Technical Bulletin 2020/3

Technical developments and emerging risks from July to September 2020

AUDIT SCOTLAND

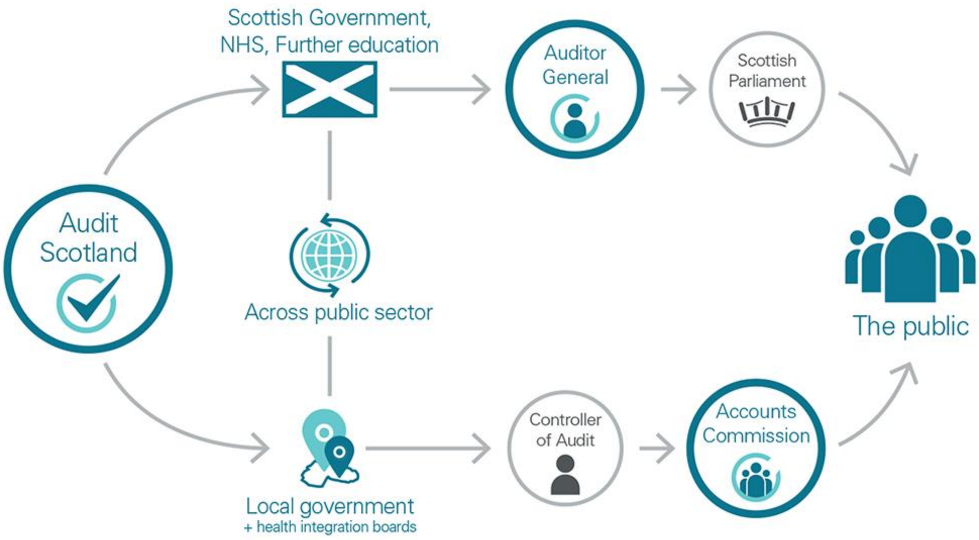
Prepared for appointed auditors and audited bodies in all sectors

22 September 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.

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 risks of misstatement emerging in the quarter.

Technical Bulletins provide information on developments and guidance on emerging risks

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.

Highlights summary

5. Professional Support draws attention in the following table to certain items in this Technical Bulletin:

Professional Support has provided technical advice to auditors on a number of issues [see paragraphs 7, 47, 49, and 51]	CIPFA/LASAAC has issued the 2020/21 accounting code for local government[see paragraph 8]	CIPFA/LASAAC has issued the draft 2021/22 accounting code [see paragraph 21]
The SPPA has issued the proposed remedy to the McCloud judgement [see paragraph 27]	The SPPA has issued a circular on the Goodwin tribunal [see paragraph 32]	A recent judicial review ruling impacts on the structures built on common good land [see paragraph 35]
Professional Support has published guidance on risks of misstatements in the 2019/20 annual report and accounts of colleges [see paragraph 53]	Professional Support has published model 2019/20 Independent Auditor's Reports for colleges [see paragraph 57]	The SFC has issued the 2019/20 Accounts Direction for colleges [see paragraph 61]
The SFC has issued guidance on the 2019/20 financial statements of colleges [see paragraph 64]	The FRC has a issued a revised auditing standard on risks of material misstatement [see paragraph 67]	The FRC has issued a report on the financial reporting effects of COVID-19 [see paragraph 70]

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

Auditor Action
Auditors should consider the application of this advice to their own audits

Advice to auditors

7. The following table summarises requests for technical advice made by auditors to Professional Support during the quarter in respect of the audit of the 2019/20 annual accounts which applies to all public bodies, along with the advice offered:

Property, plant and equipment

A body has replaced a section of the roof of a building. Should the cost of the replaced section be capitalised?

The appropriate treatment depends on whether the replaced section is being treated (i) as a separate component or (ii) as part of an asset (e.g. the asset is the whole roof or indeed the building itself).

Where the replaced section is a separate component, it is relatively straight-forward. The cost can be capitalised as follows:

- The replaced section is derecognised. If the original cost of the roof is not known, it should be estimated.
- The cost of the new section is capitalised and treated as a separate asset.
- The new section/asset is depreciated over its own useful life.

Where the replaced section is part of an asset, further consideration is required. The first question is whether the work was undertaken to repair damage to the roof. If that is the case, the cost of the work can be capitalised as follows:

- The damage means the asset was impaired and therefore an impairment loss should have been recognised (and consequent reduction in the carrying amount of the asset).
- The cost of the new section is capitalised and added to the carrying amount of the asset.

