Technical Bulletin 2019/4

Technical developments and emerging risks from October to December 2019

Prepared for appointed auditors and audited bodies in all sectors

11 December 2019

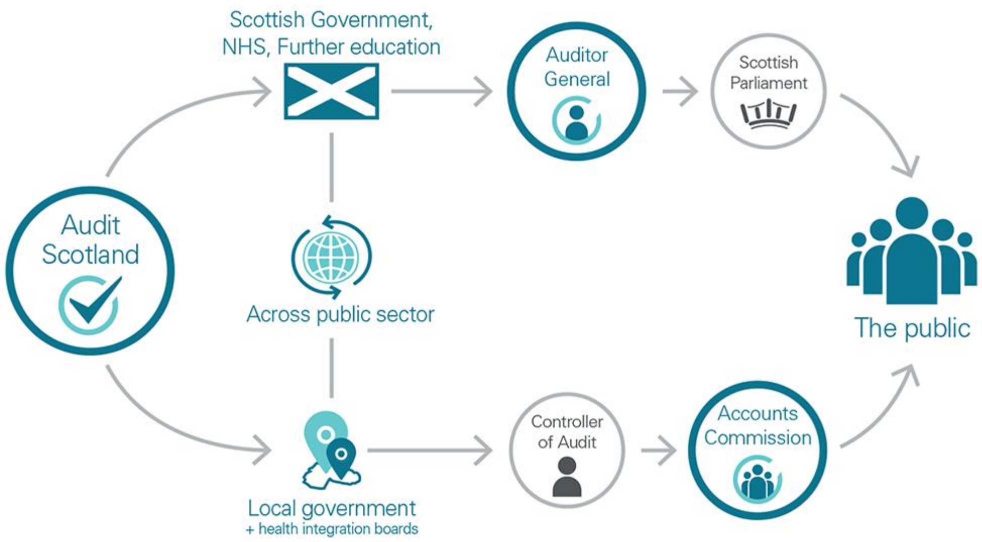
Who we are

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

- The Auditor General is an independent crown appointment, made on the recommendation of the Scottish Parliament, to audit the Scottish Government, NHS and other bodies and report to Parliament on their financial health and performance.

- The Accounts Commission is an independent public body appointed by Scottish ministers to hold local government to account. The Controller of Audit is an independent post established by statute, with powers to report directly to the Commission on the audit of local government.

- Audit Scotland is governed by a board, consisting of the Auditor General, the chair of the Accounts Commission, a non-executive board chair, and two non-executive members appointed by the Scottish Commission for Public Audit, a commission of the Scottish Parliament.



About us

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

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

- carrying out relevant and timely audits of the way the public sector manages and spends money

- reporting our findings and conclusions in public

- identifying risks, making clear and relevant recommendations.

Contents

Introduction

Purpose

1. The purpose of Technical Bulletins from Audit Scotland's Professional Support is to provide auditors appointed by the Auditor General and Accounts Commission with:
   - information on the main technical developments in each sector and on professional matters during the quarter
   - guidance on any emerging risks identified in the quarter.
2. Appointed auditors are required to pay due regard to Technical Bulletins. The information on technical developments is aimed at highlighting the key points that Professional Support considers auditors in the Scottish public sector require to be aware of. It may still be necessary for auditors to read the source material if greater detail is required. These can be accessed by using the hyperlinks. They are also available from the Technical Reference Library maintained by Professional Support.

Technical Bulletins provide information on developments and guidance on emerging risks

3. The actions by auditors recommended by Professional Support in respect of each item are highlighted in red and are also summarised at the end of each section.
4. Technical Bulletins are also published on the Audit Scotland website and therefore are available to audited bodies and other stakeholders. Hyperlinks indicated with an asterisk link to the Technical Reference Library and therefore are active only for auditors.

Highlights summary

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

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

Contact point

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

Feedback on this Technical Bulletin is welcome

Section 1
Cross-sector

Guidance on planning 2019/20 audits

7. Professional Support has issued guidance to assist all appointed auditors in planning their 2019/20 audits. The guidance covers the main activities that comprise core audit work and the products associated with each activity.

8. The following table provides a summary of the key changes from last year, along with the section of the guidance in which further information is provided:

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

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

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

Summary of auditor actions in this section

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

Contact point for this section

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

Section 2
Local government sector

Auditing developments

Technical Guidance Note on risks of misstatement in 2019/20

12. Professional Support has published Technical Guidance Note (TGN) 2019/9(LG) to provide auditors with guidance on planning and performing the audit of 2019/20 annual accounts of local government bodies.

13. The TGN is intended to inform auditors' judgement when identifying and assessing the risks of material misstatement in 2019/20. The TGN supplements the Code of Audit Practice and auditors are expected to pay it due regard and use it as a primary reference source when performing 2019/20 audits.

