107. Audit Scotland's Professional Support has published [Audit of 2017/18 annual report and accounts \(health boards\) - technical guidance note 2018/2\(H\)](#) to provide guidance to all appointed external auditors on performing the audit of 2017/18 health board annual report and accounts.
108. While appointed auditors act independently and are responsible for their own conclusions and opinions, paragraph 108 of the *Code of audit practice* states that Audit Scotland 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 therefore appointed auditors should consider such guidance.
109. The technical guidance note comprises a number of modules. The modules, along with a brief summary of the contents, are set out in the following table:

| Module | Content |
|--|--|
| Overview | Guidance on auditors' overall responsibilities for the annual report and accounts; financial reporting framework that boards are required to follow; the application of ISAs (UK); presentation of financial statements; and accounting policies, estimates, and prior year errors. |
| 1 Property, plant and equipment | Each module highlights the risks of misstatement in each financial statement area, explains the financial reporting requirements applying to that area, and sets out actions for each risk that auditors should undertake to assess whether the board has met those requirements. |
| 2 Provisions, creditors and accruals | |
| 3 Other financial statement areas | As for modules 1 and 2 but this module includes a number of financial statement areas including leases, capital grants, and intangible assets etc |
| 4 Regularity of expenditure and income | This module provides guidance on auditor's responsibilities for the regularity of expenditure and income, and the risks of irregularities. It also sets out test procedures for auditors to carry out. |
| 5 Non-financial statements | This module covers the remuneration and staff report; performance report, governance statement and other non-financial statements. It explains auditors' responsibilities for these statements, sets out the different audit opinions required, highlights the main risks of misstatement, explains the financial reporting requirements applying to each statement, and sets out test procedures that auditors should undertake to assess whether the board has met those requirements. |

110. Following extensive consultation with all auditors, the technical guidance note represents an agreed position on a range of complex technical issues and is a key document as auditors perform the audit of health 2017/18 annual report and accounts.
111. 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 health site of the *Technical reference library*.
112. Auditors should use the technical guidance note when performing the audit of the 2017/18 health annual report and accounts.

2017/18 model independent auditor's reports

113. Professional Support has issued [2017/18 independent auditor's report \(health boards\) - Technical guidance note 2018/3\(H\)](#) to provide auditors with the model independent auditor's reports which should be used for the 2017/18 annual report and accounts. The technical guidance note also provides application guidance on their use.

114. In the interests of consistency, auditors are required to use the relevant model report in appendices 1 to 2 of the technical guidance note as a condition of their audit appointment. The only exception to using the wording in each model is to tailor the terminology to reflect local circumstances.
115. The model independent auditor's reports have been revised to comply with the new *ISA (UK) 700 Forming an opinion and reporting on financial statements*.
116. 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 Professional Support in advance of finalising the report.
117. Auditors should use this technical guidance note when reporting on 2017/18 audits. They should complete for each report the checklist at Appendix 3 which provides a list of the key auditor actions.
118. The technical guidance note also provides an assurance statement for the consolidation schedules at Appendix 4. Auditors should complete the auditor action checklist at Appendix 5.

Review of central work on CNORIS

119. Professional Support will be undertaking a review of the work carried out by the NHS Central Legal Office (CLO) relating to the *Clinical negligence and other risks indemnity scheme* (CNORIS). The objective of the review is to establish the extent to which the information prepared using the work of the CLO, as a management expert under *ISA (UK) 500 Audit evidence*, can be used as audit evidence.
120. Professional Support will also evaluate the appropriateness of the methodology adopted by the Scottish Government to establish the total national liability for CNORIS. The review will focus on the estimation of the liability as at 31 March 2018 with a view to assessing the reliability of the methodology used for 2017/18.
121. Professional Support will then provide auditors with the outcome of the reviews to
 - inform auditors' evaluation of the relevance and reliability of the information prepared by the CLO as audit evidence
 - provide assurance on the methodology used in the preparation of the CNORIS figures as at 31 March 2018 which are provided to NHS boards.

Accounting developments

General accounting

2017/18 accounts manual

122. The [Scottish Government Health and Social Care Directorate](#) (SGHSCD) has issued the *2017/18 NHS board manual for annual report and accounts* to complement the guidance contained in the 2017/18 FReM.

123. There have been significant presentational changes to the financial statements and some further changes to the performance report and remuneration and staff report. The main changes included in the accounts manual compared with 2016/17 are summarised in the following paragraphs. Auditors should refer to the manual when auditing health boards' 2017/18 annual report and accounts.

Financial statements

124. The presentation of the SoCNE has been amended to improve clarity and compliance with the FReM and accounting standards. The changes on page 36 of the manual include the following
- Staff costs are now presented on the face of the SoCNE as a material expenditure item.
 - Other operating expenditure categories are presented as
 - independent primary care services
 - drugs and medical supplies
 - other healthcare expenditure.
 - Operating income is presented as a single line on the face of the SoCNE.
125. The categories of expenditure included within the guidance on pages 38 to 39 have been reordered to reflect the presentation of the summary of resource outturn in the accounts template.
126. The statement of cash flows guidance on pages 43 to 46 has been amended to clarify that the net expenditure should include associates and joint ventures accounted for on an equity basis. These will then be removed as part of the adjustments for non-cash transactions
127. The guidance on the statement of changes in taxpayers' equity on page 48 has been amended to remove the line relating to transfer of non-current assets from other bodies which will now be included the movement on the revaluation reserve.

Notes

128. The main changes to the notes are summarised in the following table:

| Note | Pages | Change |
|--------|-----------|---|
| Note 2 | 68 and 69 | Revised note consolidates the previous note 3 (other operating expenditure) and note 18 (movement in working capital) to provide a single note to the cash flow statement |
| Note 3 | 70 to 73 | New note which supports the changes to the categories of expenditure disclosed in the SoCNE and consolidates the previous notes 3 to 7 into a single expenditure note |
| Note 4 | 74 to 76 | Note amends the previous note 8 on operating income to provide clearer income categories |

| Note | Pages | Change |
|---------|------------|---|
| Note 7 | 83 | Donated assets are no longer presented separately from other property, plant and equipment assets. A line for transfers to and from other NHSScotland bodies has been added. |
| Note 9 | 94 | Guidance on the operation of the NHS injury cost recovery scheme has been added. |
| Note 13 | 106 | Clarification added that NHS Central Legal Office fees and outlays should not be included in the provision for CNORIS. |
| Note 20 | 118 to 119 | Guidance on the required disclosure for 2017/18 to explain the changes in the presentation of the SoCNE. |

Performance report

129. Pages 7 and 8 have been amended as a result of changes to the presentation of the financial reporting section. The memorandum for in year outturn has an additional line to present the reported (deficit)/surplus in the financial year which is taken from the financial performance disclosure. Additional explanation has been provided to clarify the requirements of the disclosure.

Remuneration and staff report

130. Guidance on page 19 has been amended to clarify that where a director has been in post for only a part of the year, the date of appointment/resignation and the full year equivalent figures are required in the remuneration table.

Other changes

131. This version of the accounts manual does not reflect the changes in the revised version of the 2017/18 FReM explained in the central government chapter. However, a revised version of the accounts manual which reflects those changes will be issued shortly.

Guidance on 2017/18 funding for large hospital services

132. The SGHSCD has issued guidance on accounting for funding set aside for large hospital services in 2017/18.
133. Health boards and integration joint boards (IJBs) are required to agree a figure for the sum set aside to be included in their respective annual accounts. Where the required arrangements were not in place in 2016/17, IJBs were allowed to use the budget made available by the health board.
134. The guidance sets out the arrangements available for the 2017/18 annual accounts. It is expected that health boards and IJBs should have made sufficient progress to be able to agree a figure for the sum set aside to be included in their respective annual accounts.

- 135. However, in the absence of a local arrangement, data is available from NHS National Services Scotland that should allow the preparation of reliable accounting estimates.
- 136. Auditors should refer to this guidance when auditing the set aside amount in NHS boards' 2017/18 annual report and accounts.

Property, plant and equipment

2017/18 capital accounting manual

- 137. The SGHSCD has issued the *2017/18 NHS capital accounting manual (CAM)* to interpret the accounting guidance contained in the 2017/18 FReM on capital accounting issues in the NHS.
- 138. There are no significant changes from the 2016/17 CAM.
- 139. Auditors should refer to the CAM when auditing property, plant and equipment in 2017/18 annual report and accounts.

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 technical guidance note 2018/2(H)? | | | |
| 2 Have you carried out the action required by paragraphs 117 and 118 in respect of 2017/18 model independent auditor's reports? | | | |
| 3 Have you carried out the action recommended at paragraph 123 in respect of the 2017/18 NHS board manual for annual report and accounts? | | | |
| 4 Have you carried out the action recommended at paragraph 136 in respect of the large hospital services set aside? | | | |
| 5 Have you carried out the action recommended at paragraph 139 in respect of the 2017/18 capital accounting manual? | | | |

Professional Support contact for health chapter

- 140. The contact in Professional Support for this chapter is Neil Cameron, Manager (Professional Support) - 0131 625 1797 or ncameron@audit-scotland.gov.uk.

Fraud and irregularities

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

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

School fund income

141. An administrative assistant in a school misappropriated £6,000 by failing to bank school fund income.

Key features

The fraud was possible due to reconciliations and spot checks of accounts and cash balances not being carried out.

The fraud was identified during an internal audit investigation following a theft from the school safe. The administrative assistant denied any involvement in the theft, but admitted failing to bank school fund income.

Regular spot checks and bank reconciliations signed off by the head teacher have been introduced.

A report has been made to the Procurator Fiscal.

Non domestic rates income

142. A limited company defrauded over £18,600 in business rates relief through the submission of fictitious lease agreements and applications for small business bonus.

Key features

The limited company rented four industrial units. A professional rating practitioner advised the company to report to the council that three of the units had been sub-let to other companies that were under the control of the Directors of the limited company. The liability for business rates was then reduced, and transferred to the names of the different companies. This entitled all of the businesses to receive a small business bonus, reducing the rates liability to zero.

The fraud was identified when a member of the business rates team became suspicious and referred the case to the council fraud team. Subsequent enquiries established all leases were fictitious. The rating practitioner was sentenced to a four year prison term relating to charges involving fraud and violence.

The fraud was possible due to council officers failing to identify inconsistencies in documentation. For example, an examination of

- the lease agreements would have identified substantial errors such as the leases being dated prior to the limited company leasing the premises
- publically available Companies' House records would have revealed that the company registration number on the lease did not relate to the named companies and the people named as Directors were not recorded as Directors with Companies House.

Employees involved with the administration of business rates have been made aware of the weaknesses identified and a fraud awareness session relating to business rates is being developed for these employees.

Recovery action will be instigated to recover the full business rates liability from the limited company.

Auditor action checklist

| | Yes/No/N/A | Initials/date | W/P ref |
|--|------------|---------------|---------|
| 1 Have you considered whether the weaknesses in internal control that facilitated each fraud may apply at your audited bodies? | | | |

Professional Support contact for fraud chapter

143. The contact in Professional Support for this chapter is Anne Cairns, Manager (Professional Support) on 0131 625 1926 or acairns@audit-scotland.gov.uk

Technical bulletin 2018/2

April to June 2018



 AUDIT SCOTLAND

Prepared for appointed auditors in all sectors

14 June 2018

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

Extracts from the code of audit practice

Technical support

40. Auditors appointed by the Auditor General for Scotland or the Accounts Commission are responsible for giving an opinion on the financial statements and reporting on other related matters. Audit Scotland provides technical support to appointed auditors in respect of these responsibilities to inform their professional judgement.

108. Audit Scotland provides technical support and guidance to all appointed auditors. While appointed auditors act independently, and are responsible for their own conclusions and opinions, Audit Scotland has a role in ensuring that those conclusions and opinions are reached on the basis of informed judgement.

An element of the technical support and guidance to appointed auditors referred to in the above extracts from the [Code of audit practice](#) is technical bulletins provided by Audit Scotland's Professional Support.

The purpose of technical bulletins is to provide appointed auditors with

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

This technical bulletin applies to appointed auditors in all sectors, though some chapters apply to a particular sector.

Technical bulletins are available to appointed auditors from the *Technical reference library* maintained by Professional Support, and are published on the [Audit Scotland website](#) so that audited bodies and other stakeholders can access them.

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

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

Audit Scotland makes no representation as to the completeness or accuracy of the contents of technical bulletins or that legal or technical guidance is correct. Points of law, in particular, can ultimately be decided only by the Courts. Audit Scotland accepts no responsibility for any loss or damage caused as a result of any person relying upon anything contained in this technical bulletin.

Headlines chapter

This chapter provides brief headlines for the items on technical developments and guidance on emerging risks in this technical bulletin, classified by the audit year to which they relate, and referenced to the paragraph number containing the main item.

| Cross-sector chapter | | Item paragraphs |
|---|--|-----------------|
| 2017/18 audit year | | |
| <i>Technical developments</i> | | |
| The Cabinet Office has issued guidance on disclosing trade union facility time information. | | 1 - 4 |

| Local authority chapter | | Item paragraphs |
|---|--|-----------------|
| 2017/18 audit year | | |
| <i>Technical developments</i> | | |
| Professional Support has published a good practice note on disclosing the expenditure and funding analysis. | | 23 - 25 |
| LASAAC has issued an advisory note on internal transactions. | | 26 - 30 |
| CIPFA/LASAAC has issued a clarification statement on LOBOs. | | 31 - 35 |
| PWC has issued a report for auditors on actuarial information. | | 36 - 40 |
| CIPFA has published revised guidance on audit committees. | | 44 - 49 |
| Professional Support has published model independent auditor's reports. | | 50 - 54 |
| Professional Support has published guidance for auditors on dealing with statutory objections to the annual accounts. | | 55 - 57 |
| Professional Support has published guidance for auditors on certifying grant claims. | | 58 - 60 |
| The DWP has issued circulars on housing benefit. | | 61 - 64 |
| LASAAC has published revised guidance on IJB accounts. | | 65 - 67 |

| Local authority chapter | Item paragraphs |
|--|-----------------|
| Professional Support has published a good practice note on IJB accounts. | 68 - 70 |
| Emerging risks | |
| Professional Support has provided guidance on signing IJB accounts. | 71 - 73 |
| 2018/19 audit year | |
| Technical developments | |
| CIPFA/LASAAC has published the 2018/19 accounting code. | 5 - 22 |
| 2019/20 audit year | |
| Technical developments | |
| CIPFA/LASAAC has issued a consultation paper on leases. | 41 - 43 |

| Central government chapter | Item paragraphs |
|--|-----------------|
| 2017/18 audit year | |
| Technical developments | |
| The European Commission has issued guidance on non-financial reporting. | 78 - 81 |
| The Scottish Government has issued a revised internal control checklist. | 82 |
| 2019/20 audit year | |
| Technical developments | |
| Treasury has issued an exposure draft on leases. | 75 - 77 |

| Health chapter | Item paragraphs |
|---|-----------------|
| 2017/18 audit year | |
| Technical developments | |
| The SGHSCD has re-issued the 2017/18 accounts manual. | 84 - 88 |

| Health chapter | Item paragraphs |
|---|-----------------|
| The SGHSCD has issued a letter on the large hospital services set aside. | 103 - 104 |
| Professional Support has issued the outcome of a review of CNORIS | 100 - 102 |
| The SGHSCD has issued guidance on trade union facility time disclosures. | 109 - 110 |
| The SGHSCD has issued letters on the use of charitable funds. | 114 - 116 |
| Emerging risks | |
| Professional Support has provided guidance on the use of health board names. | 89 - 91 |
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| Professional developments chapter | Item paragraphs |
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Cross-sector chapter

This chapter contains information on the main technical developments in the quarter that are relevant to appointed auditors in all sectors.

Non-financial statements

Remuneration report

Guidance on trade union facility time disclosures

1. The [Cabinet Office](#) has issued [supporting guidance](#) on [The Trade Union \(Facility Time Publication Requirements\) Regulations 2017](#). The regulations apply from 1 April 2017 and require public sector employers to collect and publish a range of information on trade union (TU) facility time in respect of their employees who are TU representatives.
2. The requirements apply to bodies listed in schedule 1 of the regulations which includes local authorities, health boards and central government bodies. Bodies which have fewer than 50 full time equivalent employees are exempt.
3. The information that bodies are required to collate and publish is summarised in the following table:

| Required information to be disclosed | Comments |
|--|--|
| Number of employees who were relevant TU officials during the year | Bodies should report the total number of employees who were a TU official at any point during the year, including any for only part of the year. |
| The number of employees who were relevant TU officials during the year as a percentage of their working hours spent on facility time | Facility time is the provision of paid or unpaid time off from an employee's normal role to undertake TU duties and activities. The percentage of working hours should be reported in the following bandings: a)0%, b)1 – 50%, c) 51-99% or d)100%. |
| Percentage of the total pay bill spent on facility time | The total cost of facility time as a percentage of the total pay bill, including the gross amount spent on wages, pension contributions, and national insurance contributions. |
| Time spent on paid trade union activities as a percentage of total paid facility time hours | This relates to the time taken off for TU activities in respect of which a TU representative receives wages from the relevant public sector employer as a percentage of total facility time (i.e. duties and activities). |

4. Relevant bodies are required to publish this information

- on websites (both their own and one central one maintained by the Government) before 31 July each year
- in the remuneration and staff report (or equivalent) in their annual report and accounts. This should not be in the audited part of the report.

Local authority chapter

This chapter contains information on the main technical developments in the quarter and guidance from Audit Scotland's Professional Support on any emerging risks that are relevant to appointed auditors in the local authority sector.

Financial statements

2018/19 accounting code

5. The [CIPFA/LASAAC Local Authority Code Board](#) (CIPFA/LASAAC) has issued the 2018/19 edition of the [Code of practice for local authority accounting in the UK](#) (2018/19 accounting code). The main changes in the 2018/19 accounting code are as follows
 - Section 2.7 has been revised following the adoption of *IFRS 15 Revenue from contracts with customers*, with additional guidance on the principles of revenue recognition added to section 2.1.
 - Section 3.4 has been amended in respect of segmental reporting requirements.
 - Chapter 7 has been fully revised to reflect the adoption of *IFRS 9 Financial instruments*.
 - Sections 5.2 and 8.1 have been amended to remove the requirement to disclose an analysis of debtors and creditors over public sector bodies.
6. Auditors should assess whether local authorities are making the necessary preparations to be able to comply with the requirements in the 2018/19 accounting code. The following paragraphs provide a brief synopsis of each change.

