

# Technical Bulletin

## 2020/1

Technical developments and emerging risks  
from January to March 2020



 AUDIT SCOTLAND

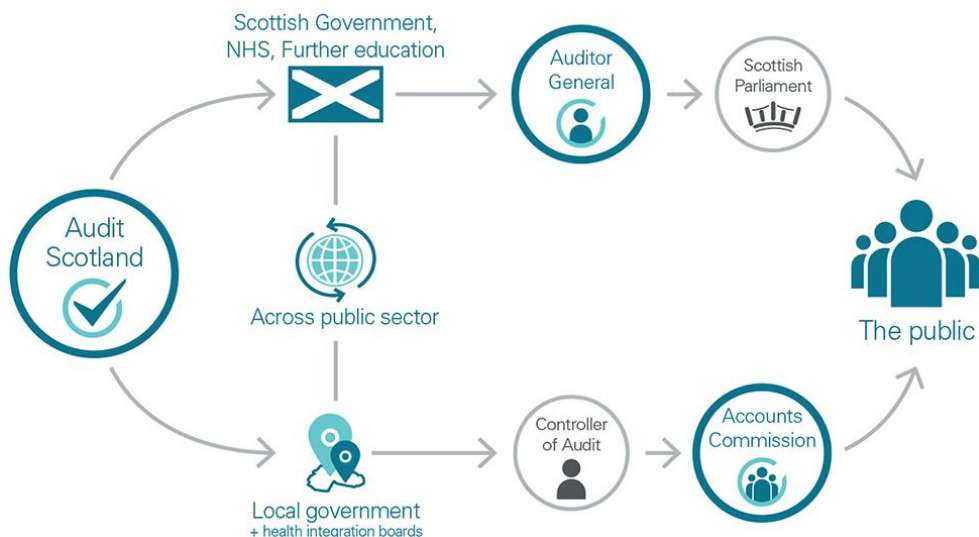
Prepared for appointed auditors and audited bodies in all sectors

31 March 2020

## 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.

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# 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.
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.

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Technical Bulletins provide information on developments and guidance on emerging risks

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## Highlights summary

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

Highlights summary		
The Financial Reporting Council has issued guidance on issues arising from the COVID-19 pandemic [see paragraph 8]	Professional Support has published guidance for auditors on dealing with statutory objections to the unaudited 2019/20 local government annual accounts [see paragraph 14]	Professional Support has published a protocol for audit assurances in respect of the Local Government Pension Scheme [see paragraph 15]
CIPFA has issued guidance on IFRS 16 in local government [see paragraph 20]	CIPFA has issued a briefing on accounting for the McCloud and Sargeant judgements in 2019/20 [see paragraph 25]	Professional Support has published a Good Practice Note on Management Commentaries [see paragraph 30]
Professional Support has published guidance on risks of misstatement in 2019/20 annual report accounts of central government bodies [see paragraph 35]	Treasury has issued the 2019/20 and 2020/21 editions of the FReM [see paragraphs 41 and 43 respectively]	Professional Support has published 2019/20 model Independent Auditor's Report for health boards [see paragraph 68]

## Highlights summary

The Scottish Government has issued the 2019/20 accounts manual for health boards [see paragraph 74]

The Technical Accounting Group has issued guidance on applying IFRS 15 to research and development contracts [see paragraph 78].

The Financial Reporting Council has issued a number of revised auditing standards [see paragraph 83]

The Financial Reporting Council has issued an exposure draft of proposed revisions to ISA (UK) 315 on auditing estimates [see paragraph 84]

The Bryden Review has issued a report on the quality and effectiveness of audit [see paragraph 87]

The International Accounting Standards Board has issued an exposure draft on improving the presentation of and disclosures in the financial statements [see paragraph 88]

## Impact of COVID 19

- This bulletin refers to some developments that relate specifically to the [COVID 19](#) pandemic. However, COVID 19 has the potential to impact on many of the items included in this bulletin, particularly any dates referred to. While information is correct at the time of publication on 31 March 2020, all items may therefore be subject to change in due course, including changes arising from the forthcoming Coronavirus (Scotland) Act 2020 and proposals around local government annual accounts.

## Contact point

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

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Feedback on this  
Technical Bulletin is  
welcome

