Technical bulletin 2017/2

April to June 2017

Prepared by Audit Strategy
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Audit Scotland is a statutory body set up in April 2000 under the Public Finance and Accountability (Scotland) Act 2000. We help the Auditor General for Scotland and the Accounts Commission check that organisations spending public money use it properly, efficiently and effectively.

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Foreword

Technical bulletins are prepared by Audit Scotland's Audit Strategy business group, and approved by the Assistant Auditor General, to provide external auditors appointed by the Accounts Commission and Auditor General for Scotland with

- information on the main public sector technical developments in the quarter that are relevant to their audit appointment
- guidance from Audit Strategy on any emerging risks identified in the quarter.

Technical bulletins are available to external auditors from Audit Scotland's *Technical reference library,* and published on the Audit Scotland website so that audited bodies and other stakeholders can access them.

It is important that auditors read this technical bulletin promptly so they are familiar with the information and guidance provided. The auditor action checklist section at the end of each chapter should be completed by a senior member of the audit team.

The articles on technical developments are intended to highlight the key points that Audit Strategy considers external auditors require to be aware of. It may still be necessary for auditors to read the source material where greater detail is required. The documents referred to in the articles can be obtained by using the hyperlinks, where available. They are also available to external auditors from Audit Scotland's *Technical reference library*.

While auditors act independently, and are responsible for their own conclusions and opinions, Audit Strategy has a role in ensuring that those conclusions and opinions are reached on the basis of informed judgement. Consistency in similar circumstances is important and paragraph 108 of **Audit Scotland's *Code of audit practice* therefore states that auditors should normally follow Audit Strategy guidance.** This means that auditors are expected to follow the guidance or provide a reasonable explanation as to why not. Auditors should advise Audit Strategy promptly if they intend not to follow guidance provided in this technical bulletin on an emerging risk.

Audit Strategy encourages feedback on this technical bulletin. Comments should be sent to pobrien@audit-scotland.gov.uk.

More in-depth and extensive guidance is provided in separate technical guidance notes published by Audit Strategy. Technical guidance notes published in the quarter are referred to in this technical bulletin, and can be obtained by using the hyperlinks to the Audit Scotland website.

Headlines

This chapter provides brief headlines for the articles on technical developments and guidance in this technical bulletin, classified by the audit year to which it relates, and referenced to the paragraphs containing the main article.

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Cross-sectoral chapter

Introduction

This chapter contains information on the main technical developments, and guidance from Audit Strategy on any emerging risks, in the quarter that are relevant to all sectors.

It should be read by all external auditors. Information on developments and guidance from Audit Strategy in the quarter that are relevant to only one sector are covered in the relevant sector-specific chapter.

Auditing developments

Proposed changes to auditing accounting estimates

1. The International Auditing and Assurance Standards Board has issued an exposure draft of proposed changes to *ISA 540 Auditing accounting estimates and related disclosures.* The exposure draft includes enhanced requirements for risk assessment procedures and the auditor's work effort in responding to the assessed risks of material misstatement in respect of the reasonableness of accounting estimates.

2. It also highlights that the auditor's identification and assessment of the risks of material misstatement, and the auditor's responses to those assessed risks, are affected by the following three factors which are incorporated throughout the exposure draft
   - complexity
   - the need for the use of judgment by management
   - estimation uncertainty.

3. The exposure draft also contains several key provisions that are designed to enhance the auditor's application of professional scepticism and consideration of the potential for management bias, including
   - enhanced risk assessment requirements
   - more granular requirements with respect to obtaining audit evidence
   - requirements to 'stand back' and evaluate the audit evidence obtained.

4. The Financial Reporting Council (FRC) will respond to the consultation and expects in due course to update its ISA (UK) 540 in line with the IAASB's final standard.

Accounting developments

General accounting

Discussion paper on disclosure

5. The International Accounting Standards Board (IASB) has issued a discussion paper under its *Principles of disclosure* project. The Discussion paper: Disclosure initiative - principles of disclosure considers the existing requirements in *IAS 1 Presentation of financial statements* with a view to either amending parts of it or creating a new disclosure standard (both options are referred to in the discussion paper as a general disclosure standard).

