Technical Bulletin 2022/3

Technical developments and emerging risks from July to September 2022

Prepared by Audit Scotland for appointed auditors and audited bodies in all sectors

20 September 2022

Contents

1: Introduction

Contact: Paul O’Brien, Pobrien@audit-scotland.gov.uk

Purpose

The purpose of Technical Bulletins from Audit Scotland’s Professional Support is to provide auditors appointed by the Auditor General for Scotland and Accounts Commission for Scotland with:

- information on the main technical developments in each sector during the quarter
- information on professional matters during the quarter that are expected to have applicability to the public sector
- summaries of selected responses to requests from auditors for technical consultations with Professional Support.

Appointed auditors are required by the Code of Audit Practice 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 generally to be aware of. It may still be necessary for auditors to read the source material if greater detail is required in the circumstances of a specific audited body. Source material can be accessed by using the hyperlinks, where provided.

Any specific actions that Professional Support recommends that auditors take are highlighted in green.

Technical Bulletins are also published on the Audit Scotland website and therefore are available for audited bodies and other stakeholders to access. However, hyperlinks to source material indicated with an asterisk (*) link to files on Audit Scotland’s SharePoint* and are only accessible by auditors.

Highlighted items

The following table highlights a selection of items in this Technical Bulletin:

Highlighted items		
Professional Support has published guidance for auditors on examining and reporting on the 2020/21 WGA returns [paragraph 1].	CIPFA/LASAAC has issued a statement on its consultation on infrastructure assets [paragraph 8].	The Scottish Government has issued statutory overrides in respect of accounting for infrastructure assets in local government [paragraph 11].
The Scottish Government has issued revised statutory guidance on accounting for service concession arrangements and leases in local government [paragraph 14].	CIPFA/LASAAC has issued the local government accounting code for 2022/23 [paragraph 18].	CIPFA/LASAAC has issued an exposure draft of the accounting code for 2023/24 [paragraph 25].
Professional Support has published guidance on certifying the 2021/22 HB subsidy claim [paragraph 34].	Professional Support has provided responses to requests for technical consultations from auditors [paragraph 38].	Professional Support has published guidance on risks of misstatement in the 2021/22 annual report and accounts of colleges [paragraph 39].
Professional Support has published model forms of Independent Auditor's Reports for colleges for 2021/22 [paragraph 42].	The SFC has issued the 2021/22 accounts direction for colleges [paragraph 47].	The SFC has issued guidance on the 2021/22 accounts direction [paragraph 49].
The FRC has issued a new framework to assist auditors in making professional judgements [paragraph 51].	The FRC has issued a report on current practice in auditor reporting [paragraph 60].	The FRC has issued an updated thematic review on the disclosure of judgements and estimates [paragraph 61].
The FRC has issued a thematic review on information on climate change in the annual accounts [paragraph 64].	The FRC has issued a report on the disclosure of digital security risks in the annual accounts [paragraph 67].	The FRC has issued a report on producing ESG data [paragraph 70].

2: All sectors

Contact: Paul O'Brien, Pobrien@audit-scotland.gov.uk

TGN on 2020/21 WGA returns

1. Professional Support has published a Technical Guidance Note (TGN) to provide appointed auditors with guidance on examining and reporting on the 2020/21 Whole of Government Accounts (WGA) returns of public bodies in Scotland. The TGN is provided with supporting material to auditors on SharePoint* and also on the Audit Scotland website

2. HM Treasury prepare WGA for the UK and are responsible for managing the production process. The National Audit Office (NAO) are the group auditor for WGA. The process has been running progressively later over the last few years and, as a result of delays in the preparation of the 2019/20 WGA, the NAO were not able to issue their Group Audit Instructions until July 2022.

3. In order to ameliorate the impact of the delay, Treasury increased the threshold for auditor assurance in England to £2 billion for 2020/21. Professional Support has agreed with the Scottish Government that threshold should also apply for all public bodies in Scotland. This increase from £500 million in previous years greatly reduces the number of bodies above the threshold.

4. Testing and reporting procedures that auditors are required to undertake in respect of providing assurance to the NAO on 2020/21 WGA returns above the threshold is included in the TGN. The procedures are consistent with the NAO's Group Audit Instructions but tailored to Scottish bodies. Reporting procedures include the submission of an Assurance Statement in a form prescribed by NAO.

5. No examination is required for bodies below the threshold, although auditors are required to complete the first eight sections of the Assurance Statement (except for minor bodies) and submit it to the NAO.

6. Treasury and the NAO originally set a date of 31 August 2022 for the submission of the audited WGA returns and Assurance Statements for 2020/21. Subsequent to the publication of the TGN, they revised the submission date to 30 September. Auditors are not expected by Professional Support to meet that date if doing so would compromise the completion of 2021/22 audits of the annual accounts, which should take priority.

7. Auditors should examine and report on the 2020/21 WGA returns of public bodies in Scotland in accordance with the TGN, and make the required submissions as soon as reasonably practicable.

3: Local government sector

Contact: Paul O’Brien, Pobrien@audit-scotland.gov.uk

Update on accounting for infrastructure assets

8. The CIPFA/LASAAC Local Authority Code Board (CIPFA/LASAAC) has issued a statement on the outcome of its consultation on proposed temporary adaptations to be included in the Code of Practice on Local Authority Accounting in the UK (accounting code) in respect of infrastructure assets (explained in Technical Bulletin 2022/2 – paragraph 17).