Revenue recognition

7. Section 2.7 of the accounting code requires local authorities to account for revenue recognition in accordance with IFRS 15. There are no interpretations or adaptations of the standard for the local authority context. Section 2.7 applies to a contract only if the counterparty to the contract is a 'service recipient'. The accounting code contains the following key definitions:

| Term | Definition |
|-------------------|---|
| Service recipient | A party that has contracted with a local authority to obtain goods or services that are an output of the authority's normal operating activities in exchange for consideration. |
| Contract | An agreement between two or more parties that creates enforceable rights and obligations. |

8. Section 2.7 requires authorities to recognise revenue from contracts with service recipients in accordance with the five steps summarised in the following table:

| Step | Action | Further detail |
|------|---|---|
| 1 | Identify the contract with a service recipient | Paragraph 2.7.2.13 sets out criteria that require to be met when identifying the contract. The criteria involve the approval of the contract, each party's rights, payment terms, commercial substance, and the probable collection of the consideration. |
| 2 | Identify the performance obligations in the contract | At contract inception, an authority is required to assess the goods or services promised in the contract and identify each promise as a performance obligation. Paragraph 2.7.2.17 gives examples of promised goods and services. |
| 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. Authorities are required to consider the terms of the contract and their customary business practices to determine the transaction price. |
| 4 | Allocate the transaction price to the performance obligations in the contract | Authorities are required to determine the stand-alone selling price at contract inception of the distinct good or service underlying each performance obligation in the contract and allocate the transaction price in proportion to those stand-alone selling prices. |
| 5 | Recognise revenue when (or as) the authority satisfies a performance obligation | A performance obligation is satisfied when a promised good or service is transferred to the service recipient. This is the point at which the service recipient obtains control. For each performance obligation identified at step 2, an authority is required to determine at contract inception whether it satisfies the performance obligation over time or at a point in time. |

9. When either party to a contract has performed, an authority is required to present the contract in the balance sheet as a contract asset, liability, or receivable as explained in the following table:

| Item | Explanation |
|--------------------|---|
| Contract assets | An authority's right to consideration when that right is conditional on something other than the passage of time, e.g. the authority's future performance |
| Contract liability | An authority's obligation to transfer goods or services for which the authority has received consideration from the service recipient |
| Receivables | An authority's right to consideration that is unconditional. This is the case where only the passage of time is required before payment is due |

10. Section 2.7.4 of the accounting code sets out the disclosure requirements. The objective of the disclosure requirements is for an authority to disclose sufficient information to enable users to understand the nature, amount, timing and uncertainty of revenue and cash flows arising from contracts with service recipients. To achieve that objective, authorities are required to disclose qualitative and quantitative information on
- its contracts with service recipients
 - contract balances
 - performance obligations
 - significant judgements.
11. Authorities are required to recognise the cumulative effect of initially applying section 2.7 and IFRS 15 as an adjustment to the opening balance of reserves at 1 April 2018.
12. As a result of the adoption of IFRS 15, additional guidance on revenue recognition more generally is provided at paragraphs 2.1.2.31. This includes revenue arising from
- fines and penalties
 - bequests and donations
 - fees and charges for statutory services.

Segmental reporting requirements

13. There are a number of changes to section 3.4 to amend or clarify segmental reporting requirements. The main changes are summarised in the following table:

| Area | Paragraph | Change |
|--|-------------|---|
| Meeting IFRS 8 reporting requirements | 3.4.2.38 a) | The primary means of meeting <i>IFRS 8 Operating segments</i> reporting requirements will be the expenditure and funding analysis rather than the service segments in the comprehensive income and expenditure statement (CIES). |
| | 3.4.2.93 | The expenditure and funding analysis presents a local authority's segmental information. |
| | 3.4.2.39 | Transactions between service segments are no longer permitted in the service analysis section of the CIES. |
| Disclosing reportable segments | 3.4.2.94 | A local authority is required to disclose factors used to identify its reportable segments, including the basis of organisation. |
| | 3.4.2.97 | Where the number of reportable segments increases above ten, the authority should consider whether a practical limit has been reached. Two or more operating segments may be aggregated into a single operating segment if aggregation is consistent with the core principle of IFRS 8, and the segments have similar economic characteristics. A description of the aggregation of the operating segments should be disclosed. |
| Format of expenditure and funding analysis | 3.4.2.99 | Additional columns may be added to ensure that local authorities clearly demonstrate the relationship of their segmental analysis, the general fund and the service analysis presented in the CIES. Adjustments other than for differences between accounting and funding may be included in column II where necessary. |

Financial instruments

14. Chapter 7 of the accounting code requires authorities to account for financial instruments in accordance with *IFRS 9 Financial instruments*, as well as *IAS 32 Financial instruments: presentation* and *IFRS 7 Financial instruments: disclosures*, except where the code contains adaptations. The main changes arising from the adoption of IFRS 9 is in respect of the
- classification approach to financial assets
 - impairment model.

15. The classification approach to financial assets is based on both
 - the authority’s business model for managing the financial assets
 - the contractual cash flow characteristics of the financial asset.
16. The three new classifications for financial assets are summarised in the following table:

| Measurement classification | Business model | Contractual cash flows |
|---|--|---|
| Amortised cost | The business objective is to hold financial assets in order to collect contractual cash flows. | The contractual terms of the financial asset give rise on specified dates to cash flows that are solely payments of principal and interest on the principal amount outstanding. |
| Fair value through other comprehensive income | The business objective is achieved by both collecting contractual cash flows and selling financial assets. | |
| Fair value through profit or loss | All financial assets not classified as above (although an authority may make an irrevocable election at initial recognition for particular investments in equity instruments to present subsequent changes in fair value in other comprehensive income). | |

17. The key features of the new impairment model are summarised in the following paragraphs.
18. An authority is required to recognise a loss allowance for expected credit losses on a financial asset (unless the counterparty is central government or another local authority). A credit loss is the difference between all contractual cash flows that are due to an authority in accordance with the contract and all the cash flows that the authority expects to receive (i.e. all cash shortfalls), discounted at the original effective interest rate.
19. The general approach to measuring the loss allowance at each reporting date is summarised in the following table:

| Significant increase in credit risk since initial recognition? | Measurement of loss allowances | Meaning |
|--|---|--|
| Yes | At an amount equal to the lifetime expected credit losses | The expected credit losses that result from all possible default events over the expected life of a financial instrument |
| No | At an amount equal to 12-month expected credit losses | The portion of lifetime expected credit losses that represent the expected credit losses that result from default events on a financial instrument that are possible within the 12 months after the reporting date |

20. The accounting code allows a simplified approach which requires recognition of a loss allowance based on lifetime expected losses from origination. Local authorities are required to apply the simplified approach in two specified cases
- trade receivables
 - contract assets that result from transactions within the scope of IFRS 15 that do not contain a significant financing component. An authority has a policy choice to apply either the simplified approach or the general approach where there is a significant financing component.
21. Non-contractual debts, such as council tax and non-domestic rates, are excluded from the scope of IFRS 9. The existing incurred loss model for the impairment of these debts continues to apply.

Debtors and creditors

22. The requirement to analyse debtors and creditors across public sector bodies has been removed. However, paragraph 3.4.2.63 has been amended to require appropriate sub-classifications to be provided in the balance sheet or in the notes.

Expenditure and funding analysis

New good practice note

23. Professional Support has published a [good practice note](#) on disclosing the expenditure and funding analysis in the annual accounts. This follows a review of the disclosures in the 2016/17 annual accounts which was the first year of the requirement.
24. Some key messages in the good practice note include the following
- The analysis should be disclosed in a prominent position within the notes.

- The number of operating segments should not be excessive.
 - The amount of total adjustments in the expenditure and funding analysis should be consistent with the total adjustments elsewhere in the annual accounts or, where there is a valid reason for a difference, this should be explained.
 - A subjective analysis of income and expenditure should be disclosed.
 - Service income analysed by operating segment should be disclosed if its reported internally.
25. Local authorities are encouraged to use the findings in this good practice note to assess and enhance their own 2017/18 disclosures. Auditors should confirm that authorities have done so.

Segmental disclosures

New guidance on internal transactions

26. The [Local Authority \(Scotland\) Accounts Advisory Committee](#) (LASAAC) has issued an [advisory note](#) on meeting the reporting requirements of *IFRS 8* in 2017/18. The guidance focusses on the treatment of internal recharges that are part of a service manager’s controllable budget.
27. In view of the different presentation options adopted in 2016/17, this advisory note is intended to support a consistent approach in 2017/18. The following table summarises the main presentation options for meeting IFRS 8 requirements in 2017/18:

| Number | Option | Comments |
|--------|--|---|
| 1 | CIES meets IFRS 8 requirements (no elimination of recharges) | Relevant internal recharges are included in service segment lines, and are not eliminated at any stage. |
| 2 | CIES meets IFRS 8 requirements (elimination of recharges) | Relevant internal recharges are included in service segment lines, but are eliminated in a separate line on the face of the CIES. A sub total should be shown before the elimination line to demonstrate compliance with IFRS 8. |
| 3 | A note meets IFRS 8 requirements | Internal recharges are not included in the CIES. A separate note is disclosed to show service segments inclusive of relevant internal recharges. |

28. The advisory note encourages the application of options 2 or 3, and has two accompanying workbooks to provide examples.

29. The advisory note also highlights that options 1 and 2 will not be available from 2018/19 because (as explained in the item on the 2018/19 accounting code) the code has been amended to no longer permit internal recharges to be included in the CIES. The adoption of option 3 in 2017/18 will assist in preparing for the change in 2018/19.
30. Auditors should refer to this guidance when auditing segmental reporting in the 2017/18 annual accounts.

Financial instruments

Clarification statement on LOBOs

31. CIPFA/LASAAC has issued a [statement](#) clarifying the required accounting treatment for loan debt contracts with lender option borrower option (LOBO) clauses.
32. Paragraph 7.1.1.2e of the 2017/18 accounting code contains an interpretation of *IAS 39 Financial instruments: Recognition and measurement* that states that options embedded in a LOBO should not be accounted for separately. The statement clarifies that
 - the reference to 'options' in that paragraph is related specifically to the call lender and borrower options that characterise LOBO clauses
 - local authorities are required to follow IAS 39 in respect of accounting for any embedded derivatives in contracts with LOBO clauses.
33. The interpretation of IAS 39 applies to so called 'vanilla' LOBOs, but does not extend to more complex LOBOs (such as 'inverse floaters' where the interest rate moves inversely with the market).
34. Local authorities should refer to application guidance in IAS 39, as well as the standard itself, when considering whether the contractual terms of these more complex LOBOs represent an embedded derivative and, if so, whether it requires to be separately accounted for.
35. Auditors should refer to this statement when auditing contracts with LOBO clauses during the audit of the 2017/18 annual accounts.

Retirement benefits

2017/18 report on actuarial information

36. PWC has prepared a report to provide support to auditors when assessing the actuaries who produce retirement benefits figures under *IAS 19 Employee benefits* as at 31 March 2018.
37. 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.

38. However, the precise scope of the actuary's work is specific to each authority and the report recommends that auditors consider the need for further procedures in relation to a number of areas including
- where an employer has requested different assumptions than those proposed by the actuary (auditors should consider the duration of liabilities when reviewing assumptions). More details can be found in section 3 of the report, with relevant questions to ask in Appendix A
 - the reasonableness of cashflow data provided by employers, particularly where there have been significant events such as redundancies, outsourcings and bulk transfers. Further details can be found in section 4 of the report.
 - where experience gains or losses exceed 10% of total assets or liabilities.
39. The report includes a number of suggested tests in respect of calculation approach and information provided to the actuary at page 20.
40. Auditors should use this report in relation to IAS 19 amounts and the work of the actuary in relation to 2017/18.

Leases

Consultation paper on adopting IFRS 16

41. CIPFA/LASAAC has issued a [consultation paper](#) on proposals for the adoption of *IFRS 16 Leases* in the accounting code from 2019/20. IFRS 16 removes the classifications of operating and finance leases under IAS 17 for lessees. It requires that a lessee recognises assets and liabilities for all leases with a term of more than 12 months unless the underlying asset is of low value. A lessee will recognise a
- right-of-use asset representing its right to use the underlying leased asset
 - lease liability representing the lessee's obligation to make lease payments for the asset.
42. IFRS 16 will have a substantial practical impact on local authority annual accounts, and authorities need to ensure that they make effective preparations for its implementation and that they have adequate governance arrangements in place. Auditors should therefore encourage local authorities to contribute to this consultation process. Comments should be sent to code.responses@cipfa.org by 7 September 2018.
43. The following table summarises some of the main questions included in the consultation along with a brief explanation of each one:

| |
|---|
| <i>Do you agree with the proposal to mandate the recognition exemption for short-term leases?</i> |
| IFRS 16 permits entities to not apply its requirements for short-term leases, i.e. those that, at the commencement date, have a lease term of 12 months or less. CIPFA/LASAAC is proposing to mandate this exemption. |

Do you agree with the proposed approach to low value assets?

IFRS 16 also permits entities to not apply its requirements for leases where the underlying asset is of low value. IFRS 16 confirms that the assessment of the value of the underlying asset is based on when it is new, regardless of its age at the time of being leased. The application guidance provides examples of what might typically be low value assets including laptops, tablet computers and small items such as office furniture and telephones. CIPFA/LASAAC is proposing to allow authorities to use this exemption.

Do you agree with the proposed approach to identifying a lease?

IFRS 16 defines a lease as a contract, or part of a contract, that conveys the right to use an asset (the underlying asset) for a period of time in exchange for consideration. At the inception of the contract, IFRS 16 requires a local authority to assess whether the contract is (or contains) a lease. This is the case if the contract conveys the right to control the use of an identified asset. The key issues to be considered when making this assessment include the following

- The underlying asset must be explicitly or implicitly specifically identified in the contract.
- A local authority does not have the 'right to use the asset' if the supplier has the substantive right to substitute the asset throughout the period of use.
- To assess whether the local authority controls the use of the asset, it must assess whether the contract conveys throughout the period of use the right to obtain substantially all the economic benefits and service potential from the use of the asset and the right to direct the use of the identified asset.

CIPFA/LASAAC do not propose adapting or interpreting IFRS 16 in relation to the identification of the lease.

Do you agree with the proposed approach to the initial measurement of the right-of-use asset and the lease liability?

At initial recognition, the right-of-use asset is measured at cost. Cost is related to the initial measurement of the lease liability with a number of potential adjustments including any lease payments made at or before the commencement date. At the commencement date, the lease liability is initially measured at the present value of the lease payments payable over the lease term.

Do you have any commentary on the approach to determining the interest rate implicit in the lease or the authority's incremental borrowing rate?

The lease liability is discounted at the rate implicit in the lease. If that cannot be readily determined, the lessee is required to use its incremental borrowing rate. Indications from the private sector are that it will be difficult to identify the interest rate implicit in the lease, and

therefore the incremental borrowing rate will need to be used. It is likely that this will also be the case for local authorities.

Which approach to the subsequent measurement of the right-of-use asset do you consider best?

The consultation paper sets out the following three options for the subsequent measurement of the right-of-use asset

- Longer-term property leases (e.g. 25 years) should continue to be measured at current value while short-term property leases are measured at depreciated historical cost as a proxy on a rebuttable presumption that this materially represents the current value of the asset.
- Right-of-use assets are measured at current value if the required information is available without undue cost or effort.
- The cost model in IFRS 16 is adopted as a proxy for the revaluation model.

Do you agree with the proposed approach to the subsequent measurement of the lease liability?

After the commencement date, subsequent measurement of the lease liability requires that a lessee

- increases the carrying amount to reflect interest on the lease liability
- reduces the carrying amount to reflect the lease payments made
- remeasures the carrying amount to reflect any reassessment (e.g. change in lease term, revised discount rate) or lease modifications (i.e. change in the scope of the lease), or to reflect revised in-substance fixed lease payments.

Subsequent measurement of lease liabilities is measured using the effective interest rate method so that the carrying amount of the lease liability is measured at amortised cost and interest expense is allocated over the lease term.

CIPFA/LASAAC is of the view that there are no specific local government circumstances requiring an interpretation or adaptation to IFRS 16.

Do you agree with the proposed approach to accounting for concessionary leases for lessees?

CIPFA/LASAAC is proposing that the right-of-use asset for leases at below market terms (i.e. concessionary leases) should be measured at fair value on initial recognition on the basis that measurement at cost would lead to an understatement. It is also proposing that the subsidy from the lessor to the lessee should be recognised as

- income; or
- a liability where a present obligation exists (as the obligation is satisfied, the liability is reduced, and income recognised).

Do you agree with retaining the finance and operating lease distinction for lessors?

The lack of symmetry between the lessee and lessor accounting models may cause practical issues. CIPFA/LASAAC is interested in establishing the extent of leasing arrangements between local authorities.

Do you agree with the proposed approach to retrospective transition?

IFRS 16 offers entities the option of applying a practical expedient on the definition of a lease. An entity is not required to reassess whether a contract is, or contains, a lease at the date of initial application. Instead, the entity is permitted

- to apply IFRS 16 to contracts that were previously identified as leases applying IAS 17 and *IFRIC 4 Arrangements containing a lease*
- not to apply IFRS 16 to contracts that were not previously identified as containing a lease applying IAS 17 and IFRIC 4.

CIPFA/LASAAC is proposing to mandate the use of this practical expedient.

IFRS 16 provides for two approaches to transition, i.e. full retrospective restatement or recognising the cumulative effect of initially applying the standard at the date of initial application as an adjustment to reserves (i.e. preceding year information is not restated).

CIPFA/LASAAC is proposing to mandate the second option.

Do you agree with the proposed transitional approach to measuring the right-of-use asset for those previously classified as operating leases?

For leases previously classified as operating leases, IFRS 16 offers the lessee the choice of measuring the right-of-use asset at

- its carrying amount as if IFRS 16 had been applied since the commencement date, or
- an amount equal to the lease liability adjusted by the amount of any prepaid or accrued lease payments relating to that lease before the date of initial application.

CIPFA/LASAAC is proposing to use the second option as it is of the view that it is easier to estimate and more understandable for the users of the financial statements.

Non-financial statements

Annual governance statements

Revised guidance on audit committees

44. The [Chartered Institute of Public Finance and Accountancy](#) (CIPFA) has published revised [guidance](#) on the function and operation of audit committees in local authorities.

45. The guidance incorporates a revised position statement on audit committees. It emphasises the importance of audit committees being in place in all principal local authorities and also recognises that audit committees are a key component of governance.
46. The purpose of an audit committee is to provide to those charged with governance independent assurance on the adequacy of the risk management framework, the internal control environment and the integrity of the financial reporting and annual governance processes.
47. There have been a number of significant developments in governance and audit practice since the previous 2013 edition of the guidance which have emphasised the importance of audit committees to adapt their remit, notably the introduction of annual governance statements. Key developments include
 - the new good governance framework
 - updates to the *Public sector internal audit standards*
 - the *Code of practice on managing the risk of fraud and corruption*.
48. The core functions of an audit committee include
 - being satisfied that the authority's annual governance statement properly reflects the risk environment and any actions required to improve it, and demonstrates how governance supports the achievements of the authority's objectives
 - considering the effectiveness of the authority's risk management arrangements and the control environment
 - considering the reports and recommendations of external audit and inspection agencies and their implications for governance, risk management or control
 - reviewing the financial statements, external auditor's opinions and reports to members, and monitoring management action in response to the issues raised by external audit.
49. Auditors should refer to this guidance when considering a local authority's annual governance statement.