If the work was not to repair damage, the question is whether the work has added to the service potential (or economic benefits) of the asset (e.g. by increasing the expected useful life). Expenditure can be included in the carrying amount of an asset (i.e. capitalised) if the expenditure has added to the future economic benefits or service potential of the asset. Where the work undertaken maintains the existing service potential (e.g. it is part of maintenance programme that was assumed when the expected useful life was originally estimated), the cost should be recognised as an expense.

Should a body be carrying out an impairment review of its office buildings at 31 March 2020?

IAS 36 Impairment of Assets sets out indications that an asset is impaired. This includes where significant changes with an adverse effect on the body have taken place during the period regarding the extent to which an asset is used. These changes include the asset becoming idle.

As most offices were not in use at 31 March 2020 due to coronavirus disease 2019 (COVID-19) suppression measures, it is likely they were impaired and it would be appropriate to obtain a valuation.

Summary of auditor actions in this section

Paragraph	Auditor actions
7	Consider the application of the advice from Professional Support to own audits

Section 2

Local government sector

Financial statements

2020/21 accounting code

8. The CIPFA/LASAAC Local Authority Code Board (CIPFA/LASAAC) has issued the Code of Practice for Local Authority Accounting in the UK* (the accounting code) which sets out local government accounting requirements for 2020/21.

9. The accounting code's financial reporting framework is based on International Financial Reporting Standards (IFRS) as adopted by the European Union, adapted for the local government context where necessary. The 2020/21 accounting code has been prepared on the basis of accounting standards and other pronouncements in effect for accounting periods commencing on or before 1 January 2020 (except for IFRS 16 Leases which has been deferred to 2021/22).

10. The changes in the 2020/21 accounting code are summarised in its Foreword. They include the following changes that Professional Support draws auditors' attention to:

- Amendments to reflect changes to the definition of material.
- The implementation of amendments to IAS 19 Employee Benefits.
- Amendments to accounting and reporting by pension funds.
- Amendments relating to financial instruments.
- The total line in Comprehensive Income and Expenditure Statement.

Amendments to reflect changes to the definition of material

11. The wording of the definition of material at paragraph 2.1.2.15 has been amended in line with an amendment to IAS 8. It now states that information is material if omitting, misstating or obscuring it could reasonably be expected to influence decisions that users make on the basis of those financial statements.

Definition now includes obscuring information

12. The main change in the definition is the reference to the concept of obscuring information. Paragraph 2.1.2.15 has therefore been added to explain that information regarding a material item may be obscured if, for example:

- the language used is vague or unclear
- information is scattered throughout the financial statements
- items are inappropriately aggregated or disaggregated
- a material item is hidden by immaterial information.

13. Paragraph 2.1.2.16 has also been added to advise that judgement is required regarding the extent of supporting disclosures that are appropriate for a specific item. In particular, the materiality of an item in a primary statement does not include a presumption that all supporting information disclosures specified in the accounting code for that item are material. This applies for both descriptive and numerical supporting information.

14. In addition, paragraph 2.1.2.17 states that judgements regarding materiality should be based on the needs of users. Additional information may be disclosed where this does not obscure information that is material for users.

Implementation of amendments to IAS 19

15. Paragraph 6.4.3.5 has been added as a result of an amendment to IAS 19. It creates an exception to the rule that financial assumptions are based on market expectations at 31 March.

16. Where a pension scheme amendment, curtailment or settlement occurs during the year the amended assumptions, as used for the remeasurement of the net defined benefit liability, are to be applied in relation to the benefits for the remainder of the year.

Amendments to accounting and reporting by pension funds

17. The following changes have been made to align with the SORP for pension funds:

- The disclosure requirement for pooled investment vehicles in the net assets statement (paragraph 6.5.3.6) has been amended to require an analysis between equities, bonds, property, hedge funds, diversified growth funds, private equity funds, infrastructure funds and other.
- The previous requirement (at paragraph 6.5.5.1) for an analysis of investment assets between 'UK' and 'overseas' and between 'quoted' and 'unquoted' has been removed.

Amendments relating to financial instruments

18. Amendments related to financial instruments are summarised in the following table:

Paragraph	Amendment
3.4.2.39(c)	Gains and losses on financial instruments classified as fair value through profit or loss have been added to the items included in the financing and investment income and expenditure line of the Comprehensive Income and Expenditure Statement.
7.2.9.1	Clarification has been added regarding the extent of the exemption from recognising a loss allowance for expected credit losses on a financial asset where the counterparty is central government. It has been clarified that the exemption does not apply to: • credit impaired assets • NDPBs unless explicitly covered by a guarantee given by their sponsor department.
7.1.1.3(c)	Clarification has been added in respect of the application of the interpretation of IFRS 9 that the options that characterise clauses within a LOBO contract should not be separately accounted for. It has been clarified that this interpretation only applies where the specified derivative elements are separable. It does not apply to a compound embedded derivative if separation of the exempted derivative is not permitted by IFRS 9.
7.1.1.3(e)	Clarification has been added that the modification of financial liabilities follows the principles specified for the modification of financial assets, i.e. when the change in terms is not substantial, it is not accounted for as an extinguishment.
7.1.6.4	The wording of the definition for a soft loan has been amended to include loans where the interest rate is specified at below zero (i.e. negative interest).