9. Although there was general support from consultees, concerns were raised by key stakeholders about the proposal that the accounting code should assume that the net book value of replaced parts of infrastructure assets is zero. For example:

- Many respondents were looking for a more positive framing of the assumption about the nil value of derecognised parts.
- Other respondents were of the view that the value of derecognised parts should be based on the best available information.

10. CIPFA/LASAAC was not able to agree an approach that addressed the concerns of all stakeholders while also supporting high quality financial reporting. CIPFA/LASAAC therefore requested the Scottish Government (and governments in England and Wales) for a temporary statutory override while a permanent solution is developed.

11. The Scottish Government has therefore issued Finance Circular 9/2022 which contains temporary statutory overrides of some of the accounting code’s requirements in so far as they relate to infrastructure assets. The statutory overrides are summarised in the following table:

Number	Accounting code para and requirement	Statutory overrides
1	Paragraph 4.1.4.3 1) d) requires disclosure of the gross carrying amount and accumulated depreciation at the beginning and end of the year for each class of property, plant and equipment.	For accounting periods commencing from 1 April 2021 until 31 March 2024, a local authority is not required to report the gross carrying amount and accumulated depreciation for infrastructure assets.
2	Paragraph 4.1.2.51 requires the carrying amount of a replaced part of an item of property, plant and equipment to be derecognised.	For the accounting periods from 1 April 2010 to 31 March 2024, a replaced part of an infrastructure asset is to be derecognised at a nil carrying amount, and no subsequent adjustment can be made to the carrying amount of the asset with respect to that part.

12. A local government body may choose not to apply the overrides. Where the body chooses to apply either or both, paragraph 33 of the circular requires that choice to be disclosed in a note.

13. Auditors should:

- establish whether each local government body is intending to apply one or both overrides
- where the body is not applying both overrides, evaluate whether the relevant accounting code requirements have been complied with
- where the body is applying one or both overrides, evaluate whether the body has made the required disclosures.

Revised statutory guidance on service concession arrangements and leases from 2022/23

14. The Scottish Government has issued Finance Circular 10/2022* to provide revised statutory guidance on accounting for service concession arrangements, leases and similar arrangements. The circular replaces Finance Circular 4/2010 from 2022/23, and provides three options for accounting for these arrangements.

15. The options include no change to the calculation of the statutory charge for the repayment of debt originally set out in Finance Circular 4/2010, which would continue to be charged over the life of the arrangement in equal instalments of principal. The provisions are included at section 2.1 of the new circular.

16. The new circular at section 2.2 sets out a temporary optional flexibility for calculating the statutory charge for the repayment of debt for service concession arrangements entered into prior to 1 April 2022. Key aspects of the flexibility related to this option are explained in the following table:

Aspect	Aspects of flexibility
Nature	The annual charge for the repayment of debt may be calculated: • in accordance with the useful life of the asset • using either equal instalments of principal or the annuity method.
Applicable years	The flexibility may be applied in either 2022/23 or 2023/24. It may have either prospective or retrospective application.
Cumulative statutory adjustment	The cumulative statutory adjustment is from the Capital Adjustment Account to the General Fund and is made as at 1 April in (depending on the year applied) either 2022 or 2023. There is no prior year restatement of statutory adjustments. The service concession arrangement liability will continue to be written down by the contractual principal repayments.

Aspect	Aspects of flexibility
Applicable arrangements	The flexibility must be applied consistently to all service concession arrangements entered into prior to 1 April 2022 with the exception of agreements with less than 5 years until completion provided the annual charge is not materially different. A body should separately identify the value of each service concession arrangement. If not, the asset and liability must be restated at market values. The flexibility does not apply to leases or any similar arrangement.
Governance	The decision to apply the flexibility must be approved by the full Council.
Prepayments	Where a prepayment was originally funded from a revenue or capital source, the body may revisit that decision and choose to fund the prepayment from borrowing. Borrowing should be recognised by a loans fund advance.
Disclosures	The reason for the change should be disclosed, along with an explanation of the movement in both the Balance Sheet and the General Fund. Where the annuity method has been applied, narrative should explain how this method links to the flow of benefits from the asset. Where an arrangement is excluded as it has fewer than five years until expiry, an explanation should be disclosed that the statutory repayment continues to be based on the contract life. Disclosure is required of the: • cumulative value charged to the General Fund prior to applying the flexibility • revised cumulative value charged to the General Fund in adopting the flexibility • funds released as a result of the flexibility.

17. The third option is set out at section 1 of the new circular and involves local government bodies adopting the accounting code requirements in full for service concession arrangements, leases and similar arrangements without any statutory adjustments. Key aspects of this option are explained in the following table:

Aspect	Summary of guidance
Cumulative statutory adjustment	All statutory charges would be reversed, such that only the accounting entries required by the accounting code remain. The cumulative financial effect of all the reversals will be a statutory adjustment from the Capital Adjustment Account to the General Fund. There is no prior year restatement of statutory adjustments.

Aspect	Summary of guidance
Applicable years	The option can be exercised in any financial year from 1 April 2022 and has retrospective application. The statutory adjustment is made as at 1 April in the year the revised arrangements are applied.
Applicable arrangements	The option applies to all service concession arrangements, leases and similar arrangements with the exception of agreements with fewer than 5 years until completion. Once this approach is taken, it should not be reversed in subsequent years.
Disclosures	An explanation should be disclosed of the basis for the accounting policy change and the impact on the balances reported within the annual accounts.