Independent auditor's report

2017/18 model reports

50. Professional Support has published [2017/18 Independent auditors report \(local authorities\) - Technical guidance note 2018/5\(LA\)](#) to provide auditors with the model independent auditor's reports which should be used for the 2017/18 annual accounts. The technical guidance note also provides application guidance on their use.
51. In the interests of consistency, auditors are required to use the relevant model report in appendices 1 to 5 of the technical guidance note as a condition of their audit appointment. The only exception to using the wording in each model is to tailor the terminology to reflect local circumstances.

52. The model independent auditor's reports have been revised to comply with the new *ISA (UK) 700 Forming an opinion and reporting on financial statements*.
53. 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 Professional Support in advance of finalising the report.
54. Auditors should use this technical guidance note when reporting on 2017/18 audits. They should complete for each report the checklist at Appendix 6 which provides a list of the key auditor actions.

Statutory objections

2017/18 guidance

55. Professional Support has issued [module 12 of technical guidance note 2017/10\(LA\)](#) to provide information and guidance on statutory objections to the 2017/19 unaudited annual accounts. Statutory objections refer to the right of interested persons under [section 101](#) of the *Local Government (Scotland) Act 1973* to inspect and to object to the unaudited annual accounts.
56. Module 12 provides auditors with guidance on dealing with any objections they receive, including cases where a hearing is required. There are no changes in statutory requirements in 2017/18. However, the module has been enhanced to provide auditors with more practical guidance. The guidance sets out
 - considering whether a submission received meets the criteria for being treated as a statutory objection
 - the actions required where the submission can be accepted as a valid objection
 - the actions required where the submission is not a valid objection.
57. Auditors should refer to this module if they receive a statutory objection to the annual accounts.

Grant claims and returns

Technical guidance notes

58. Professional Support has published [Certification of 2017/18 approved local authority grant claims and returns - Technical guidance note TGN/GEN/18](#) to provide general guidance to auditors on the certification of 2017/18 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 2017/18 under their audit appointment
 - considers the roles and responsibilities of Professional Support, grant-paying bodies, local authorities, and appointed auditors

- sets out the overall approach to be adopted by auditors
 - provides guidance on auditor reporting.
59. Professional Support also separately publishes a technical guidance note on each significant approved claim to provide auditors with specific guidance on certifying that claim. The following have been published to date for 2017/18
- [Auditor certification of the 2017/18 housing benefit subsidy claim - technical guidance note TGN/HBS/18](#)
 - [Auditor certification of the 2017/18 Bellwin scheme claims - technical guidance note TGN/BEL/18](#)
 - [Auditor certification of 2017/18 education maintenance allowances grant claim - technical guidance note TGN/EMA/18.](#)
60. Auditors should follow these technical guidance notes when reviewing and reporting on 2017/18 grant claims.

Housing benefit subsidy claim

Guidance on new regulations

61. [The Department for Work and Pensions \(DWP\)](#) has issued [HB circular A2/2018: The Universal Credit \(Miscellaneous Amendments, Saving and Transitional Provision\) Regulations 2018](#) to
- announce changes on how housing costs are funded for temporary accommodation cases
 - introduce a transition to universal credit housing payment which extends the end date of housing benefit (HB) when a claimant migrates to universal credit.

Guidance on immigration status evidence

62. The DWP has issued [HB circular U1/2018: 'Windrush generation': information for local authorities](#) on the handling of HB cases to clarify how local authorities should treat claimants unable to evidence their immigration status.

2018/19 uprating

63. The DWP has re-issued [HB circular A10/2017: Housing benefit: uprating 2018-19 \(3rd revision\)](#) to announce corrections to the previously announced benefits rates from April 2018.

Funding

64. The DWP has issued the following circulars in respect of HB funding in 2017/18 and 2018/19
- [HB circular S4/2018: Final new burdens payment 2017/18 for the real time information bulk data matching initiative](#)
 - [HB circular S5/2018 Additional new burdens funding to meet the costs of implementing welfare reform changes in 2018/19](#)

- [HB circular S6/2018 Payment of new burdens relating to the Single Fraud Investigation Service for 2018/19](#)
- [HB circular S9/2018: Transition to universal credit housing payments and removal of temporary accommodation from universal credit new burdens payments.](#)
- [HB circular S10/2018: Payment for the verify earnings and pension alerts service 2018.](#)

Specific bodies

Integration joint boards

Revised guidance

65. LASAAC has published revised [guidance](#) on accounting for health and social care integration for 2017/18. This guidance is intended to support financial reporting in both integration joint board (IJB) and council annual accounts.
66. There are no significant amendments in this further revision but the opportunity has been taken to refresh the guidance and ensure it stays up-to-date. Clarification has been added, however, that the guidance is intended to be mandatory.
67. Auditors should refer to this guidance when auditing the 2017/18 annual accounts of IJBs and councils.

New good practice note

68. Professional Support has published a [good practice note](#) on IJB annual accounts. This follows a review of the disclosures in the 2016/17 annual accounts which were chosen for review as that was the first full year of operation.
69. Some recommendations for improvements in the good practice note include the following
 - More reporting of performance including explanations for actions required to address any issues.
 - Descriptions of the risks and uncertainties should be specific to each IJB.
 - Disclosures should be both relevant and material.
 - Jargon should be avoided or, if that is not possible, explanations in plain language should be provided.
70. IJBs are encouraged to use the findings in this good practice note to assess and enhance their own 2017/18 annual accounts. Auditors should confirm that their IJBs have done so.

Annual accounts signatories

71. An auditor has sought clarification over signing the management commentary, annual governance statement and remuneration report in the IJB annual accounts when the chief officer is not available.

72. Regulation 10(4) of [The Local Authority Accounts \(Scotland\) Regulations 2014](#) states that where a local authority does not have a chief executive, the statements are to be signed by 'such other person as it nominates for that purpose'. The term 'chief executive' is defined in the regulations as a person designated by a local authority as the head of its paid service by virtue of [section 4](#) of the *Local Government and Housing Act 1989*. Section 4 applies to a council constituted under section 2 of the *Local Government etc. (Scotland) Act 1994*, but does not extend to joint boards.
73. It is for the IJB to nominate a person to sign the statements instead of a chief executive. While it makes sense for it normally to be the chief officer, this is not a requirement, and an IJB can nominate another individual.

Auditor action checklist

| | Yes/No/N/A | Initials/date | W/P ref |
|--|------------|---------------|---------|
| 1 Have you carried out the action recommended at paragraph 6 in respect of the 2018/19 accounting code? | | | |
| 2 Have you carried out the action recommended at paragraph 25 in respect of good practice in expenditure and funding analysis disclosures? | | | |
| 3 Have you carried out the action recommended at paragraph 30 in respect of segmental reporting? | | | |
| 4 Have you carried out the action recommended at paragraph 35 in respect of LOBOs? | | | |
| 5 Have you carried out the action recommended at paragraph 40 in respect of actuarial information? | | | |
| 6 Have you carried out the action recommended at paragraph 42 in respect of the consultation on leases? | | | |
| 7 Have you carried out the action recommended at paragraph 49 in respect of audit committees? | | | |
| 8 Have you carried out the action required at paragraph 54 in respect of model independent auditor's reports? | | | |
| 9 Have you carried out the action required at paragraph 57 in respect of statutory objections? | | | |
| 10 Have you carried out the action required at paragraph 60 in respect of reviewing grant claims? | | | |

| | Yes/No/N/A | Initials/date | W/P ref |
|---|------------|---------------|---------|
| 11 Have you carried out the action recommended at paragraph 67 in respect of IJB accounts? | | | |
| 12 Have you carried out the action recommended at paragraph 70 in respect of good practice in IJB accounts? | | | |

Professional Support contact for local authority chapter

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

Central government chapter

This chapter contains information on the main technical developments in the quarter and guidance from Professional Support on any emerging risks that are relevant to appointed auditors in the central government sector.

Financial statements

Leases

Exposure draft on adopting IFRS 16

75. [HM Treasury](#) has issued [IFRS 16 Leases : Exposure draft 18\(01\)](#) on proposals for the *Government financial reporting manual's* (FReM) adoption of *IFRS 16 Leases* from 2019/20. IFRS 16 removes the classifications of operating and finance leases under IAS 17 for lessees. It requires that a lessee recognises assets and liabilities for all leases with a term of more than 12 months unless the underlying asset is of low value. A lessee will recognise a
- right-of-use asset representing its right to use the underlying leased asset
 - lease liability representing the lessee's obligation to make lease payments for the asset.
76. Auditors should encourage their bodies to contribute to this consultation process. Comments should be sent to frem.consultation@hmtreasury.gsi.gov.uk by 31 July 2018. .
77. The following table summarises some of the main questions included in the consultation along with a brief explanation of each one:

Do you agree with the proposed adaptation for the definition of a contract?

IFRS 16 defines a lease as a contract, or part of a contract, that conveys the right to use an asset (the underlying asset) for a period of time in exchange for consideration. At the inception of the contract, IFRS 16 requires a body to assess whether the contract is, or contains, a lease. This is the case if the contract conveys the right to control the use of an identified asset.

Treasury believes the definition of the contract should be adapted so that it includes intra-government agreements that are not technically legally enforceable, but in substance would be considered a contract.

Do you agree with the public sector interpretation for short-term leases?

IFRS 16 permits entities to not apply its requirements for short-term leases, i.e. those that, at the commencement date, have a lease term of 12 months or less. Treasury is proposing to mandate this exemption.

Do you agree with the proposal for low value assets?

IFRS 16 also permits entities to not apply its requirements for leases where the underlying value is of low value. IFRS 16 confirms that the assessment of the value of the asset is based on the asset when it is new, regardless of its age at the time of being leased. The application guidance provides examples of what might typically be low value assets including laptops, tablet computers and small items such as office furniture and telephones.

Treasury does not propose to provide a central value for low value leases and proposes to leave the decision to apply the exemption to individual entities.

Do you agree Treasury should set an internal rate of borrowing centrally for entities to use when they cannot obtain the rate implicit in the lease?

The lease liability is discounted at the rate implicit in the lease. If that cannot be readily determined, the lessee is required to use its incremental borrowing rate. Indications from the private sector are that it will be difficult to identify the interest rate implicit in the lease, and therefore the incremental borrowing rate will need to be used.

Treasury proposes to introduce a central internal rate of borrowing for entities to apply, when they cannot obtain the rate implicit in the lease contract. In developing the central rate, Treasury proposes the application of the internal rate of borrowing to all leases irrespective of the type of underlying asset.

What valuation methodology do you believe Treasury should mandate for the public sector?

IFRS 16 states that the cost model should be used to determine the subsequent measurement of the right of use asset. The cost model under IFRS 16 is different to the cost model under IAS 16. IFRS 16 requires the asset to be carried at cost (the value of the lease liability with certain adjustments) less any accumulated depreciation, impairment losses, and any adjustments for the re-measurement of the lease liability including changes in lease term and changes in lease payments resulting from a change in an index or a rate.

Treasury proposes to adopt the IFRS 16 cost model for lessees as a proxy for the revaluation model adapted in the FReM under IAS 16. This is on the basis that leases provided by the private sector are generally constructed on market terms and contain regular rent reviews. As such, both the asset and liability would be subjected to regular re-measurement and may be considered a proxy to undertaking formal professional valuations.

Do you agree with the public sector adaptation for peppercorn leases?

Within the public sector there are a number of leases which are provided on a peppercorn basis (i.e. nominal consideration). At present, such assets are treated as finance leases under IAS 17 by both the lessee and the lessor.

The application of the IFRS 16 cost model would not result in an appropriate valuation for the assets as the lease liability would be substantially low or nil value for peppercorn leases.

Treasury proposes that peppercorn leases be treated as if they were owner occupied for the duration of the lease term and therefore be measured using the IAS 16 criteria rather than the IFRS 16 criteria.

Are there any disclosure requirements for lessee accounting which you believe are not applicable to the public sector?

The disclosure requirements for lessees in the IFRS 16 are significantly more extensive than under IAS 17.

Treasury proposes to retain the disclosure requirements in full but to emphasise the materiality considerations that entities are expected to undertake in determining whether they are required to provide particular disclosures.

Do you agree with the proposals for lessor accounting?

Lessor accounting has not substantially changed from IAS 17. The dual accounting model of finance and operating leases remains under IFRS 16 as does the criteria for assessing the classification. The lack of symmetry between the lessee and lessor accounting models may cause practical issues.

Do you agree with the public sector interpretation on grandfathering existing lease classifications?

IFRS 16 offers entities the option of applying a practical expedient on the definition of a lease. An entity is not required to reassess whether a contract is, or contains, a lease at the date of initial application. Instead, the entity is permitted

- to apply IFRS 16 to contracts that were previously identified as leases applying IAS 17 and *IFRIC 4 Arrangements containing a lease*
- not to apply IFRS 16 to contracts that were not previously identified as containing a lease applying IAS 17 and IFRIC 4.

Treasury is proposing to mandate the use of this practical expedient.

Do you agree with the transition approach for the proposed amendments?

IFRS 16 provides for two approaches to transition, i.e. full retrospective restatement or recognising the cumulative effect of initially applying the standard at the date of initial application as an adjustment to taxpayers equity (preceding year information is not restated).

Treasury is proposing to mandate the second option.

Do you agree with the public-sector interpretation for asset measurement upon transition?

For leases previously classified as operating leases, IFRS 16 offers the lessee the choice of measuring the right-of-use asset at

- its carrying amount as if IFRS 16 had been applied since the commencement date, or
- an amount equal to the lease liability adjusted by the amount of any prepaid or accrued lease payments relating to that lease before the date of initial application.

Treasury is proposing to use the second option.

Non-financial statements

Performance report/Remunerations and staff report

New guidelines

78. The [European Commission](#) has published [Guidelines on non-financial reporting](#) which are intended to help bodies disclose high-quality non-financial information in their annual report and accounts. The guidelines are relevant to the new 2017/18 FReM requirements (covered at paragraph 22 of [technical bulletin 2018/1](#)) for
- the performance report to disclose non-financial information pertaining to social matters, respect for human rights, anti-corruption and anti-bribery matters
 - the staff report to disclose information relating to employee matters such as other diversity issues, health and safety at work and trade union relationships.
79. Pages 15 and 16 of the guidelines cover the requirement to disclose information on social and employee matters. These include
- diversity issues, such as gender diversity and equal treatment in employment and occupation
 - employment issues, including employee consultation and/or participation, employment and working conditions
 - trade union relationships, including respect of trade union rights
 - human capital management including management of restructuring, career management and employability, remuneration system, training
 - health and safety at work

- impacts on vulnerable consumers;
 - community relations, including social and economic development of local communities.
80. Pages 16 and 17 cover the disclosure of information on the impact of a body's operations on human rights. It is considered best practice for a body to express its commitment to respecting human rights. This commitment may define what the organisation expects from its management, employees and business partners in relation to human rights.
81. Page 17 covers information on how the body manages anti-corruption and bribery matters. This may include disclosing
- anti-corruption policies, procedures and standards
 - criteria used in corruption-related risk assessments
 - internal control processes and resources allocated to preventing corruption and bribery
 - employees having received appropriate training
 - use of whistleblowing mechanisms.

Governance statement

Revised internal control checklist

82. The [Scottish Government Finance directorate](#) has published an amendment to the [Scottish Public Finance Manual certificates of assurance section](#) which updates the internal control checklist.

Auditor action checklist

| | Yes/No/N/A | Initials/date | W/P ref |
|--|------------|---------------|---------|
| 1 Have you carried out the action recommended at paragraph 76 in respect of the exposure draft on IFRS 16? | | | |

Professional Support contacts for central government chapter

83. The contacts in Professional Support for this chapter are
- Neil Cameron, Manager (Professional Support) - 0131 625 1797 or ncameron@audit-scotland.gov.uk.
 - Helen Cobb, Senior Adviser (Professional Support) - 0131 625 1901 or hcobb@audit-scotland.gov.uk.

Health chapter

This chapter contains information on the main technical developments in the quarter that are relevant to appointed auditors in the health sector, and guidance from Professional Support on risks emerging from the audit of 2017/18 health annual report and accounts.

Annual report and accounts overall

Re-issued 2017/18 accounts manual

84. The [Scottish Government Health and Social Care Directorates](#) (SGHSCD) has re-issued the *2017/18 NHS board manual for annual report and accounts* (2017/18 accounts manual) to include further changes to those in the version issued in December 2017 (covered at paragraph 31 of [technical bulletin 2018/1](#)).
85. The further changes are to reflect the amendments in the re-issued 2017/18 FReM (covered at paragraph 22 of [technical bulletin 2018/1](#)), and are summarised in the following paragraphs.

Performance report

86. Pages 6, 8 and 9 of the accounts manual have been amended to reflect the FReM requirements to disclose
 - a statement of the purpose and activities of the board including in respect of a brief description of the business model and environment, organisational structure, objectives and strategies
 - an explanation of the adoption of the going concern basis where this might be called into doubt
 - additional explanatory narrative to link risk and uncertainty with key performance indicators
 - an explanation of the relationships and linkages between information in the annual report and accounts
 - non-financial information on social matters, respect for human rights, anti-corruption, and anti-bribery matters.
87. Page 6 has also been amended to require, as a new requirement, a short summary explaining the purpose of the overview section. In addition, the disclosure of a statement from the chief executive giving their perspective on performance (previously optional) is now required.

Remuneration and staff report

88. The staff report on pages 26 to 33 has been amended to
 - include the apprenticeship levy under taxation and social security in the staff costs note, in accordance with the FReM

- define a senior employee for the purposes of the staff composition analysis as earning over £70,000 per annum (increased from £50,000)
- require information to be provided on other employee matters e.g. diversity issues.

Name of health board

89. An auditor has raised with Professional Support the issue of which name health boards should use in their annual report and accounts. [The National Health Service \(Determinations of Areas of Health Boards\)\(Scotland\) Order 1974](#) defines the geographical areas covered by health boards, and indicates the names by which the areas should be known. The accounts direction for each board refers to it as the geographical area followed by 'health board' (e.g. Fife Health Board). However, many boards drop the 'health board' from their name in common usage, such as in correspondence, signage etc, and add 'NHS' (e.g. NHS Fife).
90. There is no prescription as to which form of the name should be used in the annual report and accounts. However, where a board uses their common name, Professional Support recommends that the statutory name be referred to with an explanation that the board has chosen to use the name it is more commonly known by.
91. Whichever form of name a board uses in the annual report and accounts, auditors should use the same name in the independent auditor's report.