6. Paragraphs IN10 to IN15 provide a summary of the IASB's preliminary views. These include the disclosure principles that should be included in a general disclosure standard, and guidance on

   - the principles of effective communication
   - the location of accounting policies disclosures
   - formatting in the financial statements.

7. Paragraphs 1.5 to 1.8 of the discussion paper discuss the following three concerns around what the paper refers to as the disclosure problem

   - Financial statements do not provide enough relevant information.
   - Irrelevant information clutters the financial statements.
   - The information provided is ineffectively communicated.

8. The main causes of the disclosure problem appear to be entities having difficulties in applying judgement when deciding what information to disclose in financial statements and the most effective way to organise and communicate it. A lack of guidance on the content and structure of the financial statements, particularly regarding disclosures in the notes, contributes to these difficulties.

9. Paragraph 2.6 sets out the seven principles to help entities communicate information more effectively in the financial statements. They are that the information should be

   - entity-specific, as that is more useful
   - described as simply and directly as possible without a loss of material information and without unnecessarily increasing the length of the financial statements
   - organised in a way that highlights important matters, including providing disclosures in an appropriate order and emphasising the important matters within them
   - linked when relevant to other information in the financial statements or to other parts of the annual report to highlight relationships between pieces of information
   - not duplicated unnecessarily in different parts of the financial statements or the annual report

- provided in a way that optimises comparability among entities and across reporting periods without compromising the usefulness of the information
- provided in a format that is appropriate for that type of information, e.g. tables may be preferable for data-intensive information.

10. Other preliminary views in the discussion paper include the following
    - The term primary financial statements should be used to refer to the set of individual financial statements to differentiate them from the notes.
    - The role of the primary financial statements is to provide a structured and comparable summary of an entity's recognised assets, liabilities, equity, income and expenses.
    - The role of the notes (which should be defined as that part of the financial statements other than the primary financial statements) is to
        - provide further information necessary to disaggregate, reconcile and explain the items recognised in the primary financial statements
        - supplement the primary financial statements with other information that is necessary to meet the objective of financial statements.
    - When drafting standards in the future, rather than using the terms 'present' and 'disclose' on their own to specify the location of information in the financial statements, the intended location (i.e. 'in the primary financial statements' or 'in the notes') should also be specified.
    - Information necessary to comply with IFRS can be provided outside the financial statements if such information meets the following requirements
        - It is provided within the entity's annual report.
        - Its location outside the financial statements makes the annual report as a whole more understandable, the financial statements remain understandable and the information is faithfully represented; and
        - It is clearly identified and incorporated in the financial statements by means of a cross-reference that is made in the financial statements.
    - Accounting policies should be considered significant, and therefore be disclosed, if their disclosure is necessary for the primary users of the financial statements to understand the information in the financial statements.

11. Comments should be sent to commentletters@ifrs.org by 2 October 2017. The IASB will consider the comments received on the discussion paper before deciding whether to develop an exposure draft of proposed amendments to standards or non-mandatory guidance.

Framework for digital reporting

12. The Financial Reporting Lab has issued a report setting out a framework for future digitally-enabled corporate reporting. Characteristics of the framework set out in Digital future - a framework for future digital reporting include
    - the ability to upload or link information into reports and models

- the ability to search for relevant information and easily navigate reports.
- the corporate reports to
  - be easy to consume
  - require limited technical or specialist skill
  - be trusted as secure and authentic
  - facilitate the ability of entities to engage with their stakeholders.

13. Future reports from the LAB will consider how technologies might meet the needs of the framework.

Corporate governance developments

Revised public sector internal audit standard

14. The Chartered Institute of Public Finance and Accountancy (CIPFA) has issued a revised Public sector internal auditing standard (PSIAS) which applies from 1 April 2017. The PSIAS encompasses the mandatory elements of the Global Institute of Internal Auditors *International professional practices framework* with additional requirements and interpretations for the UK public sector.