Comprehensive Income and Expenditure Statement total line

19. A footnote has been added to paragraph 3.4.2.39 in respect of the total comprehensive (income) and expenditure' line in the Comprehensive Income and Expenditure Statement. It requires the line description used to provide clarity regarding the use of positive and negative signage. For example, where brackets are used to represent an overall surplus the description 'Total comprehensive (income) and expenditure' may be used.

IFRS 16

20. Appendix F has been added to the accounting code to set out the provisions in respect of IFRS 16 Leases that are anticipated to be included the 2021/22 accounting code. The appendix is intended to provide advanced notification of the requirements. Early adoption of IFRS 16 is not permitted.

Draft 2021/22 accounting code

21. CIPFA/LASAAC has issued a consultation paper on the accounting code for 2021/22. The main issues in the consultation are in respect of:

- the application of specific aspects of IFRS 16 Leases

- CIPFA/LASAAC's strategic plan to improve the clarity of the accounting code.

22. Responses should be sent to cipfalasaac@cipfa.org by 23 October 2020.

Application of specific aspects of IFRS 16 Leases

23. The consultation includes three areas relating to the adoption of IFRS 16 which require further consideration. They are summarised in the following table:

Area	Consideration
Service concession arrangement liability	Exposure draft B sets out proposals for measuring a service concession arrangement liability on the basis of IFRS 16. However, the consultation paper asks for views on the alternative of continuing to use IAS 37. It also asks whether any move to use IFRS 16 should be in 2021/22 or 2022/23.
Leases at a peppercorn rate or nominal amount	The adoption of IFRS 16 currently includes an interpretation where assets which are leased for nil consideration, a nominal amount, or at a peppercorn rate are treated as being analogous to donated assets. The consultation asks for views on whether the interpretation is appropriate for a lease at a peppercorn or nominal lease payment where the contractual arrangements are on commercial terms.
COVID-19-related rent concessions	An amendment to IFRS 16 provides lessees with an exemption (as a practical expedient) from assessing whether a COVID-19-related rent concession is a lease modification. It is proposed to allow local government bodies to apply the practical expedient on transition to IFRS 16.

24. A fourth area related to the treatment of housing revenue account tenancy agreements under IFRS 16 will be subject to a separate consultation paper.

Strategic plan to improve clarity

25. As part of CIPFA/LASAAC's strategic plan to improve clarity, the consultation asks for views on the following aspects of the accounting code:

Aspect	Request for views
Summary of taxpayers funding	The option to include a summary of taxpayers' funding in the narrative report
Comprehensive Income and Expenditure Statement	Whether reporting of financial performance in the Comprehensive Income and Expenditure Statement could be improved
Expenditure and Funding Analysis Note	Comments on the role of the Expenditure and Funding Analysis and whether any improvements are required
Capital accounting	Whether the application of materiality to the disclosure requirements would benefit from a review
Pensions accounting	Whether the application of materiality to the disclosure requirements would benefit from a review
Financial instruments	Whether the reporting requirements are excessive
Group accounts	Comments on the usefulness of group accounts to the users of the financial statements

Other issues

26. Other issues raised in the consultation are summarised in the following table:

Area	Paragraphs	Consideration
Redmond Review	11 to 14	There is a request for views on the impact of the recommendations in the Redmond Review on local authority financial reporting (referred to later at paragraph 39).
Interest Rate Benchmark Reform Phase 2: Amendments	50 to 55 and Exposure Draft C	Interest rate benchmarks such as interbank offered rates underpin many financial products. The amendment to IFRS 9 and other affected standards has been issued as part of the ongoing reform of interest rate benchmarks across the world. There are proposals that local government bodies should apply the amendments to IFRS 9 for changes in the basis for determining the contractual cash flows of a financial asset or financial liability as a result of interest rate benchmark reform.
Estimation uncertainty disclosures	62 to 66 and Exposure Draft D	There is a proposal that the requirements of the accounting code in respect of disclosing estimation uncertainty be augmented by referring bodies to paragraphs 126 to 127 and 129 of IAS 1. These paragraphs cover, for example, the estimation of the effects of uncertain future events, and provide examples of the types of disclosures where estimation uncertainty might apply.
IFRS 17 Insurance Contracts	71 to 78	Last year's consultation identified some local government practices that may come within the scope of IFRS 17. They are listed at paragraph 77 of the Invitation to Comment and include pension guarantees, and mutual insurance arrangements. This year, views are being requested on the types of arrangements listed, whether any others missing from the list and the incidence of such transactions.