Financial statements

Income

Recognition of funding allocations

92. Auditors have raised the issue of when it may be appropriate for health boards to defer the recognition of funding allocations. NHS allocations letters provide boards with the authority to spend under the budget approved in Parliament. However, Professional Support has confirmed with the SGHSCD that these allocations are equivalent to grant-in-aid. They should therefore be accounted for in accordance with the FReM, which requires grant-in-aid to be accounted for on a cash basis. The allocations should therefore be recognised as income on receipt.
93. Notwithstanding the requirement to account for the allocations on a cash basis, any objectives or policy outcomes stipulated in such letters are not considered conditions that require repayment if they are not satisfied. The existence of such stipulations would not therefore justify deferring recognition of the income. Whether a board spends this specific amount on these programmes or fund the programmes from their general allocation is a matter for the board to decide based on financial management and budgetary control considerations.

Authorised for issue date

94. The auditor of a health board has sought advice from Professional Support regarding the wording that boards should give when disclosing the date the financial statements were authorised for issue by the Accountable Officer.
95. The FReM requires the authorised for issue date to be disclosed in the annual report and accounts. It does not specify a location other than to exclude the title page. The accounts manual requires the date the financial statements were approved by the board to be disclosed. It notes that the authorised for issue date is usually taken as the date the accounts are adopted by the board.
96. Professional Support's advice is for boards to consider combining these disclosures to read 'The annual report and accounts were approved by the board and authorised for issue by the Accountable Officer on X June 2018'.

Provisions

Estimating pension provision

97. An auditor has queried a health board's use of life expectancy tables for the UK when calculating its pension provision at 31 March 2018.
98. The board should use the latest available, reliable information to arrive at the best estimate of the expenditure required to settle the obligation. The Office of National Statistics also prepare Scottish life expectancy tables. In Professional Support's view, it is reasonable to assume that the use of Scottish tables would result in a better estimate than the UK tables.
99. In the absence of an acceptable justification from the board for using the UK tables, it should change to using the Scottish tables for 2017/18. As Scottish tables were available in previous years but not used, this could be treated as the correction of a prior year error which would require a retrospective restatement.

Clinical negligence claims

100. Professional Support has undertaken a review of the work carried out by the NHS Central Legal Office (CLO) relating to the *Clinical negligence and other risks indemnity scheme* (CNORIS). The objective of the review was to establish the extent to which the information prepared using the work of the CLO, as a management expert under *ISA (UK) 500 Audit evidence*, can be used as audit evidence.
101. Professional Support has also evaluated the appropriateness of the methodology adopted by the Scottish Government to establish the total national liability for CNORIS. The review focused on the estimation of the liability as at 31 March 2018.
102. Professional Support has provided auditors with the outcome of the above reviews.

Large hospital services

Guidance on calculating 2017/18 set aside

103. Following the letter referred to in [technical bulletin 2018/1](#) (paragraph 132), the SGHSCD has issued a second letter on the arrangements for calculating the set aside for large hospital services in 2017/18.
104. This guidance clarifies that, similar to 2016/17, where the arrangements required for calculating the amount of set aside are still not yet in place, boards and IJBs are permitted to use the agreed budget as the basis for the entries in the financial statements.

Non-financial statements

Remuneration and staff report

Fair pay disclosure

105. An auditor has queried what figure should be used for 'remuneration' in the fair pay disclosure in the remuneration and staff report. This relates to the requirement in the FReM and the accounts manual for boards to disclose information comparing the remuneration of the highest paid director with the median remuneration of the board's staff. The main issue is whether the pension benefit component of remuneration should be included in the comparison.
106. In Professional Support's view, there is a lack of consistency in the requirements. The 2017/18 FReM refers to the [Hutton review of fair pay - implementation guidance](#), but this was last updated in 2012/13 which was before the introduction of the pension benefit component of remuneration.
107. The FReM also requires bodies to follow guidance contained in the annual employer pension notice (EPN) issued by the Cabinet Office. The approach used in the worked examples in the EPNs excludes the pension benefit component. This is consistent with an illustration in the accounts manual, which all health boards followed in 2016/17.
108. Professional Support recommends that boards follow a consistent approach in 2017/18 and exclude pension benefit from the disclosure. Professional Support will seek to clarify the requirements for 2018/19, but consider that maintaining consistency with both previous practice and the EPN for 2017/18 is a reasonable position.

Guidance on trade union facility time disclosures

109. The SGHSCD has issued guidance clarifying the arrangements for the disclosure of trade union facility time information (explained in the cross-sector chapter of this technical bulletin) in health boards' 2017/18 annual report and accounts.
110. The email advises that, if reliable information is available, it should be included within the remuneration and staff report in the 2017/18 annual report and accounts. However, if boards are not able to produce reliable information in time, the email provides explanatory wording to be used.

Performance report

Information on brokerage

111. An auditor has sought clarification as to whether the requirement to repay brokerage should be recognised as a liability in the financial statements. Brokerage relates to an advance on future funding to assist a board achieve its financial target for a year. When boards are provided with brokerage, they are required to commit to a schedule of future resource allocation reductions to facilitate repayment of the brokerage amount.
112. This commitment should not be recognised as a liability in the financial statements of the board as settlement will be based on future funding reductions.
113. However, the accounts manual requires 'additional funding' arrangements to be disclosed under the financial performance section of the performance report. This includes the disclosure of brokerage arrangements.

NHS endowment funds

Letters on use of charitable funds

114. The SGHSCD has issued two letters to the chairs of health boards asking for information on the use of NHS endowment funds established under the *National Health Service (Scotland) Act 1978*. The letters were prompted as a result of issues raised in respect of the endowment fund at NHS Tayside.
115. The letters requested that the chairs provide assurances that
 - all funds have been awarded and used in furtherance of the charitable purposes. The required response was required to advise what the board has received or applied for in terms of endowments
 - retrospective awards are not permitted. This relates to any decision to charge expenditure to exchequer funds that was later reversed by retrospectively applying for endowment funding.
116. The [Office of the Scottish Charity Regulator](#) (OSCR) has subsequently written to the SGHSCD explaining that, having considered the chairs' responses as well as reviewing the endowment funds' statement of accounts, there are no issues in other NHS endowment funds that merit the opening of an inquiry by OSCR.

Professional Support contact for health chapter

117. The contact in Professional Support for this chapter is Neil Cameron, Manager (Professional Support) - 0131 625 1797 or ncameron@audit-scotland.gov.uk.

Professional developments chapter

This chapter contains information on the main professional developments in the quarter that are relevant to appointed auditors in the public sector.

Auditing developments

Thematic review on audit culture

118. The [Financial Reporting Council](#) (FRC) has issued the results of a [thematic review](#) of audit culture. The report sets out the actions being taken by audit firms to establish, promote and embed a culture that is committed to delivering consistently high quality audits.
119. The report identifies a number of areas where more actions by firms are required. For example, the report recommends that firms should
- give additional prominence to audit specific behaviours and values within the firms' cultural design, including the fundamental principles of integrity, objectivity, independence and professional scepticism that underpin high quality audit
 - ensure that all audit partners and staff appreciate that a good audit is of significant societal value and helps to underpin transparency and integrity in business
 - balance robust processes to sanction poor quality work or behaviour with better recognition of positive contributions to high audit quality
 - further develop root cause analysis techniques to identify the behavioural or cultural factors that contributed to good and poor quality outcomes
 - improve their monitoring of how successful they are at embedding their desired culture.

Accounting developments

Proposed amendment to IAS 8

120. The [International Accounting Standards Board](#) has issued an [exposure draft](#) of proposing amendments to *IAS 8 Accounting policies, changes in accounting estimates and errors*. The proposed amendments are intended to facilitate the application of particular voluntary changes in accounting policy.
121. The relevant changes in accounting policy are those arising from explanatory material included in 'agenda decisions' published by the IFRS Interpretations Committee. The published agenda decisions explain the committee's rationale for not adding a particular matter to its standard-setting agenda.

122. The proposal is that retrospective application of a change in accounting policy resulting from an agenda decision will not be required to the extent that the cost of determining the effects exceeds the expected benefit to users.
123. Comments should be sent to commentletters@ifrs.org by 27 July 2018.

Professional Support contact for professional developments chapter

124. The contact in Audit Scotland's Professional Support for this chapter is Paul O'Brien, Senior Manager (Professional Support) - 0131 625 1795 or pobrien@audit-scotland.gov.uk.

Fraud and irregularities

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

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

Expenditure

Invoices paid to employee

125. A council IT employee embezzled over £1 million between August 2009 and May 2016 as a result of 57 payments made into two bank accounts set up by the employee.

Key features

Routine financial year end procedures highlighted an invoice where supporting information could not be found. It was discovered that the payment for this invoice was made into an employee's bank account. This resulted in both internal and Police Scotland investigations which highlighted fundamental weaknesses in the council's internal financial control systems.

The fraud was possible as the employee worked in the council IT section and had unrestricted access to several systems which allowed him to insert false invoices into the system and alter the bank payment details of suppliers without detection.

An external accountancy firm identified additional control weaknesses within budgetary control, reconciliation procedures and IT system access. Internal audit plan to follow up recommendations to ensure that they have been implemented effectively and to review the *Bank automated clearance system* (BACS) including user access levels.

The employee was immediately suspended and resigned from his position. The Police Scotland investigation resulted in the ex-employee pleading guilty and being sentenced to more than five years imprisonment.

Recovery of most of the loss has been achieved through a range of methods including recovery from the pension of the convicted individual, an ex gratia payment from a third party, and proceeds from the council's fidelity insurance policy.

Invalid funding claims (1)

126. An external service provider inappropriately claimed over £47,000 of funding from a central government body in respect of unemployed individuals who were receiving support to move towards employment. The service provider claimed payments for individuals who did not meet the eligibility criteria.

Key features

The agreement with the service provider was based on payments for successful recruitment and outcomes for unemployed individuals. An inappropriate financial claim was submitted without the necessary funding criteria having been met.

The irregularity was discovered after a whistle-blower contacted the central government body. It was facilitated by poor management of the scheme.

The central government body suspended payments to the provider and carried out an investigation. The service provider has dismissed staff as a result of the investigation.

The funding has been recovered from the service provider.

Invalid funding claims (2)

127. An advisor within a body in receipt of council funding submitted claims for £11,000 of funding using false evidence.

Key features

Internal audit carried out an investigation following receipt of information from a third party which suggested that an adviser who was an employee of a consortium delivering a project falsified claim evidence.

The falsified evidence consisted of forwarded emails regarding client activities, which the adviser could edit. Documents which were intended to evidence eligibility of benefits and identification were also tampered with.

The internal audit investigation prevented the council paying out on the ineligible claims.

The adviser resigned during the subsequent disciplinary process.

Controls have been tightened and emails alone are not allowed as evidence. Training has also been given to consortium supervisors on detecting tampered documents.

Change of bank details

128. Two separate third parties defrauded two councils of £175,000 and £25,000 by re-directing payments intended for a legitimate supplier. In each case, the fraudster sent an email from an email account purporting to be from one of the council's contractors requesting a change in bank details. Payments were then made to the new bank account.

Key features (1)

The council was notified of a change of bank details by email from a supplier. The council followed its procedures in this regard and requested confirmation details by email. The relevant information was duly received from an individual known to the council. The change was actioned and a payment made.

The supplier subsequently contacted the council looking for the payment which the council thought it had already made. It was identified that the supplier's email account had been hacked.

While the council followed its agreed procedures in this regard, it was not its practice to telephone the supplier to confirm details. The council has reviewed its procedures in respect of requests to change bank details and they now include a requirement to make a telephone call to the customer.

Around £55,000 is expected to be recovered from the bank.

Key features (2)

Emails from a perpetrator purporting to be a legitimate contractor were sent to the council's technical services department requesting a change to bank account details. The revised bank details were then communicated onwards to the accounts payable section.

The fraud was identified after a further communication was received from the same email address. This e-mail was reviewed by a senior officer who was concerned about the wording and poor use of English. The senior officer telephoned the contractor from the contact details held on the council system and informed them that their e-mail account may have been hacked or compromised.

Internal audit carried out an investigation. Telephone records for the accounts payable section identified that a call had been made to a clerical assistant in technical services and it was concluded that the accounts payable member of staff had most likely called technical services to confirm the bank details rather than directly with the contractor.

The fraud was possible as the accounts payable clerk did not have a full knowledge of the procedures to follow. In addition, there was a lack of follow up and review which should have happened at the authorisation stage of the process.

Payments totalling £21,000 were subsequently recovered through the BACS process.

Purchase of goods for personal gain

129. A street lighting technician ordered goods and materials worth £15,500 which he subsequently sold for personal gain.

Key features

The officer either placed orders for cabling material by creating a requisition on the purchasing system or placed the order first by phone, then requisitioned these through the purchasing system retrospectively. In either case, he would collect the material from the supplier without a requisition having been approved. In addition, some purchases were made 'in store' using a purchasing card. The officer subsequently sold the materials for personal gain.

The fraud was possible as control checks on these purchases were ineffective and did not identify, initially, that they were of a specific type of material that the officer would not have required as part of his normal post. The officer was circumventing the ordering processes and controls and applying them retrospectively. Issues with the purchasing IT system also meant that orders could be placed without approval.

The fraud was identified when a supervisor identified that a delivery note was missing at the point of 'signing off' procurement system orders. Copies of delivery notes were subsequently obtained from the supplier, identifying the officer who had placed the orders.

Controls are now in place within the purchasing system to ensure the any orders for goods follow the correct route for purchase authorisation. Internal Audit is reviewing the service area concerned and is also assisting with periodic reviews of compliance with purchasing card controls.

The matter has been reported to Police Scotland, and the individual has been charged. The individual also went through an internal disciplinary process and was dismissed.

Income

Council tax evasion (1)

130. A principal teacher evaded a council tax liability of £6,300.

Key features

A council tax exemption of 100% was in place at a property in relation to the previous occupier who died in May 2012. The teacher failed to notify the council that they occupied the property from that date.

The council tax evasion went undetected as limited visits were carried out on exempt properties.

The evasion was eventually identified after a visit by internal audit to properties with council tax exemptions in place identified that the council employee was resident in the property. Further investigations identified his date of entry.

Debt recovery procedures are now being carried out and a recommendation for a sanction has been passed to the employee's head of service.

Council tax evasion (2)

131. A local resident evaded a council tax liability of £16,400 by claiming an exemption he was not entitled to.

Key features

A landlord applied for a false exemption by claiming that the tenant, who was exempt because he was a member of a visiting armed force, resided at the address until 2017.

The fraud was identified when a Team Leader became suspicious. Enquiries indicated the exemption should have ended in 2005, and that the landlord had occupied the property over that period. The landlord provided paperwork which was believed to be falsified to support the fraud. When interviewed the landlord was unable to produce any evidence to support his position.

The fraud was possible due to a lack of review of exemption status once granted.

Council tax exemptions are now being reviewed.

A repayment agreement has been reached with the resident.

Theft

Theft of mobile phones

132. Mobile telephones valued at £5,400 were stolen from a council store.

Key features

The council ordered mobile phones which were placed into a council secure store on receipt. The project that the phones were ordered for did not go ahead and therefore the phones remained in storage. Fourteen months later it was discovered that these items were no longer in storage and they were presumed stolen.

The theft was possible due to the code for the door entry system to the store being widely known by employees. There were also issues with fire exits being left open and the building not being secure. In addition, the phones were not recorded on the council asset tagging system upon receipt.

Following an internal audit review, an action plan has been put in place to improve controls including periodic changes to door entry codes, ensuring fire doors remain closed, regular physical checks of stock and recording and tagging assets when received.

Auditor action checklist

| | | Yes/No/N/A | Initials/date | W/P ref |
|---|--|------------|---------------|---------|
| 1 | Have you considered whether the weaknesses in internal control that facilitated each fraud may apply at your audited bodies? | | | |

Professional Support contact for fraud and irregularity chapter

133. The contact in Professional Support for this chapter is Anne Cairns, Manager (Professional Support) on 0131 625 1926 or acairns@audit-scotland.gov.uk

Technical bulletin 2018/3

July to September 2018



 AUDIT SCOTLAND

Prepared for appointed auditors in all sectors

12 September 2018

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

Extracts from the code of audit practice

Technical support

40. Auditors appointed by the Auditor General for Scotland or the Accounts Commission are responsible for giving an opinion on the financial statements and reporting on other related matters. Audit Scotland provides technical support to appointed auditors in respect of these responsibilities to inform their professional judgement.

108. Audit Scotland provides technical support and guidance to all appointed auditors. While appointed auditors act independently, and are responsible for their own conclusions and opinions, Audit Scotland has a role in ensuring that those conclusions and opinions are reached on the basis of informed judgement.

An element of the technical support and guidance to appointed auditors referred to in the above extracts from the [Code of audit practice](#) is technical bulletins provided by Audit Scotland's Professional Support.

The purpose of technical bulletins is to provide appointed auditors with

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

This technical bulletin applies to appointed auditors in all sectors, though some chapters apply to a particular sector.

Technical bulletins are available to appointed auditors from the *Technical reference library* maintained by Professional Support, and are published on the [Audit Scotland website](#) so that audited bodies and other stakeholders can access them.

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

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

Audit Scotland makes no representation as to the completeness or accuracy of the contents of technical bulletins or that legal or technical guidance is correct. Points of law, in particular, can ultimately be decided only by the Courts. Audit Scotland accepts no responsibility for any loss or damage caused as a result of any person relying upon anything contained in this technical bulletin.