2022/23 accounting code

18. CIPFA/LASAAC has issued the accounting code* to set out local government accounting requirements for 2022/23. The financial reporting framework is based on International Financial Reporting Standards (IFRS) as adopted by the UK, adapted for the local government context where necessary.

19. The most significant change is Appendix F which sets out the requirements for accounting for leases based on IFRS 16 Leases. Although adoption of IFRS 16 is not mandatory until 2024/25, adoption before then is strongly encouraged in which case Appendix F applies.

20. Under IFRS 16, a local government body is required to assess whether a contract meets the definition of a lease. The definition is met where the contract conveys the right to control the use of an identified asset for a period of time. It should be noted that:

- Controlling the use of an identified asset involves having the right to obtain substantially all of the economic benefits and service potential from use of the asset throughout the period of use. Paragraphs B9 to B31 of IFRS 16 provide guidance in this assessment.
- The accounting code adapts the definition of a lease in IFRS 16 to remove the phrase ‘in exchange for consideration’. This means that leases include those agreements that do not include the provision of consideration (nil consideration leases).
- The assessment should take place at inception of a contract, which is usually the date of the lease agreement.
- A body should not make a reassessment on the date of implementation except in relation to leases for nil consideration. Instead, the body is required to apply IFRS 16 only to contracts that were previously identified as leases under the previous standards.

- Reassessment is required only where the terms and conditions of the contract are changed.

21. For lessees, there is no longer a distinction between finance leases and operating leases. A lessee is required to recognise a right-of-use asset and a lease liability. The following table provides a summary of the requirements:

	Right of use asset	Lease liability
Definition	An asset that represents a lessee's right to use the asset that is the subject of the lease (the underlying asset) for the lease term.	The obligation to make lease payments over the lease term.
Initial measurement – commercial terms	At cost, i.e. the amount of the initial measurement of the lease liability.	The discounted present value of outstanding lease payments.
Initial measurement – peppercorn or for nominal lease payments, or for nil consideration	At fair value.	The difference between the fair value and the lease liability is recognised in the surplus or deficit on the provision of services.
Recognition date	The date on which a lessor makes an underlying asset available for use by a lessee (commencement date).	
Subsequent measurement	Current value in accordance with section 4.1 of the accounting code. The cost model can be used as a proxy for current value unless inappropriate (such as for property assets).	The carrying amount of the lease liability is: • increased to reflect interest • reduced to reflect the lease payments made.
Exemptions	A lease that, at the commencement date, has a lease term of 12 months or less (a short-term lease) is exempt, unless it contains a purchase option. A lessee may elect to exempt leases where the underlying asset is of low value.	

22. On transition at 1 April 2022, a local government body as lessee is required to apply IFRS 16 to its leases retrospectively with the cumulative effect of initially applying IFRS 16 recognised at that date. The body should:

- not restate comparative information
- recognise the cumulative effect of initial application as an adjustment to the opening balance of reserves.

23. Appendix C of the accounting code requires a local government body that chooses to adopt IFRS 16 in 2022/23 to disclose information relating to the impact of that accounting change in 2021/22. A body should disclose:

- a statement that IFRS 16 will be adopted on a voluntary basis
- the nature of the impending changes
- a discussion of the impact that initial application of IFRS 16 is expected to have on the body's financial statements (or a statement that the impact is not known or reasonably estimable).

24. Auditors should:

- establish whether the local government body is intending to adopt IFRS 16 in 2022/23
- where adoption is planned for 2022/23, evaluate whether the required disclosures have been made in 2021/22.

Consultation on 2023/24 accounting code

25. CIPFA/LASAAC has issued an exposure draft of the accounting code for 2023/24. There are proposals related to:

- new accounting standards
- sustainability reporting
- changes to the structure or format of the accounting code.

26. Responses to the consultation should be sent to cipfalasaac@cipfa.org by 14 October 2022.

New accounting standards

27. Section A4 of the Invitation to Comment (ITC) sets out two proposed changes to the accounting code as a result of changes to accounting standards. These changes are summarised in the following table:

Accounting standard	Change to standard	Proposed change to code
Definition of Accounting Estimates, Amendments to IAS 8 Accounting Policies, Changes in Accounting Estimates and Errors	The 'change in accounting estimates' definition has been replaced with a definition of accounting estimates which describes them as "monetary amounts in financial statements that are subject to measurement uncertainty"	The revised definition of accounting estimates is included at paragraph 3.3.2.2 of the exposure draft.

Accounting standard	Change to standard	Proposed change to code
	Accounting estimates are developed if accounting policies require items to be measured in a way which involves measurement uncertainty. The effects of a change in input or a measurement technique are changes in estimates provided they do not result from the correction of a prior period error.	It is proposed that paragraphs 3.3.2.14 and 15 of the accounting code are amended to explain that: • an accounting policy may require items to be measured at monetary amounts that cannot be observed directly and must instead be estimated • a local government body is therefore required to develop an accounting estimate to achieve the objective set out by the accounting policy • a body uses measurement techniques and inputs to develop an accounting estimate. In addition, paragraph 3.3.2.18 covers the treatment of a change in an input or measurement technique.
Disclosure of Accounting Policies Amendments to IAS 1 Presentation of Financial Statements	A requirement to disclose an entity's material (rather than significant) accounting policy information. Clarification that accounting policy information may be material because of its nature, even if the related amounts are immaterial. Confirmation that if an entity discloses immaterial accounting policy information, such information must not obscure material accounting policy information.	Paragraphs 3.4.2.88 to 3.4.2.93 have been added to the exposure draft to reflect these changes. This includes at paragraph 3.4.2.90 examples of when accounting policy information is likely to be material.