Proposed remedy for McCloud judgement on pensions

27. The Scottish Public Pensions Agency (SPPA) has issued a consultation paper setting out the proposed remedy to the age discrimination provisions in the Local Government Pension Scheme (LGPS) highlighted by the McCloud and Sargeant judgements. These judgements found that transitional protections for certain members on moving from the 2009 to 2015 schemes discriminated against younger members on the grounds of age.

28. Transitional provisions provided members who were within 10 years of normal retirement age in 2012 with a statutory underpin. The underpin provided those members with benefits under either the 2009 scheme or 2015 scheme, depending on which was better. The proposed remedy is to offer the same underpin to all members of the 2015 scheme until 2022.

29. Comments on the proposed remedy should be sent to SPPAPolicy@gov.scot by 23 October 2020.

30. The issue of the consultation paper provides evidence of conditions that existed at 31 March 2020 and therefore should be treated as an adjusting event after the year end. Auditors should evaluate whether bodies consider, in discussion with their actuaries, whether the impact on estimates of pension liabilities at 31 March 2020 resulting from this information is material and therefore whether an adjustment is required. Professional Support is aware that some actuaries are already offering to provide revised reports while others do not believe this will be necessary.

31. Where the impact is not material and an adjustment to the liabilities is not made, there is no need for the body to make a disclosure to that effect.

Auditor Action

Auditors should evaluate whether bodies are considering the impact on pension liabilities

Circular on the Goodwin tribunal

32. The SPPA has issued circular 2020/04 to advise of changes to the LGPS as a result of the outcome of a recent employment tribunal (the Goodwin tribunal). The circular advises that there are changes to the pension entitlement of male survivors in opposite sex marriages to take into account the female member's service from 6 April 1978. Previously, the male spouse survivor's entitlement was based on service accrued from 6 April 1988.

33. The change is backdated to 5 December 2005. The change therefore affects the pension of male spouse survivors where their entitlement arose (i.e. where the female member died) on or after 5 December 2005.

34. Auditors should evaluate whether bodies are considering, in discussion with their actuaries, whether the impact on pension liabilities at 31 March 2020 resulting from this tribunal is material and therefore whether an adjustment is required.

Auditor Action
Auditors should evaluate whether bodies are considering the impact on pension liabilities

Judicial review on common good assets

35. A recent judicial review ruling* impacts on common good land and the structures built on it. The case under review related to a leisure centre built by a council on common good land. The council no longer uses the building and wanted to demolish it.

36. The ruling determined that buildings on common good land are generally considered to be part of the land and the title which relates to it. This would mean that legal title of such buildings rests with the common good. This includes any buildings constructed by the council on common good land.

Buildings on common good land belong to the common good

37. Although the title to the building rests with the common good, in Professional Support's view, that does not necessarily mean that it should be recognised as an asset on the common good balance sheet. Where a council uses the building to deliver a service, it may be that the council is in substance effectively leasing the asset from the common good. Where the arrangements represent a finance lease, the asset would be recognised on the council balance sheet.

38. The ruling also means that, before a council can dispose of the building or change its use, it would have to follow the consultation provisions under section 104 the Community Empowerment (Scotland) Act 2015.

Report from the Redmond Review

39. Sir Tony Redmond has issued a report following his review into the local audit of, and financial reporting by, local authorities in England.

40. The report recommends in respect of local audit in England:

- the creation of a new regulatory body called the Office of Local Audit and Regulation responsible for the procurement, contract management, regulation, and oversight of local audit
- revision of the current fee structure to ensure adequate resources are deployed
- extending the deadline for published audited annual accounts from 31 July to 30 September.

41. In respect of financial reporting for local authorities in England, the main recommendation is that a simplified statement of service information and costs is prepared by each local authority in such a way as to enable comparison with the annual budget and council tax set for the year. The new statement would be prepared in addition to the statutory accounts, and would be subject to audit. An illustration of the new statement is provided at Annex 4 to the report.

Proposal for new service statement

42. The report consequently recommends that CIPFA/LASAAC should review the statutory annual accounts to determine whether there is scope to remove disclosures that may no longer be considered to be necessary.