15. The PSIAS comprises the following main sections
    - Section 3 states that the mission of internal audit is to enhance and protect organisational value by providing risk-based and objective assurance, advice and insight.
    - Section 4 defines internal auditing as an independent, objective assurance and consulting activity designed to add value and improve an organisation's operations.
    - Section 5 sets out the core principles which articulate internal audit effectiveness. For an internal audit function to be considered effective, all principles should be present and operating effectively. They include demonstrating competence and due professional care; being objective and free from undue influence; aligning with the strategies, objectives, and risks of the organisation; and being appropriately positioned and adequately resourced.
    - Section 6 sets out the code of ethics.
    - Section 7 sets out the standards for the professional practice of internal auditing.

16. The PSIAS has been revised to reflect changes to the international standards. The changes include, for example, emphasising that safeguards are required to avoid conflicts of interest where the head of internal audit's role extends beyond internal auditing.

Other developments

Severance arrangements

17. The Scottish Government has issued a consultation paper to seek views on possible changes to severance arrangements in the Scottish public sector. This is as a result of new powers

conferred on Scottish Ministers in relation to capping and recovery of exit payments in devolved public sector bodies and existing powers that relate to exit payment terms.

18. Exit payment is the term used in the consultation to refer to any financial or non-financial transfer to an employee which does not represent remuneration for normal on-going activities that are part of their employment, e.g. cash lump sums, and early access to unreduced pension.

19. The UK Government's reform of public sector exit payments includes

- capping the total cost of an exit payment to £95,000
- recovering public sector exit payments when an individual on a salary of £80,000 or more returns to work in the public sector within 12 months
- reforming exit payment (severance) terms including imposing a maximum tariff for calculating exit payments of three weeks' pay per year of service, and a ceiling of 15 months on the maximum number of months' salary that can be paid.

20. Scottish Ministers can decide whether to adopt an exit payment cap and/or recovery measures similar to those being implemented by the UK Government or set a different level of cap and/or salary ceiling in relation to recovery provisions. They could also specify the types of payments to be included in that cap and/or recovery provisions.

21. Comments should be sent to severance-policy-for-scotland@gov.scot by 23 June 2017.

Audit Strategy contact for cross-sector chapter

22. The contact in Audit Strategy for this chapter is Paul O'Brien, Senior Manager (Technical) - 0131 625 1795 or pobrien@audit-scotland.gov.uk.

Local authority sector

Introduction

This chapter contains information on the main technical developments, and guidance from Audit Strategy on any emerging risks, in the quarter that are relevant to the local authority sector.

It should be read by external auditors with appointments in the local authority sector. Auditors should also read the cross-sectoral chapter.

Auditing developments

Technical guidance notes

2016/17 model independent auditor's reports

23. Audit Strategy has issued 2016/17 Independent auditor's report (local authorities) - technical guidance note 2017/5(LA) to provide auditors with the model independent auditor's reports which should be used for the 2016/17 local authority annual accounts. The technical guidance note also provides application guidance on their use.

24. In the interests of consistency, auditors are required to use the relevant model report in appendices 1 to 4 of the technical guidance note as a condition of their audit appointment. The only exceptions to using the wording in each model are cases where amendments are required to tailor the terminology to reflect local circumstances.

25. The models for 2016/17 are required to comply with *ISA (UK&I) 700 The independent auditor’s report on financial statements*. This standard will be replaced from 2017/18 by the new *ISA (UK) 700 Forming an opinion and reporting on financial statements*, which contains a revised structure for the independent auditor's report. Although ISA (UK) 700 does not yet formally apply, the model reports for 2016/17 have been revised to follow the structure set out in that new standard, while also complying with the minimum requirements of ISA (UK&I) 700.

26. The models have also been revised to reflect the new reporting requirements for 2016/17 for auditors to express opinions on whether

    - the management commentary has been properly prepared in accordance with statutory guidance
    - the governance statement is consistent with the financial statements and has been properly prepared in accordance with the good governance framework.

27. Any proposed modifications to any audit opinion or conclusion in the model reports, or the inclusion of 'emphasis of matter' or 'other matter' paragraphs, should be discussed with the Audit Strategy in advance of finalising the report.

28. Auditors should use this technical guidance note when reporting on 2016/17 audits. They should complete for each report the checklist at Appendix 5 which provides a list of the key auditor actions.