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

14. The TGN structure comprises a number of modules:

- The Overview Module provides an overall introduction and covers risks of misstatement in areas that are pervasive to the financial statements as a whole.
- Modules 1 to 9 set out risks of misstatement for specific classes of transactions, balances and disclosures in the financial statements. These modules explain the appropriate related accounting treatment and set out the action auditors should undertake to evaluate whether the body has followed the required treatment.
- Module 10 covers the audited part of the Remuneration Report
- Module 11 sets out procedures for Statutory Other Information (i.e. Management Commentary and Annual Governance Statement).

15. The TGN also provides specific guidance on the application of the above modules to integration joint boards (Module 12), pension fund accounts (Module 13) and section 106 charity accounts (Module 14).

16. As part of the package of enhancements being made to the Technical Reference Library, a dedicated page* has been created for auditors to access which contains hyperlinks to each module. A version of the TGN which combines all the modules is also freely available from the Audit Scotland website.

17. In summary, TGN 2019/9(LG) has been updated/revised as follows:

- The modules have been streamlined to focus solely on risks of misstatement in the annual accounts.
- New risks of misstatement have been added to reflect frequently asked questions arising from 2018/19 audits and changed requirements in 2019/20 (particularly Modules 1, 2, 3 and 9); guidance has been refreshed/enhanced on some pre-existing risks; and a number of risks included last year have been removed as their likelihood or impact has reduced.
- Risks related to employee benefits are now all within the same module (Module 4).
- Risks related to the audited part of the Remuneration Report are now in a separate module (Module 10).
- Module 11 on Statutory Other Information has been revised to align with the audit quality report from the FRC into audit quality in that area.

Review into external audit in England

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

The review scope is restricted to England

19. However, the review has assumed greater significance due to other concurrent reviews into audit quality not least the Kingman Review (explained at paragraph 125 of Technical Bulletin 2019/1) which recommended that the arrangements for local audit in England needed to be fundamentally rethought.

20. The Redmond Review is examining the existing purpose, scope and quality of local government audits and the supporting regulatory framework in order to determine whether:

- they are operating in line with the policy intent set out in the 2014 Act
- the reforms have improved the effectiveness of the framework along with the transparency of financial information presented by local government bodies
- the current statutory framework for local government financial reporting supports the transparent disclosure of financial performance and enables users of the accounts to hold bodies to account.

21. In order to inform its conclusions, the Redmond Review has issued a call for views on the quality and effectiveness of the audit of local government in England and the transparency of financial reporting. Views are particularly sought on how the accounts and audit could be improved to provide greater assurance to locally elected members along with local taxpayers and service users. The paper asks for views on whether:

- the external audit process covers the right things given the interests of the primary users
- auditors have sufficient understanding of the business to focus on the right risks
- going concern reporting by auditors is meaningful when assessing the body's resilience
- auditor reporting is timely and communicates useful information
- statutory adjustments drive sub-optimal behaviours.

The paper questions the meaningfulness of going concern audit reporting

22. Views should be sent to Redmond.Review@communities.gov.uk by 20 December. Although the scope of the review is restricted to England, Audit Scotland has submitted a response to explain how the public audit model in Scotland operates.

Financial statements developments

2019/20 guidance notes

23. The Chartered Institute of Public Finance and Accountancy (CIPFA) has issued guidance notes* on the 2019/20 accounting code*. The overall aim of the guidance notes is to explain and illustrate how to apply the accounting requirements of the accounting code, provide background to those requirements, and illustrate how they might be applied in practical situations. The guidance is not mandatory.

The guidance notes are not mandatory

24. This edition of the guidance notes has been updated to reflect changes to the 2019/20 accounting code including the following:

- Module 1 augments the description of adaptations and interpretations of standards, explains the process for identifying statutory adjustments, and confirms the relevance of application guidance within standards.
- Module 2 (Section A) reflects changes to the accounting code arising from the revisions to the Conceptual Framework in relation to: the objectives of the financial statements; qualitative characteristics of useful financial information; and definitions of assets, liabilities, income and expenses.
- Module 3 (Section A and Section F) includes guidance on how to reflect voluntary transfers between the Revaluation Reserve and the General Fund in the Movement in Reserves Statement and Expenditure and Funding Analysis.
- Module 4 provides guidance on accounting for voluntary transfers of an element of the revaluation gain to General Fund balances.

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

25. Other aspects of the guidance notes that auditors may find it helpful to refer to are summarised in the following table:

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

2019/20 disclosure checklist

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

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

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

28. Auditors should:

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

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

Auditor action

Auditors should carry out the actions at paragraphs 28 and 29

Discussion papers on improving local government financial reporting

The discussion paper sets out options for improving financial reporting

30. The CIPFA/LASAAC Local Authority Code Board has issued a discussion paper on improving local government financial reporting. The paper discusses the requirements for local government accounts, particularly in respect of identifying users, focusing on their needs, presenting information and addressing issues relating to specific topics.