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# Section 1

## Cross sector

### COVID-19-related accounting and auditing guidance

8. The [Financial Reporting Council](#) (FRC) has issued guidance for both auditors and preparers of financial statements on issues arising from the COVID-19 pandemic.
9. Initial [audit guidance](#) acknowledged the practical difficulties in preparing financial statements and carrying out audits, and the need for auditors to develop alternative audit procedures to gather sufficient, appropriate audit evidence. However, the guidance is clear that this should not undermine the delivery of high quality audits, which should continue to comply fully with international standards on auditing. Where additional time is required to complete audits, it is important that this is taken even at the risk of not meeting deadlines.
10. The FRC followed up that initial guidance with a [bulletin](#) that provides a list of factors auditors should be considering when carrying out audits in the current circumstances, along with guidance on how they might be addressed. Some key points raised in the bulletin are as follows:
  - The impact of COVID-19 is likely to require auditors to revisit their risk assessment and the proposed response to identified risks. In particular, auditors should consider whether their assessment of risks of material misstatement due to fraud or irregularity needs to be heightened.
  - Auditors will need to agree with audit committees how to communicate with them through means other than physical meetings.
  - Given restrictions on travel, movement and visiting sites, auditors will need to think about whether there are other ways for them to obtain sufficient, appropriate audit evidence, including greater use of technology.
  - Auditors' assessment of the sufficiency and appropriateness of audit evidence should be clearly documented on the file. The assessment should recognise how the auditor addresses any risk that the quality and reliability of such evidence may be lower, for example through more directed testing of items.
  - Auditors should identify those items where the verification of original source documentation or physical assets are absolutely vital.
  - The current circumstances may lead to more modified opinions in the Independent Auditor's Report. This may be where sufficient appropriate audit evidence cannot be obtained or due to the existence of material misstatements caused by, for example, the failure to recognise the impairment of assets or adequate provisions for obligations, or to provide related disclosures.
  - Where auditors intend to modify their opinion, they should engage with audit committees to explain whether the nature of the modification may be ameliorated by allowing the auditor additional time to undertake their work, and obtain the evidence required.
  - Auditors will need to consider how they demonstrate and record an appropriate level of professional scepticism to reflect that audits may be delivered in a different way.
11. The FRC has also issued [guidance](#) aimed at the boards of entities on disclosing risks and uncertainties related to COVID 19, as well as [further guidance](#) on corporate governance and reporting in an environment impacted by COVID 19 which:
  - highlights some key areas of focus in maintaining strong corporate governance
  - provides high-level guidance on some of the most pervasive issues when preparing the annual report and other corporate reporting.

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**Auditors should continue to comply fully with required standards**

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**Factors for auditors to consider**

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**12.** The guidance highlights that the need for clear leadership, robust governance and effective decision making based on reliable information is stronger than ever. It advises boards to develop and implement mitigating actions and processes to ensure that they continue to operate an effective control environment. This should address key reporting and other controls on which entities have placed reliance historically, but which may not prove effective in the current circumstances.

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**The need for robust  
governance is  
stronger than ever**

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**13.** The guidance in respect of corporate reporting covers:

- the need for narrative reporting to provide forward-looking information that is specific to the entity
- the increased importance of providing information on significant judgements applied in the preparation of the financial statements, sources of estimation uncertainty and other assumptions made
- the judgement required in determining the appropriate reporting response to events after the reporting date and the extent to which qualitative or quantitative disclosures may be appropriate.

# Section 2

## Local government sector

### Auditing developments

#### Technical Guidance Note on statutory objections in 2019/20

14. Professional Support has published [Technical Guidance Note \(TGN\) 2020/3\(LG\)\\*](#) to provide auditors with guidance on dealing with statutory objections to the unaudited 2019/20 local government annual accounts.

#### Auditor action

**Auditors should pay due regard to TGN 2020/3(LG)**

#### Assurance protocol on LGPS

15. Professional Support has published a [protocol\\*](#) which provides an agreed framework for:
- Local Government Pension Scheme (LGPS) pension fund auditors to request assurances from employer body auditors in respect of pension contributions payable by the employer body to the pension fund
  - employer body auditors to request assurances from pension fund auditors in respect of information provided by the pension fund to the actuary in relation to their reports on employer bodies.
16. Auditors may judge that it is not necessary to request any assurances from other auditors. However, where assurances are judged to be appropriate, this protocol sets out the potential range of assurances.

### Financial statements developments

#### Suspension of 2019/20 accounting code

17. The [Chartered Institute of Public Finance and Accountancy](#) (CIPFA) and the Chair of the [CIPFA/LASAAC Local Authority Code Board](#) have issued a [joint statement](#) on proposals to replace the 2019/20 Code of Practice on Local Authority Accounting in the UK (accounting code) with a simplified version in order to ease the burden as local authorities respond to the impact of COVID-19.
18. The proposal is to be discussed by CIPFA/LASAAC in early April. Professional Support will advise auditors of the outcome of the discussions in due course. Even if agreed, any change would be subject to approval from the Financial Reporting Advisory Board and other stakeholders.

**Proposal to replace 2019/20 accounting code with a simplified version**

#### Guidance on leases under IFRS 16

19. CIPFA has issued [IFRS 16 An Early Guide for Local Authority Practitioners\\*](#) to provide guidance on how the provisions of IFRS 16 Leases are expected to apply in local government. The guide covers requirement in respect of:
- the identification of leases
  - the recognition of right-of-use assets and liabilities and their subsequent measurement
  - treatment of gains and losses
  - derecognition and presentation and disclosure in the financial statements
  - the management of leases within the Prudential Framework.
20. The guide also covers the transitional arrangements for moving to these new requirements, such as:
- the recognition of right-of-use assets and liabilities for leases previously accounted for as operating leases by lessees



- the mechanics of making the transition, including the application of transitional provisions and the preparation of relevant disclosure notes.