28. Section B6 proposes to implement IFRS 17 Insurance Contracts from 2025/26, but expects that the standard will apply to local government bodies only in limited circumstances.

Sustainability reporting

29. Section C 7.4 advises that, although there is currently no explicit requirement for local government bodies to produce a sustainability report, sustainability matters should feature in the Management Commentary.

30. In addition to narrative reporting requirements, sustainability reporting will increasingly have a wider impact on the financial statements. A table at paragraph 52 in the ITC provides a list of areas that may be impacted. Examples include:

- asset values
- significant risks that key assumptions may change within the next financial year (e.g. due to potential changes in the regulatory environment)
- any estimation assumptions and uncertainty created by environmental issues
- new additions capitalised to meet climate or other environmental needs
- impairment impacts because of:
  - flooding, coastal defence erosion etc
  - regulatory requirements imposing different building standards
  - assets not meeting environmental standards.
- policy commitments to meet climate change needs that create an obligating event.

31. As the impacts of environmental and sustainability reporting are already covered by the standard provisions of the accounting code, no changes are explicitly required. However, stakeholders' views are sought on the proposal to add this area to CIPFA/LASAAC's strategic plan.

Changes to the structure or format of the accounting code

32. CIPFA/LASAAC considers that it would be timely to consider the structure and format of the accounting code. Preliminary objectives for the review are listed at paragraph 61 of the ITC and include ensuring that the code:

- promotes high-quality financial reporting
- ensures that users are able to understand how a local government body reports its financial position, performance and cash flows
- supports communication of the key messages
- is structured so that its provisions are readily accessible
- clearly sets out where reporting differs from the private sector and the rest of the public sector.

33. CIPFA LASAAC is still considering the objectives for the review and is seeking views.

TGN on certifying 2021/22 HB subsidy claims

34. Professional Support has published TGN/HBS/22 on certifying the 2021/22 housing benefit (HB) subsidy claim. The TGN is provided with supporting material to auditors on SharePoint* and is also available from the Audit Scotland website. The TGN:

- provides guidance for auditors on the examination of the HB subsidy claim, including highlighting the main risk areas
- sets out and explains an overview of the certification approach, the preliminary procedures (at section 1), testing procedures (at section 2), procedures for evaluating results and agreeing amendments (section 3) completion procedures (at section 4) and post-certification procedures (at section 5) that auditors should carry out (all summarised in the checklist at Appendix 1)
- provides examples of reporting errors and observations in a letter to the Department for Work and Pensions (DWP) at Appendix 3
- provides examples of reporting the results of any post-certification procedures at Appendix 4.

35. The approach set out in the TGN is based on the Housing Benefits Assurance Procedures (HBAP) produced by the DWP and used by auditors throughout the UK. However, Professional Support has negotiated with the DWP changes to certification testing for Scottish local authorities for 2021/22. The changes are intended to rationalise the level of auditor testing required by HBAP, and are summarised as follows:

- For local authorities, where auditors have assessed the risks of inaccuracy as low, and with an HB caseload of under 5,000 cases, a smaller initial sample of 10 rent allowances and 10 rent rebates should be selected. A sample size of 20 remains for authorities above that caseload.
- There is no longer a requirement to test a separate sample of 20 modified scheme claims (although any modified scheme claims selected within the initial sample should be tested).

36. The submission deadline for the HB subsidy certification is 31 January 2023.

37. Auditors should certify 2021/22 HB subsidy claims in accordance with TGN/HBS/22.

Technical consultations with auditors

Professional Support responds to requests from auditors for technical consultations

38. The following tables summarise requests from auditors for technical consultations with Professional Support in respect of issues arising from the audit of the 2021/22 annual accounts of local government bodies, along with the advice offered:

Can indexation be used to value land and buildings in local government?

The accounting code contains an interpretation of IAS 16 which requires valuations of land and buildings to be in accordance with RICS valuation standards. The valuation of land and buildings is normally undertaken by professionally qualified valuers. Under RICS standards, a qualified valuer may carry out a:

- valuation inspection, which involves a site visit; or
- desktop investigation where digital mapping is used instead of a site visit.

In Professional Support's view, the use of indices by an accountant to approximate a change in the value of land and buildings does not constitute a valuation in accordance with RICS standards. Professional Support has discussed the matter with CIPFA who has confirmed that indexation is not supported by the accounting code.

However, indices may be used to identify cases where a valuation by a professional valuer under RICS standards is necessary. For example, the accounting code requires assets to be revalued at least every five years, but more regularly if that frequency is insufficient to keep pace with changes in current value. A five-year interval between valuations is dependent on the carrying amount of the asset not being materially different from its current value. Indices may be a useful tool to either demonstrate that is the case or, if a material change is indicated, flag that a valuation by a valuer is necessary.

How should accumulated depreciation be treated at the date of revaluation of property, plant and equipment?

When an item of property, plant and equipment is revalued, the carrying amount of that asset is adjusted to the revalued amount. At the date of the revaluation, paragraph 35 of IAS 16 sets out the following two options for how the asset should be treated:

(a) The gross carrying amount is adjusted in a manner that is consistent with the revaluation of the carrying amount of the asset. The accumulated depreciation at the date of the revaluation is adjusted to equal the difference between the gross carrying amount and the carrying amount of the asset.