31. Some of the key issues are summarised in the following paragraphs.

Primary users

Primary users have an interest in accountability for public resources

32. The discussion paper suggests that the accounting code should more explicitly identify primary users of the accounts as those who have an interest in local government's accountability for public resources. This would clearly recognise the stewardship role of elected members in administering public resources, on behalf of current and future taxpayers and service users.

33. The accounting code could also include a specific requirement to assess relevance and faithful representation, including materiality, based on the needs of such primary users. Potentially, the accounting code could require the provision of additional information for other significant user groups, provided this does not obscure the information for the primary users.

34. A requirement to disclose the judgements made regarding the relevant user groups, and their needs, may be appropriate.

Statutory adjustments

35. Primary users need clear information concerning the receipt and application of taxation funding. The discussion paper suggests that a specific section of the financial statements could therefore be developed relating to taxpayer funding. Examples of possible content are:

A separate section on taxpayer funding is suggested

- taxpayer funds used to provide services in the reporting year
- commitments of future taxpayer funding streams arising from statutory adjustments
- the stewardship of taxpayer funds under the statutory adjustment framework
- financial risks related to the commitment of future taxpayer funding arising from statutory mitigation arrangements.

36. The discussion paper also considers whether the accounting code's adaptations and interpretations are appropriate alternatives to statutory adjustments in some instances.

Comprehensive Income and Expenditure Statement

CIES could focus on statutory costs

37. The adaptation of normal accounting presentation requirements should be considered so that the Comprehensive Income and Expenditure Statement (CIES) reflects the expenditure supported by taxation. One option could be to split the Surplus or Deficit on Provision of Services (SDPS) section between statutory cost (to clearly show the expenditure charged to taxpayer funds), and the adjustments made to reflect accounting standards. Examples of presentation are illustrated in Appendix A of the paper.

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

38. A further question is whether a service analysis is required for the CIES if such an analysis is provided in a separate section related to taxpayer funds. This could allow an analysis in the CIES based on type, rather than purpose, of expenditure (e.g. by employee costs, property costs etc).

Capital

39. The paper considers the cost of assets valuation and the maintenance of the detailed accounting information required. It challenges the relevance and role of precise market-based valuation for primary users, and suggests a change in focus and direction relating to the application of current value.

40. In particular, the level of accuracy required could be more appropriately balanced with the costs incurred. Adaptations could specify that current value information is provided to meet primary user needs, not for the purposes of valuing a local government body nor for an assessment of the security available to lenders. The specification could support an appropriate degree of estimation which better reflects the costs and benefits arising from current value information.

Appropriate estimating of asset values

41. The paper also raises the potential to:

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

Pensions

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

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

Pension liabilities in the Balance Sheet could be replaced with disclosures

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

Financial instruments

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

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

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

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

Group

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

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

Differential reporting

49. CIPFA/LASAAC has also issued a related discussion paper on the concept of differential reporting.

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

Bodies could apply different financial reporting requirements depending on their size

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

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

52. A differential reporting framework could be a potential solution where the volume and complexity of accounting standards mean the cost of producing financial statements outweigh their benefits.

53. The paper presents a number of options for a differential reporting framework in local government, and highlights some of the challenges.

Options are discussed for differential reporting in local government

Wider audit scope developments

New financial management code

54. CIPFA has published a [Financial Management (FM) Code*] which is designed to support good practice in financial management and to assist local government bodies in demonstrating their financial sustainability.

55. Local government bodies are required to apply the requirements of the FM Code with effect from 1 April 2020 on a 'shadow year' basis. The first full year of compliance will therefore be 2021/22, with earlier adoption encouraged. Bodies will be required to demonstrate that the requirements of the FM code are being satisfied.

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

56. The principles that underlie the FM Code are summarised in the following table:

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

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

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

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

Principles are supported by standards which require to be complied with

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

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

Summary of auditor actions in this section

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

Contact point for this section

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

Section 3

Central government sector

Accounting developments

Consultation on 2020/21 FReM

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

Proposal to restructure FReM

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

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

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

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

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

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

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

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

New Performance Report requirements

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

Wider scope developments

Changes in severance policy

68. The Scottish Government has issued Finance Guidance Note 2019/6 to announce amendments to the Settlement Agreements, Severance, Early Retirement and Redundancy Terms chapter of Scottish Public Finance Manual to reflect changes in the severance policy.