### Draft revised statutory guidance on financial instruments

21. The [Scottish Government](#) has issued a [consultation draft\\*](#) of proposed revisions to the statutory guidance on financial instruments. The proposed revisions, currently intended to apply from 2019/20, relate to the use of capital receipts to fund premiums incurred on the early repayment of debt.
22. As capital receipts held in the Capital Fund (or Capital Receipts Reserve) cannot be used to fund the cost of premiums, it is proposed that capital receipts that are to be used in that way should be:
  - credited directly to the Capital Grants and Receipts Unapplied Account as a statutory adjustment
  - transferred from the Capital Grants and Receipts Unapplied Account to the General Fund as a movement in reserves.
23. Capital receipts may be used to fund the cost of premiums as they are incurred or to fund the annual charge for those premiums that have been deferred and held in the Financial Instruments Adjustments Account (FIAA). The draft guidance therefore sets out four possible scenarios, depending on whether:
  - the local authority wants to fund the premium when incurred or the annual charge
  - the receipt will be applied in the year received or set aside.
24. The four scenarios, and the particular requirements applying to each, are summarised in the following table:

Fund	Capital receipt	Requirements
Annual charge	Received in year	The value of the capital receipt transferred cannot be more than the annual charge to be funded
	Set aside	Additional charges require to be made equal to the capital receipt being set aside for that use, and the schedule of annual charges adjusted accordingly
Premium when incurred	Received in year	The value of the capital receipt transferred cannot be more than the premium to be funded
	Set aside	This option is available only if there are no deferred premiums held in the FIAA

### Bulletin on accounting for McCloud judgement

25. CIPFA has issued a [briefing](#) on accounting for the McCloud and Sargeant judgements (the judgements) in 2019/20.
26. The briefing advises that the announcement in July 2019 by the Treasury that the judgements would apply to all public service pension schemes confirms that the judgements create a legal obligation for the LGPS. All members of the schemes who fell outside the transitional arrangements at the transition date will need to have their benefits brought up to the level of members who were protected under those arrangements. The valuation of the IAS 19 liability should therefore take into account the expected impact.
27. As details of the remedy for the schemes are not yet available, there is uncertainty about the basis for valuing the impact of the judgements. Nonetheless estimation needs to be undertaken by actuaries based on the membership profile of the individual body, rather than the scheme as a whole. Therefore, bodies should be engaging actuaries to provide IAS 19 valuations using assumptions specific to each body, and the body's membership profile.
28. The appropriate accounting treatment in 2019/20 depends on whether the impact of the judgements was recognised in the pension liability in 2018/19 as summarised in the following table:

Capital receipts held in the Capital Fund cannot be used to fund premiums

IAS 19 liability should take into account the expected impact of the judgements.

Recognised in IAS 19 liability in 2018/19	Treatment in 2019/20
Yes	Changes in the liability arising from changes in assumptions should be treated as an actuarial gain/loss
No	Recognition of the liability for the impact of the judgement as a past service cost

29. Bodies should consider the need to disclose information about the basis of estimation where these might have a significant risk of material adjustment to the carrying amount within the next 12 months.

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**Auditor action**  
Auditors should confirm that the impact of the judgements is properly reflected

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## Statutory other information developments

### Good practice note on Management Commentaries

30. Professional Support has published a [Good Practice Note](#) following a review of the 2018/19 Management Commentaries within the annual accounts of Scotland's 32 councils. The review goes beyond basic compliance, and considers eight characteristics of financial reporting which Professional Support believes make for a high quality Management Commentary. The [Good Practice Note](#) is structured around these characteristics, and it discusses and highlights some of the good practice adopted by councils in relation to each one. The note also includes points for councils to consider in striving to achieve good practice.
31. The review was carried out by a team with knowledge of the relevant financial reporting framework. However, the team does not have a detailed understanding of each council's particular circumstances or the specific underlying transactions. The illustrations used in the Good Practice Note are all taken unchanged from councils' 2018/19 Management Commentaries.
32. Bodies are encouraged to use the findings in this [Good Practice Note](#) to assess and enhance their own Management Commentary.

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**Auditor action**  
Auditors should encourage bodies to use the Good Practice Note

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## Grant claims and other returns developments

### Housing benefits

33. [The Department for Work and Pensions \(DWP\)](#) has issued the housing benefit subsidy claim form and notes for its completion for 2019/20 as well as:
- [HB Circular A1/2020](#) and [HB Circular A2/2020](#) to advise of respectively the benefits rates war pension rates from April 2020
  - [HB circular A3/2020](#) to set out changes to the severe disability premium process from March 2020.

## Summary of auditor actions in this section

Paragraphs	Auditor actions
14	Pay due regard to TGN 2020/3(LG) when dealing with objections to the 2019/20 annual accounts
26 - 30	Confirm that the impact of the McCloud judgement is properly reflected in the IAS 19 liability at 31 March 2020
31 - 34	Encourage bodies to use the Good Practice Note on Management Commentaries

## Contact point for this section

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

# Section 3

## Central government sector

### Auditing developments

#### Technical Guidance Note on risks of misstatement in 2019/20

- 35.** Professional Support has published Technical Guidance Note (TGN) 2020/1 to provide auditors with guidance on planning and performing the audit of 2019/20 annual report accounts of central government bodies.
- 36.** 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.
- 37.** 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 8 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 9 covers irregularities in income and expenditure
  - Module 10 covers the audited part of the Remuneration and Staff Report
  - Module 11 sets out procedures for Statutory Other Information (i.e. Performance Report and Governance Statement).
- 38.** The TGN also provides specific guidance on the application of the above modules to charitable NDPBs (Module 12) and, as explained in Section 3 of this bulletin, health boards (Module 13).
- 39.** 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.