43. Annex 5 of the report lists relevant recommendations made by the Kingman Review, CMA Study and Brydon Review, and comments on how Redmond has addressed them and how they may impact on the future of local authority audit.

Grant claims and other returns

Housing benefits certification

44. The Department for Work and Pensions (DWP) has issued the Module 5 Software Diagnostic Tool* component of the HBAP approach to the certification of the 2019/20 housing benefit subsidy claims for councils using Northgate Orbis benefit systems.

Submission of certified claims

45. The Scottish Government and the DWP have advised Professional Support that email submissions for grant claims (return and covering letter with electronic signatures) are acceptable and should be sent to the addresses listed in the following table:

Claim	Email address
Education Maintenance Allowances	Fraser.Young@gov.scot
Housing Benefit Subsidy	lawelfare.lapaymentsandsubsidy@dwp.gsi.gov.uk
Non-Domestic Rate Income	lgfstats@gov.scot

46. Paper copies should also be sent for the Scottish Government claims once their offices are open.

Advice to auditors

47. The following table summarises a selection of requests for technical advice made by auditors to Professional Support during the quarter in respect of the audit of the 2019/20 annual accounts of local government bodies, along with the advice offered:

Auditor Action
Auditors should consider the application of this advice to their own audits

Property, plant and equipment

Can a local government body capitalise a number of laptops that individually fall below the capitalisation de minimis?
Local government bodies can set a de minimis level for capital expenditure below which items will not be capitalised. Paragraph 4.1.4.1 of the accounting code requires the de minimis level to be disclosed in the accounting policies. A body could group similar items, such as laptops, and capitalise them even if individually they are below the de minimis. Where a body intends to group assets, they should explain that within their accounting policies.

Employee benefits/pension funds

What is the potential impact for the pension fund and for participating employers if a valuer discloses a material uncertainty in their valuation reports for investment property held by the pension fund at 31 March 2020?
The consideration for pension funds is the same in principle as when the valuer of local government bodies declares a material uncertainty in a valuation report for land and buildings (explained in Technical Bulletin 2020/2 at paragraph 14). An explanation should be added to the estimation uncertainty note. For participating bodies, the value of their attributable assets is estimated by rolling forward the valuation from the last triennial valuation at 31 March 2017. A material uncertainty declared in respect of the 31 March 2020 valuation does not therefore directly impact on the participating bodies' assets at that date. It could therefore be argued that the estimation uncertainty note is not required to highlight the material uncertainty. However, employer bodies should consider whether it may be helpful to users if they included a reference to the material uncertainty, for example, in the Management Commentary.

Arms length external organisations

A council has issued a letter of comfort to support an arms-length external organisation (ALEO) meet any liabilities that they are unable meet as a result of COVID-19. How should this be reflected in the council's financial statements?

The letter of comfort may constitute a financial guarantee if it requires the council to make specified payments to reimburse the holder of a debt if the ALEO fails to make a payment under a contract. Where this is the case, the accounting code requires the council to recognise the financial guarantee as a provision under IFRS 9. The provision should be recognised at fair value, estimated by considering the probability of the guarantee being called and the likely amount payable.

If the letter of comfort does not constitute a financial guarantee, it is likely that the disclosure by the council of a contingent liability would be appropriate.

The auditors of an ALEO have reported that the going concern basis of accounting is not appropriate. What impact does that have on the financial statements of the council?

It is likely that this is a sufficiently significant event after the year end to warrant disclosure in the council's annual accounts. The extent and nature of disclosure will be determined by the significance of the ALEO to the council's operations. Where the ALEO is to be disbanded, the arrangements for the continued delivery of its activities will be of interest to users.

Where the ALEO is included in the group financial statements as a subsidiary, further consideration will be required. The ALEO not being a going concern does not necessarily impact on the values of its assets and liabilities. For example, there may be an agreement that the assets and liabilities will transfer to the council at the carrying amount. Where that is not the case, and the ALEO's assets are considered to be overstated, and the overstatement is material to the group financial statements, a consolidation adjustment would be appropriate to remove the overstatement.

The auditors of the ALEO have reported that the going concern basis of accounting is not appropriate for the ALEO. What impact does that have on the Independent Auditors Report for the council?

The reporting by the council's auditor of conclusions related to going concern under ISA (UK) 570 relates only to the council itself. Going concern issues in respect of an ALEO do not affect those conclusions and therefore should not be reported in the 'conclusions related to going concern' paragraph in the Independent Auditor's Report.

Where the matter is considered to be of such importance that it is fundamental to users' understanding of the financial statements, an emphasis of matter paragraph should be considered under ISA (UK) 706. This may be the case where the ALEO is to be disbanded, and the arrangements for the continued delivery of its activities will have a substantial impact on the council.

