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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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.

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.

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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 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
Summary of proposed change *IAS 19 Employee benefits: Plan amendment, curtailment or settlement* 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. 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.		

Legislative and policy changes

Subject: Transfers to statutory reserves	ITC paragraphs: 53 to 55	Exposure draft: B1

Summary of proposed change

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.

Subject: Statutory adjustments for the revaluation elements of depreciation	ITC paragraphs: 56 to 59	Exposure draft: B2

Summary of proposed change

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.

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.

Conceptual framework

Subject: Concepts and principles	ITC paragraphs: 69 to 72	Exposure draft: C1

Summary of proposed change

The main areas for change included in section 2.1 of the accounting code arising from the new conceptual framework are:

- 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
Summary of proposed change The following proposed definitions have been added: • 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
Summary of proposed change It is proposed to add explanatory information on statutory adjustments, i.e. the statutory requirements that establish what is chargeable to the general fund.		

Post implementation reviews

Subject: Group accounts	ITC paragraph: 78	Exposure draft: N/A
Summary of consultation The consultation seeks views on: • 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
Summary of consultation The consultation seeks views on whether the code: • should include more specific guidance on *IFRS 3 Business combinations* • 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
Summary of consultation The consultation seeks views on whether the code should be specific about the treatment of third party income for service concession arrangements.		

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: • 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 *The Trade Union (Facility Time Publication Requirements) Regulations 2017* 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 *Code of good governance for Scotland's colleges*. 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:

<table>
<tr><th>Module</th><th>Content</th></tr>
<tr><td>Overview</td><td>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</td></tr>
<tr><td>1 Tangible fixed assets</td><td rowspan="3">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.</td></tr>
<tr><td>2 Provisions, creditors and accruals</td></tr>
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<tr><td>4 Other financial statement areas</td><td>As for modules 1 to 3 but this module includes a number of financial statement areas including leases, intangible assets, government grants etc</td></tr>
<tr><td>5 Regularity of expenditure and income</td><td>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.</td></tr>
<tr><td>6 Non-financial statements</td><td>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.</td></tr>
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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	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: • smooth any volatility in reported results • recognise that some of the reported costs do not have an immediate cash impact on the college. Adjustments should only include figures which are visible elsewhere in the accounts. Colleges are required to provide a short explanation of the adjusting items. A model note has been added at Annex G.

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	These include: • using wording to drive questioning or challenging management where appropriate • more focus on identifying indicators of possible management bias • requiring further audit procedures to be designed and performed in a manner that is not biased toward obtaining audit evidence that may be corroborative or towards excluding audit evidence that may be contradictory • an enhanced retrospective review and an overall evaluation based on procedures performed.
Emphasising the importance of the need to consider internal control.	There are improved linkages to ISAs(UK) 315 and 330.
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.ukby 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