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**Auditor action**  
**Auditors should pay due regard to TGN 2020/1**

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#### 2019/20 GBS account information

- 40.** Professional Support intend obtaining information on account balances at 31 March 2020 for central government bodies from the Government Banking Service (GBS) and distribute them to relevant auditors.

### Annual report and accounts developments

#### Revised 2019/20 FReM

- 41.** [HM Treasury](#) has issued a revised version of the [2019/20 Government Financial Reporting Manual](#) (the FReM).
- 42.** There are no significant changes in requirements. Annex 5 has been added to this revised version to provide additional good practice guidance on narrative reporting.

#### 2020/21 FReM

- 43.** Treasury has issued the [2020/21 FReM](#). The main changes are in respect of the structure of the FReM which has been revised into four parts as set out 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

44. 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, in particular, 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.

45. 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, for annual reports and accounts, the needs of Parliament as the primary user take precedence.

46. 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 and refers to annexe 4 which contains links to resources for better narrative reporting.

47. Chapter 4 groups together all the high-level guidance relating to the annual report and accounts and provides an overview of the required format.

48. 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**

49. The new chapter 6 now covers revised requirements on the Accountability Report including a new requirement to disclose staff turnover in the Remuneration and Staff Report.

50. The remaining chapters 7 to 13 remain largely unchanged from the requirements in the previous sections of the FReM they are taken from.

## Financial statements developments

### Revised guidance on IFRS 16

51. Treasury has issued revised [guidance](#) on applying IFRS 16 on the central government sector. The guidance has been revised to reflect budgeting guidance and make minor clarifications.

### 2019/20 discount rates

52. Treasury has issued [PES\(2019\)11\\*](#) which announces the change in the discount rate for general provisions, post-employment benefits liabilities, and financial instruments as at 31 March 2020.

53. The nominal discount rates to be applied as at 31 March 2020 for discounting general provisions recognised under IAS 37 are set out in the following table:

Category	Period	Percentage
Short term	Within 5 years	0.51%
Medium term	Between 5 and 10 years	0.55%
Long term	Between 10 and 40 years	1.99%
Very long term	More than 40 years	1.99%

54. As nominal rates do not take inflation into account, cash flows require to be inflated separately. There is a rebuttable assumption that the inflation rates specified in the paper will be used (unless other rates are clearly more applicable). The specified rates are:

- 1.99% for up to two years from the year end
- 2% for after two years.

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

Use	Rate from 31 March 2020
Real rate used for valuing unfunded pension scheme liabilities and early departure provisions	(0.5)%
Nominal rate for unwinding discount on liabilities (interest)	1.8%
Rate used for funded pension schemes	Based on returns from AA corporate bonds at 31 March

56. The financial instrument discount rates to be applied at 31 March 2020 are set out in the following table:

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

57. The paper also specifies a rate to be used for leases under IFRS 16. The 2020 nominal lease discount rate of 1.27% is only relevant for transition to IFRS 16 and for new leases that commence or are remeasured between 1 January 2020 and 31 December 2020.

## 2019/20 disclosure guide

58. The [National Audit Office](#) (NAO) has issued the [2019/20 FReM Disclosure Guide](#) which is designed to ensure that bodies covered by the FReM have prepared their 2019/20 financial statements in the appropriate form and have complied with all disclosure requirements.

59. The guide is cross-referenced to the 2019/20 FReM, individual financial reporting standards, and the Companies Act 2006. Auditors will need to generate a tailored checklist by selecting the criteria that are material to their audited body.

60. While the guide is designed primarily for the NAO's internal use, auditors in Scotland may also find it helpful. When checking that the FReM's disclosure requirements have been met, auditors should:

### Auditor action

Auditors should refer to this guidance when auditing the 2019/20 financial statements

### Auditor action

Auditors should consider requesting that bodies complete this guide

- consider requesting that the body completes the NAO's 2019/20 disclosure guide for the financial statements
- investigate the reasons for any non-compliance that the guide highlights
- evaluate whether the body's responses in the guide are consistent with auditor's knowledge.

## Remuneration and staff report

### Guidance on 2019/20 disclosures

61. The [Cabinet Office](#) has issued [EPN 597 2019/20 Disclosure of salary, pension and compensation information](#) to provide guidance on the preparation of the pay pension and compensation disclosures in the remuneration and staff report for 2019/20. Example disclosures are provided at Annex 13C.
62. There are no significant changes to the remuneration disclosures set out from 2018/19.
63. The guidance does not reflect the application of the FReM's requirements to Scottish bodies and therefore auditors should refer to [Module 11\\*](#) of Technical Guidance Note 2020/1.

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**Auditor action**  
Auditors should refer to this guidance when auditing the Remuneration and Staff Report in the 2019/20 annual report and accounts

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## Statutory other information developments

### Revised internal control checklist

64. The Scottish Government has issued [Finance Guidance Note 2020/1](#) which announces amendments to the [certificates of assurance](#) section of the Scottish Public Finance Manual.
65. The [internal control checklist](#) has been updated, with new questions added on:
  - assessing the level of skills and training of those staff directly managing key risks
  - the arrangements in place for the realisation of benefits and capturing lessons from major investment projects
  - assurance on grant awards and grant manager skills and training
  - ensuring appropriate contracts are place for all procurement.