2016/17 guidance on statutory objections

29. Audit Strategy has issued module 12 of technical guidance note 2016/10(LA) to provide information and guidance on statutory objections to the unaudited annual accounts. Statutory objections refer to the right of interested persons under section 101 of the *Local Government (Scotland) Act 1973* to inspect and to object to the unaudited annual accounts.

30. Module 12 provides auditors with guidance on dealing with any objections they receive, including cases where a hearing is required. This includes
    - considering whether a submission received meets the criteria for being treated as a statutory objection
    - the actions required where the submission can be accepted as a valid objection
    - the actions required where the submission is not a valid objection.

31. Auditors should refer to this module if they receive a statutory objection to the accounts.

Accounting developments

General accounting

2017/18 accounting code

32. The CIPFA/LASAAC Local Authority Code Board has issued the *Code of practice on local authority accounting in the UK 2017/18* (accounting code) which sets out local authority accounting requirements for 2017/18.

33. 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 authority context where necessary. The 2017/18 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 2017. The changes in this edition of the accounting code that are relevant to Scottish local authorities are summarised in the following paragraphs.

34. Paragraph 3.4.2.87 has been added to require local authorities, when assessing the significance of a particular accounting policy, to consider whether disclosure would assist users in understanding how transactions are reflected in the financial statements. The paragraph advises that it is useful for an authority to disclose
    - the choice of policy made by the authority when the accounting code allows different policies
    - each significant accounting policy that, while not specifically required by the accounting code, the authority selects and applies to apply to particular transactions or events.

35. Paragraph 3.4.2.23 has been amended to clarify the requirements for going concern reporting. Local authorities that can only be discontinued under statutory prescription are required to prepare their financial statements on a going concern basis of accounting. Transfers of services under local government reorganisation do not negate the presumption that the financial statements should be prepared on that basis. The paragraph clarifies that other bodies that prepare financial statements in accordance with the code that may be discontinued without statutory prescription should follow the going concern reporting requirements in IAS 1.

36. Paragraph 6.5.5.1 has been amended to require pension funds to disclose information on investment management transaction costs, including the amount for each asset class, their nature, and how they arise for different types of investment. This was previously only a recommendation in the 2016/17 code.

37. Auditors should confirm that their local authorities are making the necessary arrangements to ensure they can comply with the new requirements.

Guidance on application of IFRS 9 and IFRS 15 from 2018/19

38. CIPFA has issued *Forthcoming provisions for IFRS 9 and IFRS 15* to set out the provisions to be adopted in the 2018/19 accounting code for *IFRS 9 Financial instruments* and *IFRS 15 Revenue from contracts with customers*.

39. IFRS 9 and IFRS 15 include significant changes to the financial reporting requirements for financial instruments and revenue recognition. The guidance has been issued early to allow local authorities time to make the necessary changes to their financial systems and processes and to assess the financial consequences. Early adoption of these standards is not permitted.

40. The first section of the guidance sets out the changes to the accounting code for IFRS 9, and therefore most of the changes relate to chapter 7 of the accounting code. IFRS 9 replaces *IAS 39 Financial instruments: recognition and measurement*, and includes

- a single classification approach for financial assets driven by cash flow characteristics and how an instrument is managed
- a forward looking ‘expected loss’ model for impairment rather than the ‘incurred loss’ model under IAS 39
- new provisions on hedge accounting.

41. The second section sets out the changes for IFRS 15 and therefore the majority are focused on section 2.7 of the code. IFRS 15 replaces *IAS 18 Revenue* and *IAS 11 Construction contracts* and their associated interpretations. The core principle in IFRS 15 for local authorities is that they should recognise revenue to depict the transfer of promised goods or services to the service recipient or customer in an amount that reflects the consideration to which the authority expects to be entitled in exchange for those goods or services.

42. Each section of the guidance also includes the consequential amendments to the other chapters and sections of the code.

43. Auditors should refer to this guidance when assessing local authority's preparations for complying with the IFRS 9 and IFRS 15 from 2018/19.

Other developments

Housing benefit

Certification of 2016/17 subsidy claims

44. Audit Strategy has published Auditor certification of the 2016/17 housing benefit subsidy claim-technical guidance note TGN/HBS/17 to provide guidance to auditors on certifying 2016/17 housing benefit (HB) subsidy claims.