(b) The accumulated depreciation is eliminated against the gross carrying amount of the asset.

For local government bodies, the accounting code has since 2016/17 contained an adaptation to IAS 16 at paragraph 4.1.1.6 which withdraws option (a). Accumulated depreciation should therefore be eliminated against the gross carrying amount of the asset.

Should a local authority be recognising a provision or disclosing a contingent liability for cases of historical child abuse in care?

The Redress for Survivors (Historical Child Abuse in Care) (Scotland) Act 2021established a scheme for financial redress for survivors of historical child abuse in relevant care settings in Scotland.

Should a local authority be recognising a provision or disclosing a contingent liability for cases of historical child abuse in care?

The scheme includes the establishment of Redress Scotland as an arm's-length, independent body to make determinations in connection with applications by individuals under the scheme. Redress Scotland advises the Scottish Government on the amount of redress payments and to whom they should be paid.

A number of public and charitable bodies contribute towards the funding of redress payments. The local government sector makes a contribution to recognise the collective responsibility of all local authorities. The contribution is to be top-spliced from the local government settlement for ten years from 2022/23; it is not allocated to individual local authorities but rather it is made at a sector level. The Act specially provides that making a contribution is not evidence of liability in connection with an allegation of abuse.

Professional Support has considered the legal form under which the scheme has been set up and has concluded that individual local authorities do not have a legal or constructive obligation to provide redress. Rather local government as a sector is simply making a financial contribution through top slicing of total revenue grant. There does not therefore appear to be any obligation that would require a local authority to recognise a provision or disclose a contingent liability. The substance of the scheme reflects that legal form so there does not appear to be any substance over form argument.

Can the statutory method for repaying Loans Fund advances be used for repayments after 31 March 2021?

Finance circular 7/2016 provides statutory guidance on the prudent repayment of Loans Fund advances. The statutory guidance allows the method required by the Local Government (Scotland) Act 1975 (the statutory method) to continue to be used for advances made up to 31 March 2021. Repayments for those advances can continue to us the statutory method until the end of the repayment period.

The statutory method is not available for new loans fund advances made after 31 March 2021. A prudent repayment method for these advances is required as set out in the statutory guidance.

It should be noted that this advice supersedes paragraph 35 in Module 3 of TGN 2021/8(LG) which incorrectly states that the statutory method is not permitted for repaying advances made after 1 April 2016 (the date referred to should have been 1 April 2021).

4: College sector

Contact: Neil Cameron, Ncameron@audit-scotland.gov.uk

TGN on risks of material misstatement in 2021/22

39. Professional Support has published Module 14 of TGN 2022/1. The TGN is intended to inform auditors' judgement when identifying and assessing the risks of material misstatement in the 2021/22 annual report and accounts of central government bodies generally. Module 14 provides:

- guidance on applying the other modules to the audit of the 2021/22 annual report and accounts of colleges
- supplementary guidance on the risks of misstatements in areas specific to colleges

40. Module 14 is available with the rest of the TGN and supporting material to auditors on SharePoint* and is also freely available to download from the Audit Scotland website.

41. Auditors are expected to pay due regard to Module 14 and use it as a primary reference source when performing 2021/22 audits of colleges. Auditors should advise Professional Support of any intended departures from the guidance.

TGN on 2021/22 model IARs

42. Professional Support has published TGN 2022/6(C) to provide auditors with model forms of Independent Auditor's Reports (IAR) which should be used for the 2021/22 annual report and accounts of colleges.

43. Auditors are required by the Code of Audit Practice to prepare their IARs in accordance with the TGN. The TGN is available with supporting material to auditors on SharePoint* and are also freely available from the Audit Scotland website.

44. The model form of IARs set out in Appendices 1 and 2 of the TGN have been tailored to reflect relevant public sector legislation and augmented by the reporting requirements of the Auditor General.

45. There are a number of changes to the model forms of IAR and to the application guidance in 2021/22. These are summarised in the following table:

Area	Change
Model IARs	Changes have been made in the 'Conclusions relating to going concern' and the 'Responsibilities of the Board of Management' sections of the model IARs to better explain the application of going concern in the public sector. There are also some minor wording clarifications.
Application guidance	Changes in the guidance include: • permitting auditors to amend the specified wording that explains the extent to which the audit is capable of detecting irregularities • advice for auditors to encourage bodies to use the titles specified by the Statement of Recommended Practice – Accounting for Further and Higher Education 2019 (the SORP) or Government Financial Reporting Manual (FReM) • advice on how to deal with the inclusion of any voluntary reports.

46. Auditors should for 2021/22 audits:

- use the relevant model form of IAR for each college
- follow the specified wording other than where tailoring adjustments are set out in the application guidance in the TGN
- consult with Professional Support on any modified opinion or conclusion
- complete an auditor action checklist provided at Appendix 4 for each IAR prepared.

2021/22 accounts direction

47. The Scottish Funding Council (SFC) has issued their Accounts Direction for Scotland's Colleges 2021/22. The direction requires colleges to:

- comply with the SORP in preparing their financial statements
- include a Performance Report and Accountability Report in their annual report and accounts in accordance with the FReM.

48. Specific mandatory disclosure requirements for colleges are set out in Appendix 2 to the direction. The main changes are as follows:

- Paragraph 8 has been added to require the performance analysis section of the Performance Report to include:
  - a description of the way in which the college has promoted equality of delivery of service to different groups and had due regard to public sector equality duty under the Equality Act 2010

  - brief commentary outlining the Fair Work practices that have been developed in agreement with the college's workforce and the progress the college has made in their implementation.