## Wider audit scope developments

### Financial management

66. The Scottish Government has issued [Finance Guidance Note 2020/3](#) to announce recent additional guidance for Accountable Officers during the current Covid-19 situation. Some key aspects of the guidance are as follows:
  - Director Generals are asked to consider which activities may be reduced, stopped, or re-profiled, thereby releasing savings that can be redirected to cover the cost of COVID-19
  - Where actions are required to be taken as a priority in order to support the health and safety of the public, Accountable Officers should document this decision and seek subsequent approval.
  - Director Generals should manage any COVID-19 spend of £1 million or less but should keep track of it. Where expenditure exceeds that amount, a template at Annex A should be submitted for sign off by the Cabinet Secretary.
  - Accountable officers should also assess whether any expenditure undertaken as a result of the outbreak has appropriate statutory power. If there is no statutory power, it may still be possible to undertake the expenditure if Ministers possess the necessary common law powers or the expenditure is not of a continuing nature.
67. The Scottish Government has also issued [Finance Guidance Note 2020/4](#) to advise of a relaxation of normal controls to allow expiring leases to be extended for up to one year in lieu of submitting formal business cases.

## Summary of auditor actions in this section

Paragraphs	Auditor actions
35 - 39	Pay due regard to TGN 2020/1 when auditing the 2019/20 annual report and accounts
52 - 57	Refer to the guidance on 2019/20 discount rates
58 - 60	Consider requesting bodies to complete the 2019/20 disclosure guide
61 - 63	Refer to the guidance on remuneration disclosures when auditing the 2019/20 Remuneration and Staff Report

## Contact point for this section

- 68.** The main contact point for this section of the Technical Bulletin is Neil Cameron, Manager (Professional Support) – [ncameron@audit-scotland.gov.uk](mailto:ncameron@audit-scotland.gov.uk).

# Section 4

## Health sector

### Auditing developments

#### Technical guidance note on risks of misstatement in 2019/20

69. Professional Support has published [Module 13](#) of TGN 2020/1 to provide:
- guidance on applying the other modules to the audit of the annual report and accounts of health boards
  - supplementary guidance on the risks of misstatements in the areas specific to health boards.

#### Auditor action

Auditors should use this guidance when performing the audit of the 2019/20 annual report and accounts

#### 2019/20 model independent auditor's reports

70. Professional Support has published [Technical Guidance Note 2020/2\(H\) 2019/20 Independent Auditor's Report for Health Boards](#) to provide auditors with the model Independent Auditor's Reports which should be used for the 2019/20 annual report and accounts. The technical guidance note also provides application guidance on their use.
71. In the interests of consistency, auditors are required to use the relevant model report in appendices 1 to 2 of the Technical Guidance Note as a condition of their audit appointment. The only exception to using the wording in each model is to tailor the terminology to reflect local circumstances.
72. There have been no significant changes to the model Independent Auditor's Reports for 2019/20, although some enhancements have been made to the guidance to make the required auditor actions clearer.

#### Auditor action

Auditors should use this TGN when reporting the audit of the 2019/20 annual report and accounts and complete the relevant checklists

#### Review of central work on CNORIS

73. Professional Support will be undertaking a review of the work carried out by the NHS Central Legal Office (CLO) relating to the Clinical Negligence and Other Risks Indemnity Scheme (CNORIS). The objective of the review is to establish the extent to which the information prepared using the work of the CLO, as a management expert under ISA (UK) 500, can be used as audit evidence.
74. Professional Support will also evaluate the appropriateness of the methodology adopted by the Scottish Government to establish the total national liability for CNORIS. The review will focus on the estimation of the liability as at 31 March 2020 with a view to assessing the reliability of the methodology used for 2019/20.
75. Professional Support will then provide auditors with the outcome of the reviews to:
- inform auditors' evaluation of the relevance and reliability of the information prepared by the CLO as audit evidence
  - provide assurance on the methodology used in the preparation of the CNORIS figures as at 31 March 2020 which are provided to boards.

### Annual report and accounts overall developments

#### 2019/20 accounts manual

76. The [Scottish Government](#) has issued the [2019/20 Manual for the Annual Report and Accounts of NHS Boards\\*](#) (accounts manual) to complement the guidance contained in the 2019/20 FReM.

#### Auditor action

Auditors should refer to the accounts manual when auditing the 2019/20 annual report and accounts



77. The main changes included in the accounts manual compared with 2018/19 are summarised the following table:

Area	Change
Performance Report	The disclosure on financial performance on page 8 has been amended to reflect the introduction of the three year planning cycle which provides flexibility to incur a 1% overspend within an overall breakeven period of 3 years.
Remuneration and Staff Report	The guidance on disclosure of information in the remuneration report has been amended to be consistent with the FReM and General Data Protection Regulations. Boards are required to advise individuals in advance on the intention to disclose. Previously the manual required boards to obtain consent for disclosure.  Page 31 has been amended to deduct staff costs charged to capital expenditure in the reconciliation to income and expenditure
Performance Report and Accountability Report generally	These sections have been amended to clarify which disclosures are required by the FReM or the Scottish Government which are suggested guidance to assist boards.
Summary of resource outturn (SoRO)	The SoRO has been moved from the foot of the Statement of Comprehensive Net Expenditure to note 2. This is to help clarify that the SoRO is not a primary financial statement.
Pension costs	The narrative at Note 19 has been updated for pension scheme disclosure requirements and qualifying earnings.