Headlines chapter

This chapter provides brief headlines for the items on technical developments and guidance on emerging risks in this technical bulletin, classified by the audit year to which they relate, and referenced to the paragraph number containing the main item.

| Cross-sector chapter | Item paragraphs |
|---|-----------------|
| 2017/18 audit year | |
| <i>Technical developments</i> | |
| The Scottish Government has issued guidance on trade union facility time disclosures. | 1 - 3 |
| Audit Scotland has published a report on the 2016/17 NFI. | 4 - 9 |

| Local authority chapter | Item paragraphs |
|---|-----------------|
| 2017/18 audit year | |
| <i>Technical developments</i> | |
| PSAA has issued two HBCOUNT modules. | 47 |
| Treasury has issued guidance on preparing WGA returns. | 54 - 58 |
| Professional Support has issued a technical guidance note on reviewing WGA returns. | 56 - 57 |
| <i>Emerging risks</i> | |
| Professional Support has provided guidance on reversing impairment losses. | 13 - 18 |
| Professional Support has provided guidance on retirement benefits in respect of | |
| <ul style="list-style-type: none"> pension asset valuation | 19 - 24 |
| <ul style="list-style-type: none"> experience gains. | 25 - 29 |
| Professional Support has provided guidance on the insurance fund. | |
| Professional Support has provided guidance on group financial statements in respect of loan impairment. | 33 - 36 |

| Local authority chapter | Item paragraphs |
|---|------------------------|
| Professional Support has provided guidance on capital grants. | 37 - 39 |
| Professional Support has provided guidance on remuneration reports in respect of <ul style="list-style-type: none"> • prior year figures • self-employed officers | 40 - 41 42 - 44 |
| Professional Support has provided guidance on ineligible service charges. | 46 - 51 |
| Professional Support has provided guidance on reserve balances in joint boards. | 56 - 57 |
| Professional Support has provided guidance on the charity test. | 58 - 59 |
| 2018/19 audit year | |
| <i>Technical developments</i> | |
| CIPFA has issued revised treasury management guidance notes | 60 - 61 |
| 2019/20 audit year | |
| <i>Technical developments</i> | |
| CIPFA/LASAAC has issued a consultation draft of the 2019/20 accounting code. | 10 - 12 |

| Central government chapter | Item paragraphs |
|---|------------------------|
| 2017/18 audit year | |
| <i>Technical developments</i> | |
| Treasury has issued guidance on preparing WGA returns | 63 - 64 |
| Professional Support has issued a technical guidance note on reviewing WGA returns. | 65 - 66 |

| Further education chapter | Item paragraphs |
|--|-----------------|
| 2017/18 audit year | |
| <i>Technical developments</i> | |
| The SFC has issued the 2017/18 accounts direction. | 68 - 70 |
| Professional Support has published a technical guidance note on auditing the 2017/18 annual report and accounts. | 71 - 76 |
| The SFC has issued guidance on 2017/18 financial statements. | 77 - 79 |
| The SFC has issued guidance on the early retirement provision. | 80 - 81 |
| Professional Support has published a technical guidance note on 2017/18 model independent auditor's reports. | 82 - 86 |
| The Auditor General has issued an overview report. | 87 - 88 |

| Professional developments chapter | Item paragraphs |
|--|-----------------|
| 2017/18 audit year | |
| <i>Technical developments</i> | |
| The FRC has issued a report on auditing defined benefit pension obligations. | 90 - 91 |
| 2018/19 audit year | |
| <i>Technical developments</i> | |
| The FRC has issued revised guidance on the strategic report. | 95 - 101 |
| 2018/19 audit year | |
| <i>Technical developments</i> | |
| The FRC has issued proposed changes to the standard on auditing estimates. | 92 - 94 |

| Fraud and irregularity chapter | Item paragraphs |
|---|------------------------|
| Professional Support has provided a summary of reported fraud cases and other irregularities. | 103 - 105 |

Cross-sector chapter

This chapter contains information on the main technical developments in the quarter that are relevant to appointed auditors in all sectors.

Non-financial statements

Remuneration report

Guidance on trade union facility time disclosures

1. The [Scottish Government](#) has issued [guidance](#) on *The Trade Union (Facility Time Publication Requirements) Regulations 2017* (see [technical bulletin 2018/2](#) - paragraph 1). The guidance applies from 1 April 2017 and aims to ensure that the facility time data is set in the context of the benefits that facility time bring to the workforce.
2. Annex A provides a facility time statement issued by the Scottish Government and Scottish Trades Union Congress which bodies may wish to use to accentuate the positive benefits of facility time.
3. The contacts in Professional Support for this guidance are:
 - Paul O'Brien, Senior Manager (Professional Support) - 0131 625 1795 or pobrien@audit-scotland.gov.uk (local authorities)
 - Neil Cameron, Manager (Professional Support) - 0131 625 1797 or ncameron@audit-scotland.gov.uk (other sectors).

Wider scope

Governance and transparency

NFI report

4. [Audit Scotland](#) has published a [report](#) on the 2016/17 *National fraud Initiative* (NFI) exercise. Almost 100 public bodies participated in the exercise, which is coordinated by Audit Scotland every two years.
5. The NFI compares electronic data about individuals held by different public bodies to help identify fraud or error. Matches resulted in an estimated £18.6 million of outcomes since the last report in 2016. This figure includes an estimate of projected future losses that the NFI has prevented.
6. The latest exercise in Scotland has led to:
 - £4.8 million of overpayments being recovered to date
 - £4,802 council tax discounts reduced or removed
 - 280 public service pensions stopped or reduced

- 4,505 blue badges stopped or flagged for future checks
 - 710 housing benefit (HB) payments stopped or reduced
 - £1.8million in further savings from the NFI 2014/15.
7. The matches which generated the most results were pensions (£6.3m), council tax discounts (£4.4m), blue badges (£2.6m) and benefits (£2.1m).
8. The report:
- notes that there is strong evidence that most bodies take advantage of the opportunities provided by the NFI
 - highlights that some could act more promptly to investigate matches, prevent frauds and correct errors
 - makes a number of recommendations to support further improvement.
9. The contact in Professional Support for the NFI report is Anne Cairns, Manager (Professional Support) on 0131 625 1926 or acairns@audit-scotland.gov.uk.

Local authority chapter

This chapter contains information on the main technical developments in the quarter that are relevant to appointed auditors in the local authority sector, and guidance from Audit Scotland's Professional Support on risks emerging from the audit of 2017/18 local authority annual accounts.

Financial statements

Consultation on 2019/20 accounting code

10. The [CIPFA/LASAAC Local Authority Code Board](#) (CIPFA/LASAAC) has issued the [consultation draft](#) of the *Code of practice on local authority accounting in the UK* for 2019/20 (the 2019/20 accounting code). It comprises an invitation to comment (ITC) as well as extracts from the draft code (ED1 to ED 4) with the proposed amendments set out.
11. The most significant proposed change to the 2019/20 accounting code is in respect of leases which is covered in a separate consultation (see [technical bulletin 2018/2](#) - paragraph 43). This consultation contains a number of items arising from:
 - narrow scope amendments to standards
 - legislative and policy changes
 - the International Accounting Standard Board's new conceptual framework
 - formalising the descriptions of adaptations, interpretations and statutory adjustments
 - post implementation reviews of group accounts standards and service concession arrangements.
12. Responses should be submitted to code.responses@cipfa.org by 8 October 2018. The main proposals that apply to Scottish local authorities are summarised in the following tables:

Narrow scope amendments

| Subject: Pension plan amendment, curtailment and settlement | ITC paragraphs: 21 to 26 | Exposure draft: A1 |
|---|--------------------------|--------------------|
| <p>Summary of proposed change</p> <p><i>IAS 19 Employee benefits: Plan amendment, curtailment or settlement</i> requires that when a plan amendment, curtailment or settlement occurs during the year that entities use updated actuarial assumptions to determine current service cost and net interest for the remaining annual reporting period.</p> <p>Currently the accounting code's adoption of IAS 19 is such that local authorities are not required to use updated assumptions for such changes. It is proposed that the code is amended to reflect the amendment to IAS 19.</p> | | |

Legislative and policy changes

| | | |
|---|---------------------------------|---------------------------|
| Subject: Transfers to statutory reserves | ITC paragraphs: 53 to 55 | Exposure draft: B1 |
| <p>Summary of proposed change</p> <p>It is proposed to add an additional line to the movement in reserves statement and expenditure and funding analysis to reflect transfers between statutory reserves. The proposals formalise existing practice.</p> | | |

| | | |
|---|---------------------------------|---------------------------|
| Subject: Statutory adjustments for the revaluation elements of depreciation | ITC paragraphs: 56 to 59 | Exposure draft: B2 |
| <p>Summary of proposed change</p> <p>IAS 16 allows for a voluntary transfer of some of the revaluation surplus to retained earnings as depreciation is charged, instead of moving the whole revaluation surplus to retained earnings on derecognition. The code currently treats this transfer as a statutory adjustment.</p> <p>It is proposed that the transfer should be directly between the revaluation reserve and the general fund, instead of being routed through the capital adjustment account and presented as a statutory adjustment.</p> | | |

Conceptual framework

| | | |
|--|---------------------------------|---------------------------|
| Subject: Concepts and principles | ITC paragraphs: 69 to 72 | Exposure draft: C1 |
| <p>Summary of proposed change</p> <p>The main areas for change included in section 2.1 of the accounting code arising from the new conceptual framework are:</p> <ul style="list-style-type: none"> • updates on the objectives of the financial statements, including the detail of their scope • updates to the qualitative characteristics of useful financial information in relation to prudence (the exercise of caution when making judgements under conditions of uncertainty), measurement uncertainty (even a high level does not prevent an estimate from providing useful information) and substance over form • inclusion of the new definitions of the elements of the financial statements that are defined in terms of economic resource (a right that has the potential to produce economic benefits and/or service potential) • updates to include the revised process and criteria for recognition and the new provisions on derecognition (normally occurs when the item no longer meets the definition of an asset or liability, e.g. when the authority loses control of an asset, or no longer has a present obligation for a liability). • amendments to include the new definition of measurement basis (an identified feature of the item being measured, e.g. historical cost, fair value or fulfilment value). | | |

Adaptations, interpretations and statutory adjustments

| Subject: Clarification of descriptions of adaptations and interpretations | ITC paragraphs: 73 to 74 | Exposure draft: D1 |
|--|---------------------------------|---------------------------|
| <p>Summary of proposed change</p> <p>The following proposed definitions have been added:</p> <ul style="list-style-type: none"> • An adaptation is a change to the provisions of a standard to reflect local government circumstances. • An interpretation does not amend the standard but sets out how the standard should be applied to reflect local government circumstances. | | |

| Subject: Process for statutory adjustments | ITC paragraph: 75 | Exposure draft: D2 |
|--|--------------------------|---------------------------|
| <p>Summary of proposed change</p> <p>It is proposed to add explanatory information on statutory adjustments, i.e. the statutory requirements that establish what is chargeable to the general fund.</p> | | |

Post implementation reviews

| Subject: Group accounts | ITC paragraph: 78 | Exposure draft: N/A |
|---|--------------------------|----------------------------|
| <p>Summary of consultation</p> <p>The consultation seeks views on:</p> <ul style="list-style-type: none"> • the prominence of the group accounts in local authority financial statements • whether the code could be augmented to ensure that the presentation and disclosure of group accounts transactions are appropriately signposted. | | |

| Subject: Public sector combinations | ITC paragraph: 79 to 81 | Exposure draft: N/A |
|---|--------------------------------|----------------------------|
| <p>Summary of consultation</p> <p>The consultation seeks views on whether the code:</p> <ul style="list-style-type: none"> • should include more specific guidance on <i>IFRS 3 Business combinations</i> • provides appropriate reporting requirements for local government public sector combinations. | | |

| Subject: Third party income in service concession arrangements | ITC paragraph: 82 to 85 | Exposure draft: N/A |
|---|--------------------------------|----------------------------|
| <p>Summary of consultation</p> <p>The consultation seeks views on whether the code should be specific about the treatment of third party income for service concession arrangements.</p> | | |

Property, plant and equipment

Reversing impairment loss

13. An auditor has asked for Professional Support's view on when it is appropriate to reverse an impairment loss on property, plant and equipment. The council was not differentiating between revaluation losses and impairment losses when using revaluation gains to reverse previous losses.
14. Councils should maintain adequate records in respect of both revaluation losses and impairment losses (e.g. the amount, date etc). Although initially accounted for in the same way, revaluation losses should be differentiated from impairment losses as the treatment of any reversal differs.
15. A previous revaluation loss that was recognised in the comprehensive income and expenditure (CIES) should always be reversed by a subsequent revaluation gain (less any depreciation that would have been charged had the loss never been recorded). There is no need for there to be any causal link between the two events.
16. However, a previous impairment loss should only be reversed where there is evidence of genuine reversal of the event or change in circumstances, i.e. where there has been a change in the estimates of the asset's recoverable amount. For impairments relating to physical damage or loss to the asset, this is highly unlikely to be the case. If an asset is reconstructed, the reconstruction should be accounted for as subsequent expenditure on the existing asset or a new asset in its own right.
17. For impairment losses, councils should therefore record the reason for the loss, so they can assess whether a reversal is permissible.
18. In addition, the auditor advised that the impairment losses arose due to capital expenditure being written off as it did not add to value. Writing off expenditure on an asset and describing it as 'expenditure that does not add value' is unlikely to be the appropriate treatment or description. It is more likely that one of the following options applies:
 - A component has been replaced, in which case the replaced component should first have been derecognised allowing expenditure on the new component to be added to the asset value in full; or
 - An impairment loss should have been recognised before the reconstruction work was carried out, allowing expenditure incurred on the work to be added to the asset value in full.

Retirement benefits

Asset valuation

19. Auditors have sought Professional Support's advice on cases where estimated investment asset returns used by the actuary to calculate the employing authority's share of pension fund assets are significantly lower than actual returns.

20. Under the local government pension scheme (LGPS), a detailed exercise to allocate assets between employers is carried out at each triennial valuation date. These employer asset allocations are then 'rolled forward' to subsequent year ends for IAS 19 purposes and amended for subsequent cash flows from dealing with members and from investment returns.
21. Actuaries typically produce IAS 19 reports in April before full cashflow data is available. Investment returns for the last few months of the year are estimated using market indices.
22. Actual investment returns to 31 March are generally available in May. Auditors should compare actual returns with those estimated by the actuary and consider whether the figures required to be updated.
23. Where employer assets are misstated as a result of estimates not been revised to include the latest information, and amounts are above the auditors reporting threshold, auditors are required by auditing standards to request amendment of the figures in the accounts.
24. Where the misstatement is judged to be material but is not corrected, auditors should consider a qualified opinion on the financial statements.

Experience gains and losses

25. An auditor has queried whether significant IAS 19 experience gains in 2017/18 indicates a problem with the IAS 19 report. Experience adjustments result from the effects of differences between the previous actuarial assumptions and what has actually occurred.
26. The IAS 19 figures at 31 March 2018 were rolled-forward from the triennial valuation as at 31 March 2017, rather than 31 March 2014 which was used for the 31 March 2017 IAS 19 figures. The use of a new triennial valuation is likely to lead to significant 'experience' items, which can be as high as 10% of total assets or liabilities.
27. These experience items relate to updated individual member data, as the roll-forward methodologies use approximate methods which do not allow for individual member movements. Most employers will have experience gains in 2017/18 as a result of:
 - salary growth running at below the long term assumed rate
 - pension increases being lower than anticipated (for deferred pensions and pensions in payment).
28. The incidence of other experience items will be less uniform across employers and will depend on patterns of membership movement and mortality. For example:
 - Ongoing severance and increased mortality in some cases may well contribute to larger than usual experience gains.
 - Smaller authorities are perhaps more likely to be outliers in terms of experience items.
29. Auditors should pay particular attention to experience gains or losses in IAS 19 figures and should generally seek further justification for any gains or losses which exceed 10% of total assets or liabilities.

Reserves

Insurance fund

30. Auditors have raised with Professional Support the issue of local authorities recognising a provision for repairing damage to their own properties. As the authorities are not under any obligation to repair the damage, the criteria for recognising a provision is not met. Derecognising the provision should be treated as a prior year error rather than as a change in estimate, and therefore retrospective restatement would be required.
31. One council intended transferring the provision balance to an earmarked reserve to protect the insurance fund. Scottish local authorities have no statutory powers to create earmarked reserves. This sum of money being set aside should either be transferred to the insurance fund or be treated as an earmarked portion of the general fund.
32. An auditor also queried whether it was correct treatment for a council, which charged internal premiums to service segments, to include any under-recovery in other operating expenditure rather than allocate the amount to services. It is important that all relevant expenditure (e.g. external premiums, impairment losses, payment of claims etc) is charged to the CIES rather than directly to the insurance fund. This could be apportioned over services or charged to an insurance support service. The treatment of internal premiums in the CIES in 2017/18 depends on how they treated for internal management purposes. From 2018/19, internal premiums will no longer be permitted in the CIES.

Group financial statements

Loan impairment

33. An auditor has asked for Professional Support's advice on accounting for the impairment of a council's loan to a subsidiary. The council had 'written off' the loan to the subsidiary which is in financial distress.
34. If the subsidiary was in financial difficulties, it was appropriate for the council to recognise an impairment loss and remeasure the loan to the present value of estimated future cash flows.
35. It is appropriate for the subsidiary to recognise the creditor. There remains a liability regardless of the accounting treatment in the council's accounts. If the financial position of the subsidiary improves, the impairment loss previously recognised by the council can be reversed.
36. Loans between a parent and a subsidiary should be eliminated as consolidation adjustments so there should not be a creditor balance in the group accounts. The correct consolidation entries would be a debit to the creditor and a credit to the general fund (to remove the impact of the impairment loss which from a group perspective did not occur).

Income

Capital grants/donated assets

37. An auditor has queried with Professional Support the treatment of a capital grant received by a council from the Scottish Government a couple of years ago to buy a brownfield site and donate it to a housing association to build on. The asset remains in the council's balance sheet at the cost price.
38. The entries on receipt of the grant would have been a credit to the CIES (with a statutory adjustment from the general fund to the capital adjustment account), and recognition of the asset.
39. As the council were aware that the intention was to donate the site, they should have carried out an impairment assessment to calculate the recoverable amount. This is the higher of the asset's net selling price and its value in use (i.e. the present value of the asset's remaining service potential). As the carrying amount would have been greater than its recoverable amount (which was presumably zero), the council should have recognised an impairment loss. If the council did not do so, they should consider recognising the impairment loss as the correction of a prior year error in 2017/18 (debit capital adjustment account, credit asset).

Non-financial statements

Remuneration report

Prior year figures

40. An auditor has sought Professional Support's view on whether councils should include in the 2017/18 remuneration report prior year figures for two senior councillors whose appointments ended during 2016/17.
41. [The Local Authority Accounts \(Scotland\) Regulations 2014](#) only require information for individuals who were a 'relevant person' in the financial year to which the remuneration report relates, i.e. during 2017/18. Prior year information is not required for individuals who stopped being a 'relevant person' during the previous year.

Self-employed officers

42. An auditor has queried whether remuneration report disclosure requirements apply to senior officers who are self-employed. A 'relevant person' includes an individual 'holding office' with the authority, i.e. the individual does not have to be employed by the authority. This means the requirements apply to a self-employed individual.
43. The individual in question was paid monthly via an invoice which varied each month and held the post for only the final eight months of the year. The definition of remuneration in the accounts regulations includes fees paid so the amount disclosed should be the amount of fees payable for the eight month period.

44. However, finance circular 8/2011 suggests that a full year equivalent salary should also be disclosed. Given the variable nature of the fees, this would have to be estimated for the first four months and disclosed as such.

Grant claims and returns

Housing benefit subsidy claim

2017/18 HBCOUNT

45. [Public Sector Audit Appointments](#) has issued the two modules of the 2017/18 HB COUNT as set out in the following table:

| Module | Tool | Explanation |
|--------|---------------------|---|
| 4 | Analytical review | This tool provides a number of useful worksheets including the following two which require to be completed: <ul style="list-style-type: none"> The year-to-year worksheet where 2016/17 claim data is entered manually for comparison against 2017/18 data. The key ratios worksheet that allows comparison with other authorities. |
| 5 | Software diagnostic | The module contains a control matrix that requires to be completed by auditors |

Ineligible service charges

46. Professional Support has identified that some housing providers (e.g. housing associations) in Scotland are changing the service charge elements within their rent charge to tenants. Some elements of these new charges may not be eligible for HB.
47. The 2006 HB regulations do not provide a specific list of service charges that are eligible for HB. However, Schedule 1 provides examples of ineligible service charges, e.g. aids and adaptations or the provision of an alarm service.
48. As a basic principle for a service charge to be eligible, it must be a condition of the right to occupy the dwelling and not a service charge that the tenant can choose to have. This means the following points are relevant:
- Where the tenant can choose whether to accept services offered to them (and as a result whether to pay for the service), the service is not a condition of the right to occupy the dwelling.
 - Where non-payment of a service merely results in the service being withdrawn rather than the right to occupy being withdrawn, the charge is not a condition of the right to occupy the dwelling.