- A suggested table for the amended fair pay disclosure has been added to the example Remuneration Report at Appendix 8.

Guidance on 2021/22 financial statements

49. The SFC has issued guidance notes on completion of the 2021/22 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.

50. There are no significant changes from 2020/21.

5. Professional developments

Contact: Paul O’Brien, Pobrien@audit-scotland.gov.uk

New framework for making professional judgements

51. The Financial Reporting Council (FRC) has issued a new framework to assist auditors in making professional judgements. Professional judgement involves applying training, knowledge and experience in making informed decisions about appropriate courses of action. The effective exercise of professional judgement is a critical feature of any audit.

52. The framework is intended to enhance the quality and consistency of professional judgements by helping auditors take account of all relevant considerations and improve their more intuitive judgement-making.

53. Although written for auditors, the framework may be useful for others in the financial reporting chain, or for specialists providing expert input into an audit. It could also be useful for audit committees in enhancing their understanding of an auditor’s judgement process.

54. The framework consists of the following four components:

- An appropriate mindset for exercising professional judgement.
- A suggested professional judgement process.
- Effective consultation with a range of relevant parties.
- Factors that can impact on how challenging it is to exercise professional judgement in an appropriate manner.

Mindset

55. The guidance highlights five aspects of mindset that are especially relevant to exercising professional judgement in an effective manner. They are summarised in the following table:

Aspect	Summary of guidance
Appreciation of the purpose of audit and its public interest benefits	Understanding that the purpose of an audit is to enhance the confidence and understanding of users of the financial statements helps emphasise that the interests of the users should be paramount when making judgements. Awareness of the public interest benefits of an audit may motivate the auditor to be objective, professionally sceptical, and committed to quality.

Aspect	Summary of guidance
Professional scepticism	Professional scepticism may be especially relevant when gathering and analysing information, and when effectively challenging management.
Understanding biases and other relevant psychological factors	There are a range of biases that can subconsciously hinder objective reasoning (e.g. availability, confirmation, groupthink, and overconfidence). Certain personality traits may be detrimental to good judgement, e.g. an undue fear of conflict, unwillingness to challenge figures of authority, impatience or stubbornness. Some traits support an effective judgement process, e.g. perceptiveness and a willingness to consult and listen. An auditor's feelings and beliefs affect how susceptible they are to judgement traps such as allowing motivation to unduly influence how information is evaluated. Understanding the above factors assists the auditor in developing strategies to mitigate or cultivate such factors.
Sensitivity to uncertainty	An awareness of the presence of uncertainty can assist the auditor in identifying when they need to exercise professional judgement. An appreciation that some information sources may be more or less reliable than others allows auditors to direct their work efforts in a more effective way. An awareness that not all uncertainty can be eliminated allows the auditor to build mitigating actions into their judgement process.
Commitment to quality	it is important that the auditor is committed to making quality judgements, e.g. by being willing to delay signing the audit opinion to provide the team with enough time to perform a robust professional judgement process.

Professional judgement trigger and process

56. This portion of the framework comprises a series of steps to structure the way in which a judgement is carried out. The steps are summarised in the following table:

Step	Summary of guidance
Remain alert to situations which require the exercise of professional judgement	In deciding whether to use a formal judgement process, auditors should consider the complexity and importance of the judgement being made, their experience and any precedents.

Step	Summary of guidance
Consider who is the right person to make the judgement	Auditors consider the relevant knowledge, skills and experience required; the complexity and importance of the judgement; and the available time and resources. Where an auditor engages an expert to provide a view, the auditor remains responsible for the judgement.
Appropriately frame the issue	Taking the time to fully define and understand the problem, including relevant risks, is a key part of an effective judgement process. The main components of this step are: • articulating objectives to clarify the intended outcomes • identifying the alternatives that will be judged.
Marshal your information	This is a key step as it provides the evidence base. Page 16 of the guidance provides examples of the various enquiries, knowledge and experience from which relevant information may be drawn. Auditors should employ a questioning mindset in seeking information that may contradict as well as corroborate management assertions, while remaining alert to conditions that may indicate information may not be authentic, and to any inconsistencies between different information.
Stand back, and conclude	This includes considering whether: • a judgement step has been inappropriately skipped • all relevant alternatives have been identified and assessed • the judgement has been unduly affected by bias • the course of action decided upon might undermine some of the auditor's other objectives.
Document, communicate and reflect	Effective documentation allows others to understand how judgements were made and the rationale and quality of evidence for the decision reached. Documentation is unlikely to take place at a single point in the audit, but will iterate over time. Key audit matters reported may include significant professional judgments. Auditors should reflect on the process and assess what went well and what could be improved in future.

Consultation

57. It is important that audit teams encourage a healthy culture of debate and challenge to facilitate the input of those with relevant experience and expertise, and provide the opportunity to coach less experienced members of the team.

58. Consultation outside the team, such as with an external expert or an engagement quality reviewer, can further widen the available pool of expertise.