45. Auditors should follow this technical guidance note when reviewing and reporting on 2016/17 HB subsidy claims.

Changes in size criteria rules

46. The Department for Work and Pensions (DWP) has issued circular 3/2017(Revised) to provide information on the provisions in The Housing Benefit and Universal Credit (Size Criteria) (Miscellaneous Amendments) Regulations 2017 which make changes to the size criteria rules. The changes are necessary in order to comply with the Supreme Court judgment in November 2016 in relation to the judicial review challenges brought against the *Removal of the spare room subsidy* (RSRS) policy.

47. In summary, the regulations allow an extra bedroom for HB claimants when

- a disabled child or disabled non-dependent adult reasonably requires overnight care from a non-resident carer and is in receipt of a specified disability benefit
- a local authority is satisfied that a couple cannot reasonably share a bedroom as a result of a member of the couple's disability and that member is in receipt of a specified disability benefit.

48. The regulations apply in both the private rented sector and social rented sector from 1 April 2017.

Removal of additional ESA

49. The DWP has issued Circular A4/2017 to provide information about The Employment and Support Allowance and Universal Credit (Miscellaneous Amendments and Transitional and Savings Provisions) Regulations 2017.

50. Employment support allowance (ESA) is the main benefit for those people of working age who cannot work because of a health condition or disability. Additional components may be paid to people on ESA in addition to the basic allowance if they are found to have limited capability for work.

51. The regulations remove the additional component for new ESA claims after 3 April 2017.

Limiting HB support to no more than two children

52. The DWP has issued Circular A5/2017 to provide information on The Social Security (Restrictions on Amounts for Children and Qualifying Young Persons) Amendment Regulations 2017 which limit to two the number of personal allowances which can be included in the HB applicable amount in respect of children and young people.

53. The changes came in to force on 6 April 2017.

New disregards from 2017/18

54. The DWP has issued Circular A6/2017 to advise of HB disregards for payments made under the new *Bereavement support payment*.

New right benefit initiative

55. The DWP has issued Circular A7/2017 to announce a new initiative which aims to target key areas of HB fraud and error. The *Right benefit initiative* (RBI) replaces the *Fraud and error reduction incentive scheme* (FERIS) for 2017/18.

56. Funding is being provided by the DWP to local authorities to target claimant 'earnings', the highest area for housing benefit fraud and error. The aim of RBI is to maximise the return on the available investment, target local authority activity on specific areas and remove elements of the previous schemes which were unattractive to local authorities.

57. Local authorities were requested to confirm that they wished to be included in the initiative. All funding is being paid in a single upfront payment (see Circular 6/2017) with no additional incentive payments linked to performance.

2017/18 funding

58. The DWP has issued the following circulars in respect of various types of HB funding:

- S4/2017 (Revised): New burdens funding: Changes to work-related activity group payments in employment and support allowance.
- S5/2017 Removal of temporary accommodation management fee in housing benefit subsidy from 1 April 2017.
- S7/2017 Additional new burdens funding to meet the costs of implementing welfare reform changes in 2017/18.
- S8/2017 Payment of new burdens relating to the Single Fraud Investigation Service project for 2017/18.

Retirement benefits

2016/17 report on actuarial information

59. PricewaterhouseCoopers has prepared a report to provide support to auditors when assessing the actuaries who produce retirement benefits figures under *IAS 19 Employee benefits* as at 31 March 2017.

60. The work carried out for the report involved assessing the competence and objectivity of, and assumptions and approach adopted by, the relevant actuaries. It found that actuaries signing-off the calculation of the figures are appropriately qualified, and the actuarial firms are experienced and well-reputed. There are no known circumstances which would impair their objectivity to produce the figures.

61. The main findings in respect of the assumptions and approach are as follows

- The actuarial assumptions proposed by the actuaries are considered to be reasonable for most employers.
- For some actuaries individual assumptions may fall outside the expected range but when all assumptions are taken together a reasonable liability figure will be produced.
- The report recommends further investigation where an employer has requested different assumptions than those proposed by the actuary.