## Financial statements developments

### 2019/20 capital accounting manual

78. The Scottish Government has issued the [2019/20 NHS Capital Accounting Manual\\*](#) (CAM) to interpret the accounting guidance contained in the 2019/20 FReM on capital accounting issues in the health sector.

79. There are no significant changes from the 2018/19 CAM.

### Guidance on income from R&D contracts

80. The NHS Scotland Technical Accounting Group has issued [guidance](#) on applying IFRS 15 to research and development contracts.

81. The guidance covers three aspects of the contracts as summarised in the following table:

Aspect	Summary of guidance
Accounting for staged payments	As the board as an enforceable right to payment for performance completed to date, the performance obligation is regarded as satisfied over time.  Income and expenditure should be recognised and presented gross as the contract progresses.
Treatment of surplus on commercial contracts	A liability should be recognised at the year end for the element of any surplus due to partners.
Recovering costs on infrastructure support and capacity building	An asset should be recognised where such costs are expected to be recovered.

### Auditor action

**Auditors should refer to the CAM when auditing property, plant and equipment in 2019/20**

## Wider audit scope developments

### Revised financial planning arrangements

82. The Scottish Government has issued a [letter\\*](#) on revised financial planning arrangements over the coming months. The Scottish Government has reviewed boards' draft mobilisation plans, and has issued a template to identify a financial baseline for additional costs in relation to Covid-19. Boards have been advised to provide as much information as possible about the assumptions used, particularly in terms of redeployment of staff and other resources from non-urgent elective care.
83. Boards are not required to submit financial reporting performance returns for months 11 and 12. Resource and capital outturns for 2019/20 are assumed to be in line with the position already agreed with boards. Final funding letters will be issued with the necessary authorisation for 2019/20 outturn.

### Contact point for this section

84. The main contact point for this section of the Technical Bulletin is Neil Cameron, Manager (Professional Support) – [ncameron@audit-scotland.gov.uk](mailto:ncameron@audit-scotland.gov.uk).

# Section 5

## Professional matters

### Auditing developments

#### Revised auditing standards

85. The [Financial Reporting Council](#) (FRC) has issued a number of revised auditing standards that apply to financial periods commencing on or after 15 December 2019. The main changes are summarised in the following table:

ISA (UK)	Summary of change
<a href="#">250A Consideration of Laws and Regulations in an Audit of the Financial Statements</a>	<p>Paragraph 13-1 has been added to require an auditor, when performing risk assessment procedures under ISA (UK) 315, to consider whether there are any indications of non-compliance with laws and regulations.</p> <p>Application guidance has been added at paragraph A11-3 on considering both quantitative and qualitative factors, including in circumstances where the direct effect on the determination of amounts and disclosures in the financial statements is not quantitatively material. For example, acts of non-compliance may not generate material fines or penalties, but may have a direct effect on disclosures due to the nature of the entity where such disclosure is important to users of the financial statements.</p>
<a href="#">700 Forming an Opinion and Reporting on the Financial Statements</a>	<p>Paragraph 29-1 has been revised so that the application of the requirement to explain in the report the extent to which the audit was considered capable of detecting irregularities has been extended from Public Interest Entities to all bodies.</p> <p>Application guidance has been added at paragraphs A39-1 to A39-3.</p> <p>The FRC has issued a revised <a href="#">bulletin</a> to provide illustrative auditor's reports for the private sector.</p>
<a href="#">701 Communication Key Audit Matters in the Independent Auditor's Report</a>	<p>Paragraph 13(b) has been revised to require auditors to report significant judgments made by the audit team with respect to each matter.</p> <p>The revisions to paragraph 16-1 are requirements to:</p> <ul style="list-style-type: none"> <li>• specify the threshold for performance materiality, in addition to materiality</li> <li>• provide an explanation of the significant judgments made by the auditor in determining materiality and performance materiality.</li> </ul>
<a href="#">720 The Auditor's Responsibilities Relating to Other Information</a>	<p>Paragraph 22-1 has been added to require an auditor, if required to report on statutory other information, to include in the auditor's report a:</p> <ul style="list-style-type: none"> <li>• description of the auditor's responsibilities relating to the statutory other information. Paragraph A53-2 advises that this may be in the body of the report, an appendix or by a reference to a website</li> <li>• conclusion thereon.</li> </ul> <p>Application guidance has been added on judging the materiality of misstatements</p>

## Proposed changes to standard on auditing estimates

**86.** The FRC has issued an [exposure draft](#) of proposed revisions to ISA (UK) 315. The proposed changes reflect recent revisions to the international standard, and are summarised in the following table:

Area	Proposal
IT business environment	This includes requiring the auditor to understand the entity's use of IT in its business, the related risks and the system of internal control addressing such risks.
Automated audit tools and techniques	Additional application guidance on the use of automated tools and techniques by auditors.
Enhancing professional scepticism	An emphasis has been added on the need for auditors to not bias their work toward obtaining corroborative evidence or excluding evidence that is contradictory.  A new requirement for the auditor, towards the end of the risk assessment process, to consider all audit evidence obtained from performing risk assessment procedures, whether corroborative or contradictory.
Purpose of risk assessment	Clarification has been added that the purpose of performing risk assessment procedures is to obtain audit evidence that provides an appropriate basis for the identification and assessment of the risks of material misstatement and the design of further audit procedures
Inherent risk factors	The concept of 'inherent risk factors' has been introduced to assist the auditor in identifying events or conditions that may affect the susceptibility of assertions about classes of transactions, account balances or disclosures to misstatement.
Significant class of transactions, account balances or disclosures	This new concept refers to those classes for which there are assertions with an identified risk of material misstatement (referred to as relevant assertions).
Spectrum of inherent risk	This new concept applies to the extent to which inherent risk varies
Significant risk	This relates to an identified risk of material misstatement for which the assessment of inherent risk is close to the upper end of the spectrum of inherent risk due to the degree to which inherent risk factors affect the combination of the likelihood of a misstatement occurring and the magnitude of the potential misstatement should that misstatement occur.
Control risk	Guidance has been added explaining that, if the auditor does not plan to test the operating effectiveness of controls, control risk should be assessed as the same as the assessment of inherent risk.

**87.** The effective date of the revised standard is proposed to be accounting periods beginning after 15 December 2021. Comments should be sent to [AAT@frc.org.uk](mailto:AAT@frc.org.uk) by 3 April 2020.

## Report from the Brydon Review

**88.** The Bryden Review has issued a [report](#) which recommends to the UK Government improvements in the quality and effectiveness of the audit of Public Interest Entities. A selection of some of the recommendations that could have relevance to the public sector are set out in the following tables.

**Redefinition of audit and its purpose**

Subject	Paragraph	Recommendation
Purpose	5.1.3 – 5.1.4	The following statement should be adopted by the Audit, Reporting and Governance Authority (ARGA), and the UK Government should enshrine it in the Companies Act:  “The purpose of an audit is to help establish and maintain deserved confidence in a company, in its directors and in the information for which they have responsibility to report, including the financial statements.”
New information	5.3.2	Auditors should be free to include original information, materially useful to a wide range of users, in their audit report, and not be confined to commenting on information stated by directors.
	5.3.12	The obligation to read and consider other information in the Annual Report be extended to material outside the Annual Report.
New profession	6.0.11	ARGA acts to create a new profession of corporate auditing, establishing the necessary professional body, to encompass today’s auditors and others with appropriate education and authorisation. ARGA would be the statutory supervisory body for that profession.
	6.0.16	There should be one encompassing descriptor with a new definition - "corporate auditor" (including environmental auditors, cyber security auditors and financial statement auditors).
Establishing the role of Principles	6.3.4	The Principles of Corporate Auditing (set out at paragraph 6.4.2) should be established to form an overarching framework governing the behaviour of corporate auditors, and standards and rules should sit within this framework.
Principles of Corporate Reporting	6.4.5	Each audit report should contain a statement to the effect that in conducting the audit the auditor has acted faithfully in accordance with the Principles of Corporate Auditing.
Audit fees	9.4.5	The audit fees should be shown on the face of the profit and loss account.
	9.4.9	The audit committee chair should be delegated to negotiate the fees for the relevant audit work. The Board should agree an ‘assurance budget’ for the audit committee which would include the fees.
	9.4.14	Audit firms should establish an independent fee-setting function making its decisions separately from those conducting the audit.

**True and fair**

Subject	Paragraph	Recommendation
Presents fairly	11.9	The Companies Act and ISA (UK) 700 should be amended to replace “true and fair” with “present fairly, in all material respects”.
Override	11.15	Auditors should judge any use of an ‘override’ in the context of their obligation to be faithful to the Principles of Corporate Auditing.

**Accounting records**

Subject	Paragraph	Recommendation
Adequate accounting records	12.4	The Companies Act should clarify what is meant by “adequate accounting records”. There should be an obligation for auditors to assess whether the directors have maintained accounting records to a standard beyond the minimum level necessary for an audit to be performed.

**Fraud**

Subject	Paragraph	Recommendation
Clarity of auditor obligations	14.1.5	ISA (UK) 240 should be amended to make clear that it is the obligation of an auditor to endeavour to detect material fraud in all reasonable ways.
Directors’ obligations	14.2.2	Directors should report on the actions they have taken to fulfil their obligations to prevent and detect material fraud against the background of their fraud risk assessment.
Forensic skills	14.3.5	The auditor’s report should state explicitly the work performed to conclude whether the directors’ statement regarding the actions they have taken to prevent and detect material fraud is appropriate. Auditors should also state what steps they have taken to assess the effectiveness of the relevant controls and to detect any such fraud.