Where the ALEO is included in the group financial statements as a subsidiary, and the ALEO's assets are considered to be overstated, and the overstatement is material to the group financial statements, auditors should consider whether a qualified opinion is appropriate if the material misstatement is not corrected.

Standards issued not yet adopted disclosure

What standards should local government bodies include in the 'standards issued but not adopted' disclosure in 2019/20

The accounting code requires a body to disclose information relating to the impact of an accounting change that will be required by a new standard that has been issued but not yet adopted. This requirement is based on IAS 8 but applies only to accounting standards that come into effect for financial years commencing on or before 1 January of the financial year in question (i.e. on or before 1 January 2020 for 2019/20).

What standards should local government bodies include in the 'standards issued but not adopted' disclosure in 2019/20

The applicable standards to be disclosed in 2019/20 are set out in the subsequent edition of the accounting code (i.e. the 2020/21 accounting code). They are summarised in the following table:

Standard	Amendment	Potential impact
IAS 28 Investments in Associates and Joint Ventures: Long-term Interests in Associates and Joint Ventures	Applies to cases when an investment in an associate or joint venture is held by a third party (e.g. unit trust)	Unlikely to apply in practice to most local government bodies
IFRS 3 Business Combinations and IFRS 11 Joint Arrangements	Applies to cases where the body is a party to a joint arrangement and obtains control	Unlikely to apply in practice to many bodies
IAS 12 Income Taxes	Relates to the recognition of the income tax consequences of dividends	May impact on the group financial statements but Is not expected to be common
IAS 23 Borrowing Costs	Affects the specification for calculating borrowing costs which can be capitalised when a weighted average borrowing cost is used	May impact for any body with a policy of capitalising borrowing costs
Amendments to IAS 19 Employee Benefits: Plan Amendment, Curtailment or Settlement	Applies where a pension scheme amendment, curtailment or settlement occurs during the year. The amended assumptions, as used for the remeasurement of the net defined benefit liability, are to be applied in relation to the benefits for the remainder of the year	Impact if a pension scheme amendment, curtailment or settlement occurs during the year
Amendments to References to the Conceptual Framework in IFRS Standards	Updates references to the framework in certain accounting standards so they refer to the 2018 version rather than the 2010 one	May impact when bodies use the Conceptual Framework to develop and apply accounting policies when the accounting code or a standard does not apply to a transaction
Amendment to line item specifications for the net assets statement as detailed in paragraph 6.5.3.6 b) of the accounting code	Requires pooled investment vehicles to be analysed between equities, bonds, property, hedge funds, diversified growth funds, private equity funds, infrastructure funds and other	Impacts on pension funds

Bodies are required to disclose known or reasonably estimable information relevant to assessing the possible impact that application of the new standard will have on the body's financial statements in 2020/21.

As the implementation of IFRS 16 in the public sector has been delayed so that it will come into effect on 1 January 2021, the disclosure requirement in the accounting code does not apply to IFRS 16 in 2019/20 and no information requires to be disclosed.

Annual Governance Statement

How should a body report its compliance with the CIPFA statement on the Role of the Chief Finance Officer in Local Government?
The statement on the Role of the Chief Finance Officer in Local Government (CFO statement) codifies the role and responsibilities of the proper officer under Section 95 of the Local Government (Scotland) Act 1973. It applies on a 'comply or explain basis'. Bodies are required to prepare their Annual Governance Statement in accordance with the Delivering Good Governance in Local Government Framework. A key element of the governance arrangements set out in the framework is ensuring that financial management arrangements conform with the governance requirements of the CFO statement. Where the arrangements do not comply, paragraph 7.9 requires the body to explain in the Annual Governance Statement why that is the case and how they deliver the same impact.

Summary of auditor actions in this section

Paragraphs	Auditor actions
27 to 31	Evaluate whether bodies are considering the impact of the proposed McCloud remedy on pension liabilities
32 to 34	Evaluate whether bodies are considering the impact of the Goodwin Tribunal on pension liabilities
47	Consider the application of the advice from Professional Support to own audits

Contact points for this section

48. The contact points for this section of the Technical Bulletin are:

- Paul O'Brien, Senior Manager (Professional Support) - pobrien@audit-scotland.gov.uk
- Anne Cairns, Manager (Professional Support) – acairns@audit-scotland.gov.uk (grant claims items only).