49. Housing associations appear to be implementing an 'enhanced housing management service' which includes a range of services and involves a significant increase in the costs charged to tenants. The services provided in some cases include areas of a social nature which will support the tenant but are not landlord management functions and therefore are not eligible for HB.
50. There is provision for councils in HB regulations to reduce what they consider to be excessive service charges and they can also restrict higher rents by referring cases to the Rent Officer. Once a council agrees a service charge is eligible with a housing provider, the council should consider the cost of a comparable service to decide whether the eligible service charge is excessive.
51. Auditors should confirm that service charges are eligible for HB when certifying the 2017/18 HB subsidy claims. This includes reviewing the arrangements between councils and housing providers and obtaining a breakdown of the elements making up a management charge.

Whole of government accounts

2017/18 guidance

52. [HM Treasury](#) has issued [guidance](#) on completing the 2017/18 returns for whole of government accounts (WGA). External auditors are required to review the returns for bodies above a prescribed threshold and report the results of their review to the National Audit Office (NAO) in an assurance statement.
53. The prescribed threshold for 2017/18 is where either gross assets (excluding property, plant and equipment, heritage assets, intangibles, investment properties, and assets held for sale), or gross liabilities (excluding pension liabilities), or gross income or gross expenditure is above £500 million.
54. Professional Support has issued [Technical guidance note 2018/6\(LA\)](#) to provide guidance for auditors on reviewing and reporting on the 2017/18 WGA returns of central government bodies above the threshold. The approach set out in the technical guidance note has been agreed with the NAO.
55. The changes in the content of the technical guidance note compared with 2016/17 are as follows:
 - The threshold for auditor assurance has increased from £350 million to £500 million.
 - The threshold for minor body status has increased from £10 million to £20 million.
 - Some fieldwork tests have been removed or refocussed.
 - The requirement to submit the ISA (UK) 260 report no longer applies.

Other bodies/accounts

Joint boards

Reserve balances

56. An auditor has queried whether joint boards and joint committees can hold reserves. Joint boards and joint committees have the power (indeed are required) to have a general fund into which income is credited and expenditure debited. While this is the same as councils, the complication for joint boards and joint committees is that their ability to recognise a balance on the general fund is determined by how they are funded. Statutory funding arrangements are set out in the relevant establishment order.
57. In simple terms, if it is implicit in the terms under which the body is funded that income must always equal expenditure, by definition it can never have a surplus, and therefore can never have a balance on the general fund. This is a consequence of the wording used rather an explicit statement that income should equal expenditure.

Section 106 charities

Charity test

58. An auditor has sought Professional Support's view on whether auditors should take any action where a section 106 charity has not made any disbursements in several years.
59. [Section 46](#) of the *Charities and Trustee Investment (Scotland) Act 2005* requires auditors to report to OSCR if they have reason to believe that a charity no longer meets the charity test (i.e. it does not provide public benefit). The failure to make any disbursements could reasonably be considered as an indicator that no public benefit is being provided.

Wider scope

Financial management

Revised treasury management guidance notes

60. The [Chartered Institute of Public Finance and Accountancy](#) (CIPFA) has issued a revised edition of its [Treasury management in the public services - guidance notes for local authorities](#). The guidance notes have been revised to reflect changes in the new treasury management code (see [technical bulletin 2018/1](#) - paragraph 5) and replace those issued in 2011.
61. Auditors should refer to these guidance notes when assessing a local authority's treasury management arrangements from 2018/19.

Auditor action checklist

| | Yes/No/N/A | Initials/date | W/P ref |
|--|------------|---------------|---------|
| 1. Have you carried out the action recommended at paragraph 51 in respect of ineligible charges for housing benefit? | | | |

Professional Support contact for local authority chapter

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

Central government chapter

This chapter contains information on the main technical developments in the quarter that are relevant to appointed auditors in the central government sector.

Whole of government accounts

2017/18 guidance

63. [HM Treasury](#) has issued [guidance](#) on completing the 2017/18 returns for whole of government accounts (WGA). External auditors are required to review the returns for bodies above a prescribed threshold and report the results of their review to the National Audit Office (NAO) in an assurance statement.
64. The prescribed threshold for 2017/18 is where either gross assets (excluding property, plant and equipment, heritage assets, intangibles, investment properties, and assets held for sale), or gross liabilities (excluding pension liabilities), or gross income or gross expenditure is above £500 million.
65. Professional Support has issued [Technical guidance note 2018/7\(CG\)](#) to provide guidance for auditors on reviewing and reporting on the 2017/18 WGA returns of central government bodies above the threshold. The approach set out in the technical guidance note has been agreed with the NAO.
66. The changes in the content of the technical guidance note compared with 2016/17 are as follows:
 - The threshold for auditor assurance has increased from £350 million to £500 million.
 - The threshold for minor body status has increased from £10 million to £20 million.
 - Some fieldwork tests have been removed or refocussed.
 - The requirement to submit the ISA (UK) 260 report no longer applies.

Professional Support contacts for central government chapter

67. The contacts in Professional Support for this chapter are:
 - Neil Cameron, Manager (Professional Support) - 0131 625 1797 or ncameron@audit-scotland.gov.uk.
 - Helen Cobb, Senior Adviser (Professional Support) - 0131 625 1901 or hcobb@audit-scotland.gov.uk.

Further education chapter

This chapter contains information on the main technical developments in the quarter that are relevant to appointed auditors in the further education sector, and guidance from Professional Support on risks emerging from the audit of 2017/18 college annual report and accounts.

Annual report and accounts overall

2017/18 accounts direction

68. The [Scottish Funding Council](#) (SFC) has issued their [accounts direction](#) for colleges for 2017/18. 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
 - include a performance report and accountability report in their annual report and accounts in accordance with the [2017/18 Government financial reporting manual](#).
69. Specific mandatory disclosure requirements for colleges are set out at Appendix 2. The main changes in the 2017/18 accounts direction are summarised in the following table:

| Paragraph | Statement | Additional disclosure requirement |
|------------------------|---|--|
| Appendix 2 paragraph 4 | Performance report - overview | A brief description of the business model and environment, organisational structure, objectives and strategies. |
| Appendix 2 paragraph 5 | Performance report – performance analysis | Narrative to explain the link between KPIs, risk and uncertainty. Non-financial information including social matters, respect for human rights, anti-corruption and anti-bribery matters Information on environmental matters including the impact of the college's business on the environment. |
| Appendix 2 paragraph 6 | Performance report – performance analysis | For 2017/18, each college has been given a fixed 'cash budget for priorities' (i.e. the cash budget allocation previously earmarked for depreciation). Clarification has been added that colleges are required to disclose how this has been spent in the form of a table showing the expenditure under each heading and the impact on the operating position. The illustrative form of wording provided |

| Paragraph | Statement | Additional disclosure requirement |
|--|---|--|
| | | at Appendix 5 of the accounts direction has been slightly reworded. |
| Appendix 2 paragraph 10 and Annex G | Performance report – performance analysis | Paragraph 10 has been amended to explain the requirement to provide details of the adjusted operating position (previously described as underlying operating position). The adjusted operating position reflects the financial performance of a college after allowing for non-cash adjustments and other one-off or distorting items. An example disclosure has been added to Annex G. |
| Appendix 2 paragraph 29 | Remuneration and staff report | This paragraph has been amended to require the staff report to disclose information on employee matters such as other diversity issues and equal treatment in employment and occupation; employment issues including employee consultation and/or participation; health and safety at work; trade union relationships; and human capital management such as career management and employability, pay policy. |
| Appendix 2 paragraph 30 Appendix 4 paragraph 17 | Remuneration and staff report | Paragraph 2 was added to reflect <i>The Trade Union (Facility Time Publication Requirements) Regulations 2017</i> which require information to be disclosed on relevant trade union officials, percentage of paybill and time spent on facility time, and paid trade union activities. Paragraph 17 of Appendix 4 has been added to provide a template for making the disclosure. |
| Appendix 3 paragraph 2 and 5 | Governance statement | Amended to require colleges to include a statement confirming compliance with the 2016 <i>Code of good governance for Scotland's colleges</i> . A form of wording for the compliance statement is provided at Appendix 3(a). |

70. Auditors should refer to this direction when undertaking the audit of colleges' 2017/18 annual report and accounts.

Technical guidance notes

Audit of 2017/18 annual report and accounts

71. Audit Scotland's Professional Support has published [Audit of 2017/18 annual report and accounts \(further education\) - technical guidance note 2018/8\(FE\)](#) to provide guidance to all appointed auditors on performing the audit of the 2017/18 further education annual report and accounts.

72. While appointed auditors act independently and are responsible for their own conclusions and opinions, paragraph 108 of the *Code of audit practice* states that Audit Scotland 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 therefore appointed auditors should consider such guidance.
73. The technical guidance note comprises a number of modules. The modules, along with a brief summary of the contents, are set out in the following table:

| Module | Content |
|--|--|
| Overview | Guidance on auditors' overall responsibilities for the annual report and accounts; financial reporting framework that colleges are required to follow; the application of ISAs (UK); presentation of financial statements; and accounting policies, estimates, and prior year errors |
| 1 Tangible fixed assets | Each module highlights the risks of misstatement in each financial statement area, explains the financial reporting requirements applying to that area, and sets out actions for each risk that auditors should undertake to assess whether the college has met those requirements. |
| 2 Provisions, creditors and accruals | |
| 3 Retirement benefits | |
| 4 Other financial statement areas | As for modules 1 to 3 but this module includes a number of financial statement areas including leases, intangible assets, government grants etc |
| 5 Regularity of expenditure and income | This module provides guidance on auditor's responsibilities for the regularity of expenditure and income, and the risks of irregularities. It also sets out test procedures for auditors to carry out. |
| 6 Non-financial statements | This module covers the remuneration and staff report; performance report, governance statement and other non-financial statements. It explains auditors' responsibilities for these statements, sets out the different audit opinions required, highlights the main risks of misstatement, explains the financial reporting requirements applying to each statement, and sets out test procedures that auditors should undertake to assess whether the college has met those requirements. |

74. Following extensive consultation with all auditors, the technical guidance note represents an agreed position on a range of complex technical issues and is a key document as auditors perform the audit of further education 2017/18 annual report and accounts.

75. 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 health site of the *Technical reference library*.
76. Auditors should use the technical guidance note when performing the audit of the 2017/18 further education annual report and accounts.

Financial statements

Guidance on 2017/18 financial statements

77. The SFC has issued [Detailed notes for guidance on completion of the 2017/18 financial statements](#) which are designed to supplement the accounts direction for 2017/18. The guidance covers key disclosures in the financial statements, including model disclosure notes set out at Annexes A to G.
78. There main changes in the guidance notes from 2016/17 are summarised in the following table:

| Paragraph | Subject | Additional disclosure requirement |
|---------------------------------|--------------------------------------|---|
| Paragraph 7 | Grants from arm's-length foundations | Colleges are required to disclose separately any revenue or capital grants received from arms-length foundations. |
| Paragraph 18 and Annex F | Summary pension note | Paragraph 18 suggests the inclusion of a summary pension note which sets out the key charges and balance sheet movements related to pensions. A new model note is provided at Annex F. |
| Paragraphs 21 to 23 and Annex G | Adjusted operating position | <p>A note is required to disclose the adjusted operating position which is intended to take account of non-cash adjustments and other material one-off or distorting items on a college's financial performance. It is designed to:</p> <ul style="list-style-type: none"> • smooth any volatility in reported results • recognise that some of the reported costs do not have an immediate cash impact on the college. <p>Adjustments should only include figures which are visible elsewhere in the accounts. Colleges are required to provide a short explanation of the adjusting items.</p> <p>A model note has been added at Annex G.</p> |

79. Auditors should refer to these guidance notes when undertaking the audit of colleges' 2017/18 annual report and accounts.

Provisions and contingencies

Guidance for early retirement provision

80. The SFC issued [Guidance for early retirement provision spreadsheet completion](#) to advise that the suggested net interest rate for early retirement pension calculations in 2017/18 has been changed to 0.50%.
81. 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.

Independent auditor's reports

2017/18 model reports

82. Professional Support has issued [2017/18 Independent auditors report \(further education\) - Technical guidance note 2018/9\(FE\)](#) to provide auditors with the model independent auditor's reports which should be used for the 2017/18 annual report and accounts. The technical guidance note also provides application guidance on their use.
83. In the interests of consistency, auditors are required to use the relevant model report in appendices 1 and 2 of the technical guidance note as a condition of their audit appointment. The only exception to using the wording in each model is to tailor the terminology to reflect local circumstances.
84. 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 Professional Support in advance of finalising the report.
85. Auditors should use this technical guidance note when reporting on 2017/18 audits. They should complete for each report the checklist at Appendix 3 which provides a list of the key auditor actions.
86. The technical guidance note also provides a model auditors report for summary financial statements at Appendix 4.

Wider scope

Reports on sector

2016/17 overview

87. The Auditor General has issued [Scotland's colleges 2018](#) to provide an overview of the further education sector in Scotland.

88. The report states that the sector remains financially stable and moved from an underlying deficit in 2015/16 to an underlying surplus in 2016/17. However, this sector-wide increase masks significant variations between colleges.

Auditor action checklist

| | Yes/No/N/A | Initials/date | W/P ref |
|--|------------|---------------|---------|
| 1 Have you carried out the action recommended at paragraph 70 in respect of the 2017/18 accounts direction? | | | |
| 2 Have you used the technical guidance note referred to at paragraph 76 when performing the audit of the 2017/18 further education annual report and accounts? | | | |
| 3 Have you carried out the action recommended at paragraph 79 in respect of the 2017/18 guidance notes? | | | |
| 4 Have you carried out the action recommended at paragraph 81 in respect of the early retirement provision? | | | |
| 5 Have you used the technical guidance note referred to at paragraph 85 when reporting on the audit of the 2017/18 further education annual report and accounts? | | | |

Professional Support contact for further education chapter

89. The contact in Professional Support for this chapter is Helen Cobb, Senior Adviser (Professional Support) - 0131 625 1901 or hcobb@audit-scotland.gov.uk.

Professional developments chapter

This chapter contains information on the main professional developments in the quarter that are relevant to appointed auditors in the public sector.

Auditing developments

Audit of defined benefit pension obligations

90. The [Financial Reporting Council](#) (FRC) has issued a [report](#) based on 2017/18 audit quality reviews on the audit of defined benefit pension obligations. The report concludes that there is scope for improvement in a number of aspects of work that auditors and their experts carry out.
91. A summary of the findings is set out in the following table:

| Improvement area | Further comment |
|--|---|
| Carefully assessing the risk for the more sensitive assumptions. | Key assumptions used in calculating the pension obligations are subjective and involve significant judgement. Auditors should therefore assess the risk for the more sensitive assumptions and plan and perform appropriate procedures. |
| Clearly evidencing the work done by the auditor's actuarial expert to assess the valuation of the defined benefit obligation. | The actuarial expert's report should include sufficient information for the audit team to fully understand the actuarial expert's work, the judgements made and the basis for the conclusions and opinions expressed by the expert. |
| Considering the financial impact of key assumptions at the optimistic or pessimistic end of the acceptable range, along with the auditor's view on whether the actual assumptions are at the appropriate place in the range. | It is important that the auditor demonstrates how their independent estimate or acceptable range has been reached. Auditors should understand where assumptions sit on the acceptable range and consider whether this is appropriate to the entity's circumstances. |

| Improvement area | Further comment |
|--|---|
| Considering whether the source data is materially accurate and complete. | Auditors should clearly evidence their work on the completeness and accuracy of the source data provided to the actuary. |
| Clearly evidencing the audit work done where the IAS 19 valuation has been calculated by adjusting and rolling forward the last triennial actuarial valuation. | The valuations of the defined benefit obligation are usually determined using a roll-forward of data and assumptions from the latest triennial scheme funding valuation, adjusted for IAS 19 assumptions and methodologies and allowing for changes in experience and assumptions. There should be evidence of the actual review carried out by the auditor's actuary with an explanation of the roll-forward methodology and how the methodology had been applied, rather than simply an assertion that it had been checked. |
| Clearly analysing the different categories of investment assets so as to obtain a sufficient level of audit evidence for 'harder to value' assets. | Areas where aspects of the testing of asset valuations could be improved. Auditors should explain whether they were adopting a controls-based or substantive approach to the audit of investments, and suitably tailor the audit approach to address the specific risks that different types of investment present. |
| Obtaining sufficient audit evidence to support the allocation of the defined benefit obligation and pension scheme assets in a multi-employer scheme. | Auditors should reconcile the entity's allocation to the totals in the accounts of the pension fund. |
| Carefully considering the completeness and accuracy of the pensions related disclosures. | The report identified a number of cases where the audit of disclosures could be improved. |
| Considering whether reference to the audit work on pensions should be included in the auditor's report | Auditors should ensure they appropriately report on the work carried out on pension balances as a key audit matter, particularly where a significant risk has been identified. |

Proposed changes to standard on estimates

92. The FRC has issued [proposed changes](#) to *ISA(UK)540 Auditing accounting estimates and related disclosures*. The proposed revisions address issues arising from evolving financial reporting frameworks, particularly the move to accounting for financial instruments on an

expected loss basis. As the framework is more forward-looking, there is an increase in the complexity of accounting judgements and related disclosures

93. Key proposed changes are summarised in the following table:

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

94. Responses to the consultation are required to AAT@frc.org.uk by 21 September 2018. The revised standard is proposed to be effective for periods beginning after 15 December 2019, but early adoption is encouraged.

Accounting developments

Revised guidance on strategic reports

95. The FRC has issued revised [guidance on strategic reports](#). The guidance reflects the requirements of *The Companies Act 2006 (Strategic Report and Directors' Report) Regulations 2013* on which the requirements in the public sector for a management commentary/performance report are based. This guidance is therefore relevant to public bodies.
96. The guidance states that the objectives of the strategic report are to:
- provide insight into the entity's business model and its main strategy and objectives
 - describe the principal risks the entity faces and how they might affect its future prospects
 - provide relevant non-financial information
 - provide an analysis of the entity's past performance.
97. The strategic report should contain information that is material. Materiality depends on the nature of the matter and magnitude of its effect, judged in the particular circumstances. However, qualitative factors will often have a greater influence on the determination of materiality in the context of the strategic report, particularly in relation to non-financial information.
98. Chapter 6 of the guidance set out the communication principles on how the strategic report should be prepared. These include the report being:
- fair, balanced and understandable
 - clear and concise yet comprehensive
 - forward-looking
 - entity-specific
 - reviewed annually to ensure the structure, presentation and content continues to meet its purpose and only contains information that is relevant.
99. Chapter 7 provides helpful guidance on content. The guidance has been updated to reflect *The Companies, Partnerships and Groups (Accounts and Non-Financial Reporting) Regulations 2016* and provides assistance with:
- describing the entity's business model
 - including information on environmental matters, employees, social matters, human rights, and anti-corruption and anti-bribery matters
 - explaining relationships and linkages between different pieces of information.