69. The key features of the new policy are summarised in the following table:

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

£95,000 cap on payments

Contact point for this section

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

Section 4

Professional matters

Auditing developments

Revised standard on going concern

71. The Financial Reporting Council (FRC) has issued a revised version of ISA (UK) 570 Going Concern.

72. The ISA is closely related to IAS 1 Presentation of Financial Statements which requires the adoption of the going concern basis of accounting in financial statements, except in circumstances where management intends to liquidate the entity or to cease trading, or has no realistic alternative than to do so.

73. This requirement applies even when there are uncertainties about events or conditions that may cast significant doubt upon the entity's ability to continue as a going concern in the future.

The ISA is concerned with the going concern basis of accounting

74. The term 'going concern' as used in the ISA applies to any entity unless its management intends to liquidate the entity or to cease trading, or has no realistic alternative. The term 'ability to continue as a going concern' is equivalent to the term 'ability to continue to adopt the going concern basis of accounting' in the future.

75. The auditor's responsibilities are to obtain sufficient appropriate audit evidence regarding, and conclude on:

- whether a material uncertainty related to going concern exists; and
- the appropriateness of management's use of the going concern basis of accounting in the preparation of the financial statements.

76. A summary of the main changes in this revised version are set out in the following table:

Area	Proposed change
Linking to other ISAs	Links from ISA (UK) 570 to important principles in other ISAs have been enhanced to: • better demonstrate how they are applied in respect of going concern • provide an improved basis for the evaluation of management's assessment of the body's ability to continue to adopt the going concern basis of accounting.
Strengthening the objectives	The objectives of the ISA have been revised to require the auditor to obtain sufficient appropriate audit evidence about whether a material uncertainty related to going concern exists.
Enhancing risk assessment procedures	Clearer links have been drawn between the auditor's responsibilities in respect of going concern and the auditor's understanding of the body and its environment, the applicable financial reporting framework, and the body's system of internal control.
Evaluating management's assessment	The auditor's work effort in relation to the evaluation of management's assessment should be more robust including a more rigorous challenge of the method, information and assumptions.

Area	Proposed change
Professional scepticism and management bias	Additional requirements and application material have been added to enhance the auditor's application of professional scepticism and consideration of the potential for management bias. This includes a definition of management bias being added (i.e. a lack of neutrality by management in the preparation of information).
Enhanced auditor reporting	Where the going concern basis of accounting is appropriate, a new requirement for the auditor's report for listed entities has been added to include: • an explanation of how the auditor evaluated management's assessment of the body's ability to continue as a going concern and where relevant, key observations arising with respect to that evaluation • a conclusion that management's use of the going concern basis of accounting is appropriate • where no material uncertainty has been identified, a statement that the auditor has not identified a material uncertainty related to going concern.
Strengthening communication with those charged with governance	A new requirement has been added to place more emphasis on communications with those charged with governance in situations where management is unwilling to make or extend its assessment when requested to do so by the auditor.
Communicating with regulators	A new requirement has been added for the auditor to consider whether there are any requirements beyond the ISAs which would require the auditor to report to a regulator.

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

Report on developments in audit during 2019

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

Insufficient challenge of management

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

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

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

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

81. Other inspection findings include:

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

Accounting developments

Guide on selection accounting policies

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

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

Entities should follow three steps

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

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

Review of impairment disclosures

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

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

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

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

Some good practice examples but also common omissions

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

Review of IFRS 16 disclosures

88. The FRC has issued a report following a thematic review of interim disclosures in respect of IFRS 16 Leases. The review identified a number of areas where disclosure could be improved, including the following:

- Information about key accounting judgments made on adopting the new standard which explains the specific judgements made and the effect on the financial statements, e.g. in respect of the lease term, and whether a contract contains a lease.
- Clearer explanations of the specific transition choices made.
- A detailed reconciliation between the operating lease commitment under the previous standard and the new lease liability, with clear explanations for reconciling items.
- Alternative performance measures should be properly labelled, reconciled and explained, and not given more prominence than the IFRS-based measures.

Disclosures should explain impact of adopting IFRS 16

Contact point for this section

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

Section 5

Fraud and irregularities

Auditor action

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

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

Expenditure

Grant payments

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

Key features

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

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

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

Invalid supplier

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

Key features

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

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

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

The matter has been reported to Police Scotland.

Change of bank details

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

Key features

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

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

Key features
Payroll staff have been reminded of the requirement to verify changes. They have also received information on how to spot fraudulent emails. The case has been referred to Police Scotland.

Abuse of mobile telephone

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

Key features
The council had placed a mobile phone in a locked box at the customer's home for use by support workers. The customer managed to access the phone and used it to make calls to premium services over the period of a month. The fraud was identified when the telephone bill was received by the council. The fraud was possible as the telephone did not have a PIN authorisation code to prevent unauthorised access. The case has been reported to Police Scotland and the customer charged.

Summary of auditor actions in this section

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

Contact point

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

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