Environmental factors

59. There are a number of factors which may impact on how challenging it may be to exercise professional judgement in a quality manner. The factors are summarised in the following table:

Factor	Summary of guidance
Audit firm: culture, resources, training and processes	An audit firm can facilitate professional judgements by setting an appropriate culture, providing appropriate resources and training, and aligning reward structures to behaviours that demonstrate a commitment to audit quality.
Quantity and quality of relevant information available	If it is especially challenging to obtain relevant and reliable information, this could cause the auditor to place undue reliance on the few sources of information that are easily accessible. The quality of judgement reached should not suffer when information is scarce, though that judgement may have greater uncertainty attached to it which may lead to further work needing to be performed elsewhere.
Time and resources available	Auditors should push back if they feel under pressure to meet a timeline for making the judgement. Resources that can significantly improve the quality and range of information and insight available include: • the capacity and capability of the audit team • access to experts • technological resources such as automated tools and techniques.
Audited entity: management and those charged with governance	The audit committee can support or potentially undermine the auditor's attempts to promote a culture of healthy challenge of management and professional scepticism. The provision of clear and timely supporting information by management can reduce the risk of unnecessary delays, which could in turn lead to a rushed judgement process.

Review of auditor reporting practice

60. The FRC has issued a report which sets out the findings from research it commissioned into the current state of auditor reporting within the UK. A sample of nearly 400 auditor's reports for companies was selected, and the findings have been set out under six themes. The findings that are relevant to public audit are summarised in the following table:

Themes	Areas considered	Findings summary
Understandability and useability of auditor’s reports	This explores how the length of reports varies between firms, industrial sectors, and market segments. Objective measures such as readability scores and measurement of standardised language have been used as a proxy for understanding how useability and understandability varies.	Most auditor’s reports are located before the financial statements. The surveyed auditor’s reports did not include any modified opinions, and nothing was reported by exception. ‘Boilerplate’ text is most prevalent in shorter auditor reports, and in reports issued by firms outside the Big 4. Proxy measures of readability suggest that longer reports with less boilerplate can be harder to read.
Communicating judgements on materiality and the scope of group audits	This reviews how auditors set out the basis of judgements for the selection of materiality and performance materiality, as well as decisions on the scoping and coverage achieved by group audits.	Profit measures remain the most common benchmark used for the determination of materiality, but are becoming less common. The use of equity as a benchmark, as well as multiple benchmarks, have become more common. A high proportion of auditor reports described the professional judgements made by the auditor for the selection of materiality and performance materiality.
Key audit matters (KAMs)	This includes a review of the number of KAMs and the most common types of risks of material misstatement.	Most reports included three KAMs but there were significant variations. There has been a reduction in the average number of KAMs since the requirement was introduced. The most common type of KAM was revenue recognition. Other common KAMs related to investments, asset impairments, and financial instruments. Very few KAMs dealt with risks arising from non-compliance with laws and regulations.
Specific risks	This reviews how auditors have communicated risks arising from climate change, the COVID-19 pandemic, and alternative performance measures (APMs), and their findings from the audit procedures addressing those risks.	Risks associated with climate change were rarely reported as KAMs. The most common response to the risks associated with the pandemic was to integrate the risk within a consideration of the underlying financial statement item. KAMs on APMs are very rare.

Themes	Areas considered	Findings summary
	It also included the use of graduated findings (the auditor describes the position of estimates and judgements by their position on a range of potential outcomes) and binary findings (the auditor compares management's point estimate with a plausible range of values). when reporting on KAMs.	The use of graduated findings is rare. Binary findings are more common, and both approaches use simple, formulaic approaches to express conclusions.
Going concern	This explores how auditors have reported on the appropriateness of the going concern basis of accounting.	KAMs were the main channel for reporting where the auditor had identified heightened risks on going concern. Paragraphs on material uncertainty relating to going concern were rarely used.
Fraud and other irregularities	This explores how auditors have responded to the new requirement to explain the extent to which their audit has been designed to detect fraud and other irregularities.	Identified fraud risks tended to be those presupposed by the auditing standards. The responses to fraud risks tend to be generic and describe procedures that the auditor is required to do for any audit, rather than being specifically tailored to the circumstances of the entity.

Updated thematic review on judgements and estimates

61. The FRC has issued an update to their thematic review on the disclosure of judgements and estimates (see Technical Bulletin 2017/4 – paragraph 20). The review relates to the requirements in IAS 1 to disclose:

- judgements made by management in applying an entity's accounting policies
- sources of estimation uncertainty.

62. The review identified good examples of detailed, granular disclosure explaining management's judgements and the nature of the uncertainties relating to significant estimates. Estimates were supported by quantification, such as information about assumptions made and the specific amount at risk of material adjustment.

63. However, the review also identified the following areas for improvement which are also relevant to public bodies:

- Disclosures should explicitly state whether estimates have a significant risk of a material adjustment to the carrying amounts of assets and liabilities within the next financial year.

- Entities should reassess whether disclosures on sources of estimation uncertainty should be revised each year.

- Where additional estimate disclosures are provided (e.g. those carrying lower risk or crystallising over a longer timeframe), they should be clearly distinguished from those with a significant short-term effect.

Thematic review of climate disclosures

64. The FRC has issued a thematic review on information on climate change in the annual accounts of a sample of premium listed companies. The report:

- assesses the quality of the Task Force on Climate-related Financial Disclosures (TCFD) in response to a new Listing Rule

- considers the extent to which the financial statements reflect the impact of climate change.

65. The review highlights five main areas in which entities could significantly improve their TCFD disclosures and reporting of climate change in the financial statements. Although TCFD does not yet apply in the public sector, it is anticipated that they will form the basis of future requirements.