100. The strategic report should be considered as the top layer of information for stakeholders. Some users may require a greater level of detail, in which case the strategic report can be used to signpost to other complementary information (i.e. information that is not required but is provided voluntarily). Complementary information should generally be published separately (e.g. on the website). Signposts to such information should make clear that it does not form part of the strategic report.
101. Signposting is distinct from cross-referencing. Cross-referencing is relevant where information satisfying a disclosure requirement that applies to the strategic report is presented in a different part of the overall annual report. Cross-referencing must be used in order for the disclosure requirement to be met.

Professional Support contact for professional developments chapter

102. The contact in Audit Scotland's Professional Support for this chapter is Paul O'Brien, Senior Manager (Professional Support) - 0131 625 1795 or pobrien@audit-scotland.gov.uk.

Fraud and irregularities chapter

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

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

Expenditure

Change of bank details

103. A third party defrauded £18,000 from a council by re-directing payments intended for a legitimate supplier.

Key features

The council received an email that appeared to be from a valid supplier with an invoice for payment of services to the council. The council then subsequently received notification of a change to the supplier's bank details from the same email address. The council processed the payment to the revised bank details.

It was later identified that the new bank details were false.

The fraud was possible as the council did not contact the supplier to check the change of bank details. It is not yet clear whether the perpetrator is an employee of the supplier or the email account was hacked.

Income

School fundraising

104. Over £6,000 of cash collected at a school fundraising event was misappropriated by a third party.

Key features

The fundraising event was organised in conjunction with a council supplier. One of the supplier's employees collected the money but failed to pay the funds to the school.

The head teacher identified that the cash had not been received six months after the event and notified the counter-fraud team. The fraud was facilitated by a failure to timeously follow up non-receipt.

The perpetrator has been reported to his employer and the police.

£1,200 of the funds have so far been recovered.

Payroll

Working while claiming to be unfit for work

105. An occupational therapist defrauded £8,000 from a council by falsely claiming to be unfit for work.

Key features

The occupational therapist was on sick leave for ten months. The fraud was only identified when colleagues advised the manager that the size of the employee's business had expanded significantly during the period of absence. Covert surveillance by internal audit confirmed that the employee was working on a self-employed basis during her period of sickness absence from the council.

The fraud was facilitated by a lack of effective monitoring during the employee's absence.

The employee has been dismissed and the case has been reported to the perpetrator's professional institute. Recovery action is in progress.

Auditor action checklist

| | Yes/No/N/A | Initials/date | W/P ref |
|--|------------|---------------|---------|
| 1 Have you considered whether the weaknesses in internal control that facilitated each fraud may apply at your audited bodies? | | | |

Professional Support contact for fraud and irregularity chapter

106. The contact in Professional Support for this chapter is Anne Cairns, Manager (Professional Support) on 0131 625 1926 or acairns@audit-scotland.gov.uk

Technical bulletin 2018/4

October to December 2018



 AUDIT SCOTLAND

Prepared for appointed auditors in all sectors

11 December 2018

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

Extracts from the code of audit practice

Technical support

40. Auditors appointed by the Auditor General for Scotland or the Accounts Commission are responsible for giving an opinion on the financial statements and reporting on other related matters. Audit Scotland provides technical support to appointed auditors in respect of these responsibilities to inform their professional judgement.

108. Audit Scotland provides technical support and guidance to all appointed auditors. While appointed auditors act independently, and are responsible for their own conclusions and opinions, Audit Scotland has a role in ensuring that those conclusions and opinions are reached on the basis of informed judgement.

An element of the technical support and guidance to appointed auditors referred to in the above extracts from the [Code of audit practice](#) is technical bulletins provided by Audit Scotland's Professional Support. It is a condition of the audit appointment that auditors carry out their audits in accordance with guidance issued by Audit Scotland.

The purpose of technical bulletins is to provide appointed auditors with:

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

This technical bulletin applies to appointed auditors in all sectors, though some chapters apply to a particular sector.

Technical bulletins are available to appointed auditors from the *Technical reference library* maintained by Professional Support, and are published on the [Audit Scotland website](#) so that audited bodies and other stakeholders can access them.

The items on technical developments are intended to highlight the key points that Professional Support considers appointed auditors require to be aware of. It may still be necessary for auditors to read the source material if greater detail is required. The documents referred to in the items can be obtained by using the hyperlinks, where available. They are also available to appointed auditors from the *Technical reference library* on [ishare](#) and the [Extranet](#).

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

Audit Scotland makes no representation that legal guidance is correct. Points of law can ultimately be decided only by the Courts. Audit Scotland accepts no responsibility for any loss or damage caused as a result of any person relying upon anything contained in this technical bulletin.

Headlines chapter

This chapter provides brief headlines for the items on technical developments and guidance on emerging risks in this technical bulletin, classified by the audit year to which they relate, and referenced to the paragraph number containing the main item.

| Cross-sector chapter | Item paragraphs |
|--|-----------------------|
| 2018/19 audit year | |
| <i>Technical developments</i> | |
| Professional Support has issued guidance on planning 2018/19 audits. | 1 - 3 |

| Local government chapter | Item paragraphs |
|---|-------------------------|
| 2018/19 audit year | |
| <i>Technical developments</i> | |
| Professional Support has published guidance on planning and performing the audit of the 2018/19 annual accounts. | 5 - 9 |
| CIPFA has issued guidance notes on the 2018/19 accounting code. | 10 - 11 |
| CIPFA has issued a disclosure checklist for the 2018/19 financial statements. | 12 - 15 |
| The Scottish Government has issued revised statutory guidance on financial instruments. | 22 - 24 |
| CIPFA has issued a statement on borrowing in advance and investing in commercial property. | 25 - 27 |
| New regulations have been issued on the LGPS. | 28 - 29 |
| The DWP has issued guidance on universal credit full service. | 43 - 44 |
| The Accounts Commission has issued a financial overview report. | 46 - 47 |
| CIPFA has issued guidance on the prudential code. | 48 - 49 |
| <i>Emerging risks</i> | |
| Professional Support has provided guidance on the expiration of the statutory flexibility on equal pay and severance. | 16 - 18 |
| Professional Support has provided guidance on loans fund repayments. | 19 - 21 |

| Local government chapter | Item paragraphs |
|--|-------------------------|
| Professional Support has provided guidance on the treatment of equal pay sums as pensionable pay. | 30 - 33 |
| Professional Support has provided guidance on the potential understatement of information on leases. | 37 - 38 |
| Professional Support has issued an update on reducing the number of section 106 charities. | 39 - 42 |
| 2020/21 audit year | |
| Technical developments | |
| CIPFA/LASAAC has announced that the implementation of IFRS 16 has been deferred to 1 April 2020. | 34 - 36 |

| Central government chapter | Item paragraphs |
|--|-------------------------|
| 2018/19 audit year | |
| Technical developments | |
| Treasury has issued 2018/19 discount rates. | 51 - 56 |
| The Scottish Government has issued amendments to the SPFM. | 57 |

| College chapter | Item paragraphs |
|--|-------------------------|
| 2018/19 audit year | |
| Technical developments | |
| Professional Support has issued guidance on considering whether a college exercises significant influence over an ALF. | 59 - 60 |

| Professional developments chapter | Item paragraphs |
|--|-------------------------|
| 2018/19 audit year | |
| Technical developments | |
| The FRC has issued a report on auditors' work on other information in the annual accounts. | 62 - 65 |
| The FRC is reviewing the effectiveness of the ethical and auditing standards issued in 2016. | 66 - 67 |
| The CMA is reviewing the operation of the statutory audit market in the commercial sector. | 68 - 71 |

| Professional developments chapter | Item paragraphs |
|---|-------------------------|
| The FRC has issued a thematic review of IFRS 9. | 72 - 73 |
| The FRC has issued a thematic review of IFRS 15. | 74 |
| The FRC has issued a report on performance metrics. | 75 - 76 |

| Fraud and irregularity chapter | Item paragraphs |
|---|------------------------|
| Professional Support has provided a summary of reported fraud cases and other irregularities. | 78 |

Cross-sector chapter

This chapter contains information on the main technical developments in the quarter that are relevant to appointed auditors in all sectors.

2018/19 audit planning guidance

1. Audit Scotland's Professional Support has issued [guidance](#) to assist all appointed external auditors in planning their 2018/19 audits. The guidance covers the main activities that comprise core audit work and the products associated with each activity.
2. The following table provides a summary of the key changes in the guidance from last year:

| Nature of change | Relevant section |
|--|------------------|
| The structure of the guidance has been refreshed and revised to focus on each core audit activity. | All |
| There have been changes to the submission requirements for audit outputs. | Various |
| The list of wider scope risk areas has been refreshed. | 3 |
| The local auditor input requirements for the performance audit work programme has been updated. | 4 |
| Enhanced guidance has been provided on the role of appointed auditors in highlighting potential statutory reports. | 5E |
| There are new quarterly reporting arrangements for fraud returns. | 5J |
| The policy on non-audit services has been revised. | Appendix 2 |
| There is a new requirement to submit an annual quality report. | Appendix 5 |

3. Auditors should pay due regard to this guidance when planning their 2018/19 audits.

Auditor action checklist

| | Yes/No/N/A | Initials/date | W/P ref |
|--|------------|---------------|---------|
| 1. Have you carried out the action recommended at paragraph 3? | | | |

Professional Support contact for cross-sector chapter

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

Local government chapter

This chapter contains information on the main technical developments in the quarter that are relevant to appointed auditors in the local government sector, and guidance from Audit Scotland's Professional Support on any emerging risks.

Annual accounts overall

Technical guidance notes

Audit of 2018/19 annual accounts

5. Audit Scotland's Professional Support has published [Audit of 2018/19 annual accounts \(local government\) - technical guidance note 2018/10\(LG\)](#) to provide guidance to all appointed external auditors on planning and performing the audit of the 2018/19 annual accounts of local government bodies.
6. The technical guidance note comprises a number of modules which, along with a brief summary of the contents, are set out in the following table:

| Module | Content |
|--------------------------------------|---|
| Overview | Guidance on auditors' overall responsibilities for the annual accounts; information on <i>The Local Authority Accounts (Scotland) Regulations 2014</i> ; proper accounting practices; the application of ISAs (UK); presentation of the financial statements; accounting policies, estimates, and prior year errors; and events after the reporting period. |
| 1 Property, plant and equipment | Each module highlights the risks of misstatement in each of the main financial statement areas, explains proper accounting practices applying to that area, and sets out actions for each risk that auditors should undertake to assess whether the body has followed those practices. |
| 2 Provisions, creditors and accruals | |
| 3 Financial instruments | |
| 4 Retirement benefits | |
| 5 Reserves | |
| 6 Group financial statements | |
| 7 Leases and similar arrangements | |
| 8 Grants and other income | |

| Module | Content |
|--|--|
| 9 Other financial statement areas | As for modules 1 to 8 but this module includes a number of financial statement areas including the expenditure and funding analysis, investment property, significant trading operations, and related parties. |
| 10 Non-financial statements | This module covers the remuneration report, management commentary and annual governance statement. It explains auditors' responsibilities for these statements, sets out the different audit opinions required, highlights the main risks of misstatement, explains proper accounting practices applying to each statement, and prescribes the test procedures that auditors should undertake to assess whether the body has followed those practices. |
| 11 Integration joint boards | These modules apply the other modules to specific accounts/bodies, and provide supplementary guidance. |
| 12 Local government pension scheme fund accounts | |
| 13 Section 106 charity accounts | |

7. 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 the 2018/19 annual accounts.
8. For the purposes of the Audit Scotland website, all the modules have been combined into [one document](#). The individual modules are also available to auditors from the relevant subject pages on the local government site of the *Technical reference library* on [ishare](#) and the [Extranet](#).
9. Auditors should use the technical guidance note when planning and performing the audit of the 2018/19 annual accounts of local government bodies.

Financial statements

2018/19 accounting code guidance notes

10. The [Chartered Institute of Public Finance and Accountancy](#) (CIPFA) has issued [guidance notes](#) to assist in understanding the accounting requirements of the *2018/19 Code of practice on local authority accounting in the UK* (the accounting code). The guidance notes provide background to the 2018/19 accounting code's requirements, including detailed illustrations, but the guidance is not prescriptive.
11. The guidance notes have been amended to reflect the changes made to the 2018/19 accounting code (see [technical bulletin 2018/2](#) - paragraph 5), including the adoption of *IFRS 9 Financial instruments* and *IFRS 15 Revenue from contracts with customers*.

2018/19 disclosure checklist

12. CIPFA has issued a [disclosure checklist](#) for the 2018/19 financial statements. The checklist is intended for use as an aide-memoire to ensure that the requirements of the 2018/19 accounting code are met. It is in the form of a series of questions:
 - If the answer to a question is 'yes', the accounting code is being complied with.
 - If the answer is 'no', a justification for departing from the code should be given.
13. The accounting code's provisions enable required disclosures to be excluded if the information resulting from that disclosure is not material. This is the case even if the code or a standard contains a list of specific requirements or describes them as minimum requirements.
14. Auditors should:
 - request that the body completes the disclosure checklist
 - investigate the reasons for any non-compliance that the checklist highlights
 - assess whether the body's responses in the checklist are consistent with auditor's knowledge.
15. Where the body declines to complete the checklist, auditors should establish the alternative means by which the body satisfies itself regarding the completeness of disclosures, and assess whether the arrangements are adequate.

Provisions

Expiration of statutory adjustments on equal pay and severance

16. Auditors are reminded that the statutory adjustments allowed by [finance circular 4/2015](#) to assist with meeting the costs associated with equal pay and severance ceased to apply on 1 April 2018.
17. Where the body had opted to take advantage of the flexibility, auditors should confirm that:
 - the statutory adjustments debited to the statutory adjustment accounts have been matched by credits by 31 March 2019
 - any capital receipts credited to the statutory adjustment accounts in previous years that were not applied by 31 March 2019 have been transferred to the capital fund.
18. Further guidance on this matter is provided at module 2 (paragraphs 21 to 23 and 28) of [TGN 2018/10\(LG\)](#).

Financial instruments

Loans fund repayments

19. Professional Support has been made aware that some local government bodies are carrying out exercises to reschedule their loans fund repayments using the prudent repayment options

set out in the statutory guidance issued with [finance circular 7/2016](#). In some cases, the exercises include loans fund advances made before 1 April 2016.

20. Auditors are reminded that the statutory guidance (paragraph 33 in part 2) is clear that all loans fund advances made prior to 1 April 2016 should continue to be repaid as if paragraph 15 of Schedule 3 of the *Local Government (Scotland) Act 1975* had not been repealed. It follows that the prudent repayment options apply only to advances made from 1 April 2016.
21. Auditors should confirm that loans fund advances made before 1 April 2016 continue to be repaid in accordance with the 1975 Act. Further guidance on this matter is provided at module 3 (paragraphs 38 to 42) of [TGN 2018/10\(LG\)](#).

Revised statutory guidance

22. The Scottish Government has issued revised statutory guidance on financial instruments in [finance circular 7/2018](#). The guidance has been revised to include points when a body uses capital receipts to fund the cost of premiums. These are summarised in the following table:

| Use | Guidance |
|---|---|
| Funding the cost of premiums | Capital receipts may fund the cost of premiums either as they are incurred or as they are recharged annually back to the general fund. |
| Funding the annual charge of premiums | Where capital receipts are used to fund the annual charge, the annual charge for deferred premiums should still be made to the general fund as a statutory adjustment, with the capital receipt treated as a transfer between statutory usable reserves (i.e. debit capital receipts, credit general fund). |
| Funding additional charges | Capital receipts may be used to fund additional charges to the general fund over and above the annual charge. |
| Funding the whole premium when incurred | Where capital receipts are used to fund a premium incurred when the loan is extinguished, the cost is not transferred to the financial instrument adjustment account. Instead the capital receipts are transferred to the general fund. |
| Funding part of the premium when incurred | Where only part of the premium cost is funded from capital receipts, a body may choose to defer the remaining amount by transferring it to the financial instrument adjustment account as a statutory adjustment. |

23. The transfer from capital receipts requires to be reported in a 'Transfer to/from other statutory usable reserves' line in the movement in reserves statement.
24. For the avoidance of doubt, there are no changes to the statutory adjustments permitted by the guidance originally provided in finance circular 4/2007 (i.e. premiums and discounts associated with the refinancing of loans, soft loans at 31 March 2007, and stepped interest

rate loans as 31 March 2007). However, the guidance has been amended to clarify that all statutory adjustments require to be reported in the adjustments between accounting basis and funding basis of the movement in reserve statement or note. The analysis should clearly identify each statutory adjustment. The guidance provides suggested descriptors for each statutory adjustment at paragraphs 41 to 46.

Statement on borrowing in advance and investments in commercial property

25. CIPFA has issued a [statement](#) on borrowing in advance of need and investments in commercial property. The statement reminds local government bodies that:
 - the policy objective of treasury management investment activities is the security of funds, and that a body should avoid exposing public funds to unnecessary risk
 - bodies must not borrow more than or in advance of their needs purely in order to profit from the investment of the extra sums borrowed.
26. The statement also notes that bodies have continued to invest in commercial properties, and in some cases these investments have been financed by borrowing. CIPFA is concerned about this practice, and will therefore be issuing guidance that will:
 - make it clear that these investment approaches are not consistent with the requirements of fiscal sustainability, prudence and affordability
 - set out the substantial risks which are being incurred by such practices.
27. Auditors should confirm that the body's approach to borrowing in advance and any investments in commercial property is in accordance with the statutory guidance in [finance circular 5/2010](#).

Retirement benefit/pension funds

New LGPS regulations

28. Modules 4 and 12 of [TGN 2018/10\(LG\)](#) (on retirement benefits and pension fund accounts respectively) refer to *The Local Government Pension Scheme (Scotland) Regulations 2014* and subsequent amending regulations. However, the modules should also have referred to [The Local Government Pension Scheme \(Scotland\) Regulations 2018](#) which were issued in May 2018 and consolidate the 2014 regulations and all subsequent amendments with effect from 1 June 2018. Professional Support apologises for this oversight.
29. The main substantive impact is the table at paragraph 88 in module 12 which relates to voluntary early retirement. Under the 2018 regulations, members are allowed to retire from the age of 55 without needing permission from their employer.