Section 3

Central government sector

Advice to auditors

49. The following table summarises a request for technical advice made by auditors to Professional Support during the quarter in respect of the audit of the 2019/20 annual report and accounts of central government bodies, along with the advice offered:

Auditor action
Auditors should consider the application of this advice to their own audits

Property, plant and equipment

Can a central government body capitalise a number of laptops that individually fall below the capitalisation threshold?
Central government bodies can choose whether to have a capitalisation threshold and, if so, set their own limits. Auditors should evaluate whether the body's threshold is appropriate to its circumstances and disclosed in the accounting policies. A body could group similar items, such as laptops, and capitalise them even if individually they are below the threshold. Where a body intends to group assets below the threshold, they should explain this within their accounting policies. Bodies may wish to consider the practicality of managing grouped assets within their asset register before implementing such a policy.

Summary of auditor actions in this section

Paragraphs	Auditor actions
49	Consider the application of the advice from Professional Support to own audits

Contact point for this section

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

Section 4

Health sector

Advice to auditors

51. The following table summarises a request for technical advice made by auditors to Professional Support during the quarter in respect of the audit of the 2019/20 annual report and accounts of health boards, along with the advice offered:

Auditor action
Auditors should consider the application of this advice to their own audits

Property, plant and equipment

Can a health board capitalise a number of laptops that individually fall below the capitalisation threshold?
In contrast with central government bodies which can choose whether to have a capitalisation threshold and set their own limits, the Capital Accounting Manual (CAM) sets a threshold of £5,000. The CAM allows grouped items to be capitalised below that level subject to specified conditions. For example, they should be functionally interdependent, acquired at about the same date and have a similar useful life.

Summary of auditor actions in this section

Paragraphs	Auditor actions
51	Consider the application of the advice from Professional Support to own audits

Contact point for this section

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

Section 5

College sector

Auditing developments

Technical guidance note on risks of misstatement in 2019/20

53. Professional Support has published Module 14 of Technical Guidance Note (TGN) 2020/1 to provide auditors with guidance on planning and performing the audit of 2019/20 annual report accounts of colleges.

54. 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 Module 14 of TGN 2020/1

55. The structure of TGN 2020/1 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).

56. Module 14 has been published to provide:

- guidance on applying the other modules to the audit of the annual report and accounts of colleges
- supplementary guidance on the risks of misstatements in the areas specific to colleges.

2019/20 model independent auditor's reports

57. Professional Support has published Technical Guidance Note 2020/6(C) 2019/20 Independent Auditor's Report for Colleges to provide auditors with the model Independent Auditor's Reports which should be used for the 2019/20 annual report and accounts.

58. The model Independent Auditor's Reports set out in the Appendices of the TGN have been tailored to reflect college legislation and augmented by the reporting requirements of the Auditor General. There have been no significant changes to the model Independent Auditor's Reports for 2019/20.

59. The TGN also provides guidance on the amendments that require to, or may, be made to the wording in the models in the form of auditor actions. Some enhancements have been made to the guidance to make the required auditor actions clearer. Auditors should complete for each report the checklist at Appendix 3 which provides a list of those auditor actions.

60. Any proposed modifications to any audit opinion or conclusion, or the inclusion of 'emphasis of matter' or 'other matter' paragraphs, should be discussed with Professional Support in advance of finalising the report.

Auditor action
Auditors should pay due regard to TGN 2020/6(C) when reporting 2019/20 audits

Annual report and accounts overall developments

2019/20 Accounts Direction

61. The Scottish Funding Council (SFC) has issued their Accounts Direction for Scotland's Colleges 2019/20. The direction requires colleges to:

- comply with the Statement of Recommended Practice: Accounting for Further and Higher education (SORP) in preparing their financial statements. The 2019 edition of the SORP applies in 2019/20
- include a Performance Report and Accountability Report in their annual report and accounts in accordance with the Government Financial Reporting Manual (FReM).

Performance Report should reflect COVID-19

62. Specific mandatory disclosure requirements for colleges are set out in Appendix 2 to the direction. The main changes in Appendix 2 result from the impact of COVID-19 and those affecting the Performance Report are summarised in the following table:

Area	Change
Adjusted Operating Position	The impact of COVID-19 should not be included as a separate adjustment to the Adjusted Operating Position. Where the impact on results is significant, the narrative in the Performance Report should provide an adequate explanation.
Performance analysis	Paragraphs 4 to 6 have been added to refer to the Addendum to the 2019/20 FReM (see Technical Bulletin 2020/2 – paragraph 60) which permits colleges to omit the performance analysis section from the Performance Report. Where relevant performance information has already been published elsewhere, colleges are encouraged to refer to the relevant publication.
Performance overview in Performance Report	Paragraph 7 sets out the minimum requirements for the performance overview. Where relevant, disclosures should explain the impact of COVID-19 and EU withdrawal, as well as any mitigating actions implemented by the college.