66. The areas of improvement, along with a summary of the FRC's expectations for each, are set out in the following table:

Area of improvement	FRC expectations
Granularity and specificity	The granularity and specificity of climate-related disclosures should improve as processes to manage risks and opportunities become more embedded. The link with financial planning should be clearer and more quantified.
Balance	Discussion of climate-related risks and opportunities should be balanced and link the opportunities to any technological dependencies.
Interlinkage with other narrative disclosures	The interlinkages of TCFD with other narrative disclosures in the annual report should be considered.
Materiality	Entities should explain how they applied materiality to their TCFD disclosures. Where elements are excluded, it should be clear whether the entity has decided the elements were not relevant or material, or whether they had been omitted for other reasons such as a lack of robust data.

Area of improvement	FRC expectations
Connectivity between TCFD and financial statements disclosures	Entities should consider the connectivity between TCFD disclosures and the financial statements, and provide explanations to address whether: • the degree of emphasis placed on climate change uncertainties in the narrative reporting is consistent with the way they have been reflected in judgements and estimates applied in the financial statements • emissions reduction commitments and strategies described in the narrative have been appropriately reflected in the financial statements • the extent of progress against climate-related opportunities referred to in the narrative reporting is appropriately reflected in segmental disclosures • discussion of matters which may have an adverse effect on asset values or useful lives in the narrative reporting is consistent with positions taken in the financial statements.

Report on digital security risk disclosure

67. The FRC has issued a report on the disclosure of digital security risks in the annual accounts of a sample of companies. Digital security risks are defined for the purposes of the report as the operational, financial, reputational and stakeholder risks caused by cyber security threats, including the risk of major data breaches arising from internal lapses.

68. Digital security risk is fundamental to business continuity and resilience. Reporting on digital systems, processes and data should provide relevant information to assist stakeholders in assessing an entity's ability to remain viable and resilient.

69. The review identified that, while a significant proportion of the companies in the sample reported at least one digital-related principal risk, the disclosures are often 'boilerplate'. The report recommends a number of enhancements; those relevant to public bodies are summarised in the following table:

Area	Disclosure
Strategy	Explain how digital security and strategy are important to the entity's current and future business model, strategy and environment.
Governance	Detail the governance structures, culture and processes in place to support digital security and strategy.
Risk	Identify digital security and strategy risks and opportunities faced both now and in the future.
Events	Highlight the impact of internal and external events, and the actions and activities that respond to these.

Report on producing ESG data

70. The FRC has issued a report on the production of data on environmental, social and governance (ESG) matters. The report focusses particularly on climate issues.

71. The report identifies three elements of ESG data production which it uses to explore the current landscape, as well as the challenges faced and positive actions to address them. The three elements, along with recommended steps for each, are summarised in the following table:

Motivation	Method	Meaning
What motivates the entity to collect ESG data and how does it identify what it needs?	How is ESG data collected?	How is the data used within the entity and how does it impact decision-making?
Perform a materiality assessment to understand the relevant ESG topics and data points. Collaborate with peers to identify sector-relevant metrics, methods and sources. Identify and encourage internal champions to raise awareness.	Identify the data producers and owners across the entity. Identify the sources for the data and set out the methodology and frequency for gathering it. Apply controls over the data, including evidence trails, reviews and sign-offs. Assess which data should be subject to internal and external assurance.	Consider training and education on why ESG data is needed and how it can be used for effective strategic decision-making. Integrate ESG data in regular processes and embed in the culture. Review whether existing data and data quality is supporting strategic decision-making and whether investment in systems and resource is needed.

6. Fraud and irregularities

Contact: Anne Cairns, Acairns@audit-scotland.gov.uk

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

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

Payroll (1)

72. A council employee failed to report a £25,000 payroll overpayment over a three-year period.

Key features
An error in processing a reduction in working hours resulted in an increase to the employee's salary. The error was not identified by the authorising officer, and the employee did not report the overpayment.
The fraud was identified during a data check carried out by the council. The fraud was not detected for three years as the normal annual data checks were suspended during the pandemic.
The council has issued instructions so staff processing and authorising payroll amendments are aware of the importance of ensuring the details are correct. A new checking process has been introduced that requires staff to verify any change of working hours requests to amendment forms, contracts, and payroll details.
Disciplinary action has been taken and recovery action is in process.

Payroll (2)

73. An ex-council employee failed to report a £10,500 payroll overpayment over a seven month period.

Key features
The employee left the council's employment and moved to a health board following a secondment period. However, the council salary continued to be paid for seven months after the employee left the council.
The fraud was identified when the health board queried an invoice for recovery of the employee's costs.
The fraud was possible as the employee's manager in the council failed to complete a termination form.

Key features

The manager has been reminded of the requirement to complete termination forms. The council has re-introduced a previously suspended monthly report requiring managers to confirm the employment status of employees in their service.

The case has been referred to Police Scotland and recovery action has commenced.

Theft

74. An unidentified perpetrator stole random access memories (RAMs) valued at £12,000 from laptops stored in the office of a public body.

Key features

It was discovered during a stock check that some laptops had been opened and RAMs removed.

The theft was possible due to poor security arrangements. The perpetrator has not been identified due to the absence of CCTV.

Security procedures have been strengthened and a process for controlling the distribution of laptops has been developed.

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Technical developments and emerging risks from July to September 2022

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AUDIT SCOTLAND

Audit Scotland, 4th Floor, 102 West Port, Edinburgh EH3 9DN
Phone: 0131 625 1500 Email: **info@audit-scotland.gov.uk**
www.audit-scotland.gov.uk

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