Pensionable pay - equal pay

30. [TGN 2018/10\(LG\)](#) advises auditors to assess whether pensionable pay has been calculated correctly. Pensionable pay is defined at [regulation 20](#) of *The Local Government Pension Scheme (Scotland) Regulations 2014* (and the 2018 regulations from June 2018) as an

employee's salary, wages, and other pensionable emoluments. This includes any sum representing arrears of pay paid to achieve equal pay, but excludes any award of compensation.

31. Professional Support understands there may be some uncertainty regarding the distinction between arrears of pay and compensation. The terms are not defined in the regulations but sums representing arrears of pay include cases where:
 - an employment tribunal makes an award in respect of arrears of pay
 - a settlement agreement expressly states that the amount represents arrears of pay.
32. Compensation in contrast is any *ex gratia* sum which is not referable to pay and which is in effect is an 'injury to feelings' type award for the distress caused. However, this may include cases where the sum was calculated using pay data as a reference point if there was no acknowledgement that back pay was due and no assertions made that the sum represented arrears of pay.
33. Professional Support will provide further guidance early next year on the work auditors should carry out in this area.

Leases

Deferral of IFRS 16 implementation

34. CIPFA/LASAAC has issued a [statement](#) announcing that the implementation of *IFRS 16 Leases* has been deferred one year to 1 April 2020. The statement encourages local government bodies to continue to progress their plans for implementation and ensure they have the information, processes and systems in place.
35. The statement also highlights that the main decision regarding the implementation of IFRS 16 that remains outstanding is the approach to the subsequent measurement of the right-of-use asset (see [technical bulletin 2018/2](#) - paragraph 43 for the options being discussed). More information is expected to be provided early in 2019.
36. Auditors should confirm that local government bodies are making adequate preparations for the implementation of IFRS 16.

Potential understatement of leases information in 2018/19

37. A number of local government bodies have carried out impact assessments and preparatory work for the implementation of IFRS 16. These exercises have surfaced issues around the completeness of information held on leases, particularly licences or agreements that are not described as leases but nevertheless meet the definition for accounting purposes. In many cases the agreements have been found to be held in service departments.
38. Auditors should consider whether this indicates a risk of understatements when reporting under existing leasing standards (IAS 17 and IFRIC 4) in 2018/19.

Section 106 charities

Number of statements of accounts

39. Audit Scotland continues to strongly encourage councils to reduce the number of section 106 charities that they administer. While there has been some progress, there remains considerable scope for further reductions. The following table provides a summary of the total number of section 106 charities in 2017/18, and the progress in reducing the total numbers since the audit requirement first applied in 2013/14:

| Year | Number of section 106 charities | Rationalisation progress |
|---------|---------------------------------|--------------------------|
| 2013/14 | 384 | - |
| 2014/15 | 389 | (5) |
| 2015/16 | 307 | 82 |
| 2016/17 | 270 | 37 |
| 2017/18 | 218 | 52 |

40. While the ultimate aim is to rationalise 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. The overall number of separate sets of statements of accounts that are required for section 106 charities can therefore be reduced by the effective application of the connected charities provisions.
41. There were 77 sets of accounts in 2017/18 (down 14 from 91 in 2016/17). [Module 13](#) (Appendix 1) of TGN 2018/10(LG) shows an analysis by council and indicates the extent to which the connected charities provisions were applied in 2017/18. Seven councils made no use of the connected charities provisions and a further two only partially applied them.
42. Auditors should:
- assess whether the council is making reasonable progress in rationalising the number of section 106 charities that it administers
 - encourage the council to make full use of the connected charities provisions in 2018/19, where there is scope to do so, so that the total number of sets of accounts that requires to be audited is minimised.

Grant claims and returns

Housing benefit subsidy claim

Guidance on UCFS

43. [The Department for Work and Pensions \(DWP\)](#) has issued [HB circular A7/2018](#) to provide guidance on the award of housing benefit (HB) in areas where *Universal credit full service* (UCFS) has been introduced.
44. The circular confirms the circumstances when: a new universal credit claim is required; a HB claim can remain in payment; and a new HB claim may be accepted.

Funding

45. The DWP has issued [HB circular S11/2018](#) to announce the 2018/19 funding arrangements for supporting the costs of reviewing the self-employed HB caseload.

Wider scope

Financial management

Financial overview

46. The Accounts Commission has issued a [report](#) to provide an analysis of the financial performance of councils during 2017/18 and their financial position at the year end. It also looks ahead and comments on the financial outlook for councils. The primary sources of information for the financial overview are councils' 2017/18 audited accounts and the 2017/18 annual audit reports for each council.
47. Key messages in the report include the following:
 - Scottish Government revenue funding to councils reduced in 2017/18 (in real terms) by 2.3%. Council tax increases and increased fees and charges were used by councils to increase overall budgets by £0.3 billion (cash terms).
 - In 2017/18, councils managed funding gaps of 4% in their net expenditure budgets of £12 billion, mainly through savings and planned use of reserves.
 - Eighteen councils ended 2017/18 with lower levels of usable reserves than they had at the start of the year. Total usable reserves fell by £18 million.
 - The financial outlook is for reductions in Scottish Government revenue funding to councils. This will mean continued and increasing financial pressures on council services.
 - The impact of EU withdrawal is not yet clear, but councils need to identify the risks and develop contingency plans to manage these risks.

Revised prudential code guidance notes

48. CIPFA has issued [guidance notes](#) to give local government bodies a practical interpretation of the prudential code to enable them to meet its key principles of ensuring that capital

programmes are affordable, prudent and sustainable and to explain this effectively to those charged with governance.

49. This revised guidance updates the 2013 version and includes changes made to the prudential code in 2017 (see [technical bulletin 2018/1](#) - paragraph 51).

Auditor action checklist

| | Yes/No/N/A | Initials/date | W/P ref |
|---|------------|---------------|---------|
| 1. Have you carried out the action required at paragraph 9 in respect of TGN 2018/10(LG)? | | | |
| 2. Have you carried out the action recommended at paragraphs 14 and 15 in respect of the disclosure checklist? | | | |
| 3. Have you carried out the action recommended at paragraph 17 in respect of the expiration of the statutory adjustments for equal pay and severance costs? | | | |
| 4. Have you carried out the action recommended at paragraph? | | | |
| 5. Have you carried out the action recommended at paragraph 21 in respect of loans fund repayments? | | | |
| 6. Have you carried out the action recommended at paragraph 27 in respect of borrowing in advance and investing in commercial properties? | | | |
| 6. Have you carried out the action recommended at paragraph 36 in respect of implementing IFRS 16? | | | |
| 7. Have you carried out the action recommended at paragraph 38 in respect of potential understatement of information on leases? | | | |
| 8. Have you carried out the action recommended at paragraph 42 in respect of section 106 charities? | | | |

Professional Support contact for local government chapter

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

Central government chapter

This chapter contains information on the main technical developments in the quarter that are relevant to appointed auditors in the central government sector.

Financial statements

Provisions

2018/19 discount rates

51. HM Treasury has issued PES(2018)12 to announce the discount rate for general provisions, post-employment benefit liabilities, and financial instruments as at 31 March 2019.
52. In previous years, Treasury issued real rates for discounting general provisions recognised under IAS 37. From 2018/19, Treasury is issuing nominal rates. This should be treated as a change in estimate rather than a change in accounting policy. The nominal discount rates to be applied as at 31 March 2019 are set out in the following table:

| Category | Period | Percentage |
|----------------|-------------------------------|------------|
| Short term | Within 5 years | 0.76% |
| Medium term | Between 5 and 10 years | 1.14% |
| Long term | Between 10 years and 40 years | 1.99% |
| Very long term | More than 40 years | 1.99% |

53. As nominal rates do not take inflation into account, cash flows require to be inflated separately. There is a rebuttable assumption that the inflation rates specified in the paper will be used (unless other rates are clearly more applicable). The specified rates are:
- 2% for up to two years from the year end
 - 2.1% for after two years.
54. The discount rates for post employment benefits are set out in the following table:

| Use | Rate from 31 March 2019 |
|---|-------------------------|
| Real rate used for valuing unfunded pension scheme liabilities and early departure provisions | 0.29% |
| Nominal rate for unwinding discount on liabilities (interest costs) | 2.90% |

| Use | Rate from 31 March 2019 |
|--------------------------------------|--|
| Rate used for funded pension schemes | Based on returns from AA corporate bonds at 31 March |

55. The financial instrument discount rates to be applied at 31 March 2019 are set out in the following table:

| Type | Rate |
|---|------|
| Real rate when financial instrument indexed to RPI | 0.7% |
| Nominal rate when financial instrument is not linked to an inflationary index | 3.7% |

56. Auditors should refer to this paper when reviewing the discount rates applied to provisions in 2018/19 financial statements.

Wider scope

Financial management

57. The [Scottish Government Finance directorate](#) has published two amendments to the [Scottish Public Finance Manual](#).
- [Finance guidance note 2018/08](#) amends the property, acquisition, disposal and management section to:
 - reflect the introduction of the *Community Empowerment (Scotland) Act 2015* which sets out the rights of communities to acquire rights in publicly owned assets. The guidance clarifies that decisions on sale at less than market value still need to be consistent with the principles of Best Value.
 - set out the minimum requirements necessary for inclusion in asset registers.
 - [Finance guidance note 2018/09](#) amends the definition of major investment projects to include criteria around complexity, innovation, impact and risk.

Professional Support contacts for central government chapter

58. The contacts in Professional Support for this chapter are:
- Neil Cameron, Manager (Professional Support) - 0131 625 1797 or ncameron@audit-scotland.gov.uk.
 - Helen Cobb, Senior Adviser (Professional Support) - 0131 625 1901 or hcobb@audit-scotland.gov.uk.

College chapter

This chapter contains information on the main technical developments in the quarter that are relevant to appointed auditors in the college sector, and guidance from Professional Support on any emerging risks.

Group financial statements

Significant influence over ALFs

59. Auditors have raised with Professional Support the issue of whether colleges exercise significant influence over their arm's-length foundations (ALFs). Significant influence is defined in FRS 102 as follows:
- If a college holds 20% or more of the voting power of an entity, it is presumed that it has significant influence, unless it can be clearly demonstrated that this is not the case.
 - Conversely, if the college holds less than 20%, it is presumed that there is not significant influence, unless such influence can be clearly demonstrated.
60. In order to gain an overall picture, Professional Support requested information from all college auditors in relation to the operation of ALFs. A number of colleges identified that they hold a voting share in excess of 20% in the ALF. In order to conclude on whether there is significant influence, auditors at these colleges should consider other issues around the operation of the ALF including whether there is evidence that:
- the ALF has approved applications from third parties
 - the ALF has rejected applications from the college
 - there is a clear applications process which has been applied consistently
 - the college can exercise influence included within the ALF governing documents.

Auditor action checklist

| | Yes/No/N/A | Initials/date | W/P ref |
|--|------------|---------------|---------|
| 1 Have you carried out the action recommended at paragraph 60 in respect of determining whether colleges have significant influence over ALFs? | | | |

Professional Support contact for further education chapter

61. The contact in Professional Support for this chapter is Helen Cobb, Senior Adviser (Professional Support) - 0131 625 1901 or hcobb@audit-scotland.gov.uk.

Professional developments chapter

This chapter contains information on the main professional developments in the quarter that are relevant to appointed auditors in the public sector.

Auditing developments

Thematic review on other information

62. The [Financial Reporting Council](#) (FRC) has issued a [report](#) following a thematic review of auditors' work on other information in the annual accounts. The 'other information' is all financial and non-financial information included in a body's annual accounts other than the financial statements and the audited parts of the remuneration report.
63. The FRC observed a number of instances where insufficient work was performed to support the statements auditors make in respect of the other information in the independent auditor's report. This increases the risk that material inconsistencies or misstatements may go undetected.
64. Revisions made to ISA (UK) 720 in 2016 raised the bar in terms of the work auditors were expected to perform on the other information. However, it is clear that auditors have not responded consistently to these additional expectations and that the revised standard has not been fully effective in achieving the objectives set for them. The FRC therefore proposes to look again at these as part of the FRC's post implementation review of the 2016 standards (referred to in the following item). In addition, auditors are expected to drive improvement in the following areas:
 - More prescriptive and targeted procedures, including templates and workbooks, to guide audit teams in the work they perform.
 - Specific consideration of the other information at the planning stage of the audit.
 - Greater emphasis on the review of key non-financial information, in addition to the financial information.
 - Increased scepticism and more attention on the completeness of the information, particularly the principal risk disclosures.
 - Ensuring staff with appropriate experience and knowledge of the audit are assigned to review the other information to identify potential material misstatements and inconsistencies.
65. Audit Scotland prescribes in technical guidance notes the procedures that appointed auditors are required to carry out (e.g. module 10 of [TGN 2018/10\(LG\)](#)).

Review of audit standards

66. The FRC is [consulting with stakeholders](#) to determine how effective the changes to ethical and auditing standards in 2016 have been in delivering high quality audit. The aims of the review of the standards are to:
- gather feedback on whether the changes made to standards have had the desired impact on auditor independence, prevention of conflicts and on audit quality
 - consider whether further measures are needed to address weaknesses, and ensure that audit better meets the expectations of those who rely on it
 - consider whether auditor reporting and communication with those charged with governance could be further strengthened to better meet the needs and expectations of users.
67. Feedback and responses to the review questions should be sent to AAT@frc.org.uk by 15 February 2019.

Review of statutory audit market in the commercial sector

68. The [Competition and Markets Authority](#) are carrying out a [review](#) to consider whether the market for the provision of statutory audit in the UK commercial sector is working as well as it should. The review comes amid growing concerns about statutory audits, in particular following the collapse of construction firm Carillion and the criticism of those charged with governance, as well as recent poor results from reviews of audit quality.
69. The review is examining three main areas in the market as summarised in the following table:

| Area | Issues |
|----------------------|---|
| Choice and switching | 97% of the audits of FTSE 350 companies are undertaken by the four biggest accountancy firms. |
| Resilience | The risk that each of the four firms is 'too big to fail', potentially threatening long-term competition. |
| Incentives | Companies pick their own auditor. The review is examining concerns that this might result in a lack of challenging performance reviews. |

70. Potential outcomes being considered include:
- Restricting or prohibiting the provision of non-audit-services.
 - Reducing the barriers for firms outside the biggest four (e.g. market share cap, joint audits, breaking up the Big 4 into smaller firms).
 - Moving responsibility for appointing auditors away from companies to an independent body.
71. Audit Scotland responded to the invitation to comment by explaining the benefits of the Scottish public sector audit model.

Accounting developments

Thematic review of IFRS 9

72. The [Financial Reporting Council](#) (FRC) has issued a [report](#) summarising the key findings of a thematic review of disclosures in 2018 interim accounts relating to the implementation of *IFRS 9 Financial instruments*.
73. The review aims to provide guidance for entities when considering the completeness of their year-end disclosures. Although the report focuses on banking entities, non-banking bodies are also considered. Key findings were that the following disclosures could be improved:
- Transitional disclosures analysing the principal differences between IAS 39 and IFRS 9.
 - Qualitative and quantitative disclosures regarding determination of significant increases in credit risk, including linkage to internal credit ratings.
 - Disclosure of estimation uncertainty, in particular quantification of sensitivities of expected credit losses to changes in assumptions.
 - Discussion of the business model in assessing the classification of financial assets.

Thematic review of IFRS 15

74. The FRC has also issued a [report](#) summarising the key findings of a thematic review of interim disclosures relating to the implementation of *IFRS 15 Revenue from contracts with customers*. The review found that the following disclosures could be improved:
- Information about transitional adjustments, and linking these to changes in accounting policies.
 - Clearer explanation of the changes made to accounting policies, including the reasons for the changes and the judgements made by management in arriving at the new policies.
 - Information about performance obligations, including judgements made in determining these and the timing of their satisfaction (i.e. when control transfers to the customer).
 - The impact on the balance sheet, including disclosure of accounting policies for new items such as contract assets and contract liabilities.

Narrative reporting developments

75. The FRC has issued [Performance metrics - principles and practice](#) as a result of a project on how entities report performance. The term 'performance metrics' means all forms of metric an entity might disclose. These may include financial metrics or wider metrics compiled under internationally recognised standards or frameworks, or according to decisions and policies at the entity level. Performance metrics presented in a fair, balanced and understandable way are key to the communication between companies and investors.
76. The report identifies five principles for reporting performance metrics which are summarised in the following table:

| Principle | Explanation | Achieved by: |
|---------------------|--|--|
| Aligned to strategy | Metrics that give users insight into the entity's performance and strategy and provide indicators of the sources of long-term value. | <ul style="list-style-type: none"> disclosing metrics that management uses internally, including where and how they link to remuneration providing a combination of metrics linked to their strategic objectives, competitive advantage and business model, which may involve incorporating operational metrics alongside higher-level KPIs explaining why the metrics are important. |
| Transparent | The ability for users to understand what the metric attempts to measure and how it does so. | <ul style="list-style-type: none"> providing an explanation for the use of metrics and a full break down of non-GAAP metrics being consistent and using the same, transparent format over a number of years demonstrating that metrics which investors would expect to be attributable to specific numbers in the financial statements or reconciliations are directly drawn from them. |
| In context | Explaining what a company was trying to achieve and what it has achieved, with explanations for where this is good or poor | <ul style="list-style-type: none"> disclosing targets for metrics, showing whether performance has achieved its target or not referencing an industry benchmark when disclosing performance where this is relevant; and providing a market context that is linked to how that context affects the company. |
| Reliable | Sufficient governance and oversight the use and reporting of the metrics | <ul style="list-style-type: none"> making the governance and oversight over metrics clear explaining the levels of scrutiny to which metrics have been subjected highlighting third party information in conjunction with internal information where relevant to strategic objectives. |
| Consistent | Consistent reporting across time and reporting formats, helps build credibility | <ul style="list-style-type: none"> consistent information across reporting formats, even if it is presented differently for different audiences performance with reference to industry benchmarks or standards a five-year track record. |

Professional Support contact for chapter

77. The contact in Audit Scotland's Professional Support for this chapter is Paul O'Brien, Senior Manager (Professional Support) - 0131 625 1795 or pobrien@audit-scotland.gov.uk.

Fraud and irregularities chapter

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

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

Expenditure

Change of bank details

78. A third party defrauded £29,000 from a public body by re-directing payments intended for a legitimate supplier.

Key features

The purchase team received several emails purporting to be from a supplier. Further emails from the fraudulent email requested that bank details were amended. Subsequently a payment was made to the amended bank account.

The fraud was possible as:

- no phone call was made to the supplier to confirm the change of bank account
- subtle differences from the usual email address were not spotted.

Auditor action checklist

| | Yes/No/N/A | Initials/date | W/P ref |
|--|------------|---------------|---------|
| 1 Have you considered whether the weaknesses in internal control that facilitated each fraud may apply at your audited bodies? | | | |

Professional Support contact for fraud and irregularity chapter

79. The contact in Professional Support for this chapter is Anne Cairns, Manager (Professional Support) on 0131 625 1926 or acairns@audit-scotland.gov.uk