63. In addition, paragraph 28 requires the governance statement to explain any changes to the governance arrangements of the college, resulting from COVID-19.

Financial statements developments

Guidance on 2019/20 financial statements

64. The SFC has issued guidance notes on completion of the 2019/20 financial statements which are designed to supplement the accounts direction. The guidance covers key disclosures in the financial statements, including model disclosure notes set out at Annexes A to F.

65. The main change is that references included in previous years to guidance on an appropriate discount factor (net interest rate) as at 31 July and the spreadsheet for the calculation of the enhanced pension provision have been removed. Professional support understand that the SFC will not provide such guidance and colleges are expected to identify the appropriate discount factor.

Summary of auditor actions in this section

Paragraphs	Auditor actions
53 - 56	Pay due regard to Module 14 of TGN 2020/1 when planning and performing 2019/20 audits
57 - 60	Pay due regard to TGN 2020/6(C) when reporting 2019/20 audits

Contact point for this section

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

Section 6

Professional Matters

Revised auditing standard on risks of material misstatement

Significant judgements require to be disclosed

67. The Financial Reporting Council (FRC) has a issued a revised ISA(UK)315 Identifying and Assessing the Risks of Material Misstatement as a result of recent revisions to the international standard.

68. The effective date of the revised standard is for accounting periods beginning after 15 December 2021.

69. The main revisions are summarised in the following table:

Area	Summary of revision
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.

Thematic review of COVID-19 financial reporting effects

70. The FRC has issued a report that summarises the key findings of their review of the financial reporting effects of COVID-19 for a sample of annual accounts ending 31 March 2020.

71. The report is intended to provide useful guidance for entities by identifying areas where disclosures affected by COVID-19 can be improved, as well as providing examples demonstrating the level of detail provided by better disclosures. The following table summarises the key messages for selected areas:

Area	Report pages	Key messages
Strategic report (the private sector equivalent of the Management Commentary/ Performance Report).	22 to 31	• The forward-looking information provided in the Strategic Report is particularly important as that is where users of accounts focus to enable them to understand how an entity intends to navigate through COVID-19 related challenges. • It is important to explain clearly how the future strategy and business model may be affected by COVID-19. • Entities are expected to consider the specific resources, assets and relationships that are most under threat and the steps being taken to protect them when setting out their principal risks and uncertainties. • All stakeholders are concerned not only about an entity's workforce and how they are being retained and supported but also about how supplier, customer and other relationships have been maintained.
Presentation of the financial statements	33 to 34	• Entities need to consider whether additional items of income and expenditure arising from the COVID-19 pandemic should be separately disclosed in accordance with their existing policies for 'exceptional' items. It is good practice to include all such items in a single note or link them with cross references. • Where the effects of COVID-19 are pervasive and hard to quantify, it is helpful to provide narrative disclosures explaining the nature of the items and the uncertainties around them. • Entities are discouraged from splitting discrete items on an arbitrary basis in an attempt to quantify the portion relating to COVID-19 as it is unlikely to provide users with reliable information.
Disclosure of significant judgements and estimates	39 - 41	• Where entities find it difficult to estimate which uncertainties will crystallise or which assumptions will change within 12 months, they should consider whether a longer period is more relevant in explaining certain risks, and should tailor their disclosures to their specific circumstances. • The disclosure of sensitivity analysis or information about the range of possible outcomes in relation to estimation uncertainty is particularly valuable to users. The review identified a high number of instances where such disclosures were incomplete or missing altogether.
Impairment of non-financial assets	44 to 47	• Entities are expected to consider the pandemic an indicator of impairment because of the adverse effect it has had. • Most companies identified the impairment assessment as a key source of estimation uncertainty, and explained that the value-in-use method for calculating the recoverable amount of assets requires management to determine appropriate assumption.

Area	Report pages	Key messages
Events after the reporting period	51	• The assessment of whether there are any adjusting post balance sheets events must be made without the benefit of hindsight to ensure assets and liabilities reflect the conditions as at the period end. • As the pandemic is made up of a series of events, it may be difficult to determine whether a post balance sheet event is an adjusting or a non-adjusting event. Disclosures are required in cases where management has exercised significant judgement in making this determination. • Entities should follow the guidance in IAS 37 to determine whether a post balance sheet event is adjusting or non adjusting in cases where IAS 37 covers the specific event or circumstance, e.g. redundancy provisions.

Technical Bulletin 2020/3

If you require this publication in an alternative format and/or language, please contact us to discuss your needs: 0131 625 1500 or **info@audit-scotland.gov.uk**

For the latest news, reports and updates, follow us on:

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