**Signalling concern**

Subject	Paragraph	Recommendation
Eternal signals	16.4	There should be an obligation on the auditors to report to both the audit committee and the shareholders on the extent to which their work has been influenced and informed (or not) by any external signals which might imply enhanced risk in the company.
Menu of signals	16.7	ARGA should develop a menu of possible signals [examples set out at paragraph 16.8] and the auditors should report against the relevant parts of that menu.

**Communicating judgements**

Subject	Paragraph	Recommendation
Differences of view	17.0.4	The audit committee should describe any debate regarding differences of view between management and auditors and its outcome, including the justification for the agreed treatment. For example, where the differences of view would have led to material changes in valuation, even when these differences have been resolved, the audit committee should report on the range of the initial views and where in that range the agreed valuation lies.
Culture	17.2.6	ARGA should develop a series of examples which would illustrate the types of culture that auditors should reference in their report where there is an observed disconnect between the culture of the company claimed by the directors and the behaviour observed by the auditors.
Quality of estimates	17.4.6	The auditor’s report should include some substantive discussion of the key areas of measurement uncertainty and provide information on the ranges and sensitivities associated with the point estimates for those measurements.

## Alternative Performance Measures and Key Performance Indicators

Subject	Paragraph	Recommendation
Alternative Performance Measures	20.1.5	Alternative Performance Measures (i.e. figures based on International Financial Reporting Standards [IFRS] adjusted by management to make the underlying performance of the company more visible) should be subject to audit.
Key Performance Indicators	20.2.8	Any Key Performance Indicators used for the purpose of calculating executive remuneration should be subject to audit.

## Technology

Subject	Paragraph	Recommendation
Obstacles to progress	24.1.8	ARGA should work with auditors to create the necessary protections and policies for audit to be able to use data from the companies they audit in order to promote better quality audits.
	24.1.11	Auditors should explain in the audit report the reasons for the necessity and basis of any sampling techniques used in conducting the audit.

## Auditor liability and transparency

Subject	Paragraph	Recommendation
Greater transparency	25.2.5	Individual statutory audit reports detail the number of hours spent in conducting the audit by grade of auditor.

## Accounting developments

### Proposed changes in presentation and disclosure requirements

89. The [International Accounting Standards Board](#) has issued an [exposure draft](#) of proposals on improving how information is communicated in the financial statements.
90. The central proposal is to replace IAS 1 Presentation of Financial Statements with a new standard containing new requirements on presentation and disclosures in the financial statements.
91. Responses require to be sent to [commentletters@ifrs.org](mailto:commentletters@ifrs.org) by 30 June 2020.

It is proposed to replace IAS 1 with new presentation and disclosure requirements [

### Structure of the statement of profit or loss

92. The exposure draft proposes that an entity present the following new subtotals in the statement of profit or loss:
  - operating profit or loss
  - operating profit or loss and income and expenses from integral associates and joint ventures
  - profit or loss before financing and income tax.
93. In applying these proposed new subtotals, an entity would present in the statement of profit or loss income and expenses classified in the following categories:

Categories	Types of income and expenses
Operating	Those from an entity's main business activities. This may include from investments and financing activities if they are a main business activity.

Categories	Types of income and expenses
Integral associates and joint ventures	Those from associates and joint ventures that are integral to the main business activities of an entity and hence do not generate a return individually and largely independently of the other assets of the entity.
Investing	Those from assets that generate a return individually and largely independently of other resources held by the entity
Financing	Those from cash and cash equivalents, liabilities arising from financing activities; and the unwinding of discounts on pension liabilities and provisions.

### Aggregation and disaggregation

- 94.** Paragraphs 25 to 28 of the exposure draft propose principles and general requirements on the aggregation and disaggregation of information, applicable both to presentation in the primary financial statements and disclosures in the notes. This includes requirements that
- items should be classified and aggregated on the basis of shared characteristics
  - aggregation and disaggregation in the financial statements should not obscure relevant information or reduce the understandability of the information presented or disclosed.
- 95.** When presenting information in the primary financial statements or disclosing information in the notes, the description of the items should faithfully represent the characteristics of those items. Using a label such as 'other' to describe a group of such items would not faithfully represent those items without additional information.

### Unusual income and expenses

- 96.** There is a proposal to introduce a definition of 'unusual income and expenses', and to require all entities to disclose unusual income and expenses in a single note.
- 97.** This is defined at paragraph 100 of the exposure draft as income and expenses with limited predictive value. This would be the case where it is reasonable to expect that income or expenses of a similar type will not arise for several years.

### Management performance measures

- 98.** There are proposals to introduce a definition of 'management performance measures' and require an entity to disclose them in a single note. Management performance measures are subtotals of income and expenses that:
- are used in public communications outside financial statements
  - complement totals or subtotals specified by IFRS
  - communicate to users of financial statements management's view of an aspect of an entity's financial performance.
- 99.** An entity would comply with the general requirements in IFRS when it provides these measures, e.g. each performance measure must faithfully represent an aspect of the financial performance of the entity. The exposure draft also proposes to specify the information an entity would be required to disclose about management performance measures, including a reconciliation to the most directly comparable total or subtotal specified by IFRS.

### Contact point for this section

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





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Audit Scotland, 4th Floor, 102 West Port, Edinburgh, EH3 9DN  
T: 0131 625 1500