62. However, there is concern that accurate cash flows and details of significant events may not always be communicated to the actuaries. The report recommends that auditors consider extra tests on the cash flow data provided by employers, and satisfy themselves that any special events that they are aware of have been communicated to the actuaries.

63. Most actuaries follow a process of requesting redundancy and exit data in advance of the year end to allow more time for their calculations and reporting. This approach is reasonable provided there is a procedure to check for significant movements or employer decisions. If auditors are aware of material volumes of redundancies, particularly in the last few months, they should ensure that details of these have been passed onto the relevant actuary.

64. Auditors should use this report in relation to IAS 19 amounts and the work of the actuary in relation to 2016/17.

Grant claims

65. Audit Strategy has issued Certification of 2016/17 approved local authority grant claims and returns - Technical guidance note TGN/GEN/17 to provide general guidance to auditors on the certification of 2016/17 local authority grant claims and returns and to explain the approach and procedures to be adopted. The technical guidance note

- explains the arrangements for the certification of grant claims and other returns
- provides a list of grant claims and other returns which external auditors are required to certify in 2016/17 under their audit appointment
- considers the roles and responsibilities of grant-paying bodies, local authorities, Audit Strategy and appointed auditors
- sets out the overall approach to be adopted by auditors
- provides guidance on auditor reporting.

66. Audit Strategy also separately publishes a technical guidance note on each significant approved claim to provide auditors with specific guidance on certifying that claim. In addition

to Auditor certification of the 2016/17 housing benefit subsidy claim - Technical guidance note TGN/HBS/17 referred to at paragraph 44, the following have been published for 2016/17

- Auditor certification of the 2016/17 Bellwin scheme claims - technical guidance note TGN/BEL/17
- Auditor certification of 2016/17 education maintenance allowances grant claim - technical guidance note TGN/EMA/17
- Auditor certification of 2016/17 criminal justice social work service financial return - technical guidance note TGN/CJS/17
- Auditor certification of 2016/17 non domestic rates income returns - technical guidance note TGN/NDR/17.

67. Auditors should follow these technical guidance notes when reviewing and reporting on 2016/17 grant claims.

Auditor action checklist

	Yes/No/N/A	Initials/date	W/P ref
1 Have you carried out the action required at paragraph 28 in respect of 2016/17 model independent auditor's reports?			
2 Have you carried out the action required at paragraph 31 in respect of statutory objections to the accounts?			
3 Have you carried out the action recommended at paragraph 37 in respect of statutory objections to the accounts?			
4 Have you carried out the action recommended at paragraph 43 in respect of IFRS 9 and IFRS 15?			
5 Have you carried out the action recommended at paragraph 64 in respect of the report on IAS 19?			

Audit Strategy contacts for local authority chapter

68. The contacts in Audit Strategy for this chapter are

- Paul O'Brien, Senior Manager (Technical) - 0131 625 1795 or pobrien@audit-scotland.gov.uk.
- Anne Cairns, Manager - 0131 625 1926 or acairns@audit-scotland.gov.uk (for housing benefit).

Central government chapter

Introduction

This chapter contains information on the main technical developments, and guidance from Audit Strategy on any emerging risks, in the quarter that are relevant to the central government sector.

It should be read by external auditors with appointments in the central government sector. It should also be read by auditors with appointments in the health sector and further education sector as most of the articles also apply to those sectors. Auditors should also read the cross-sectoral chapter.

Accounting developments

Disclosure of new standards not yet effective

69. HM Treasury has issued a guide to new international financial reporting standards (IFRS) that have been issued but are not yet effective in 2016/17, and therefore require disclosure in accordance with *IAS 8 Accounting policies, changes in accounting estimates and errors*.

70. *Review of new IFRS issued and/or effective during 2016/17* clarifies that the standards that have been issued but not effective until 2017/18 include the following

    - IFRS 9 Financial instruments
    - IFRS 15 Revenue from contracts with customers
    - IAS 16 Leases.

71. Auditors should consider this guide when auditing the disclosure of standards issued but not yet effective in the 2016/17 annual report and accounts.

IFRS 9

72. IFRS 9 is replacing IAS 39, and a number of interpretations have been proposed to the 2018/19 FReM in respect of its requirements.

73. The accounting policy choice allowed under IFRS 9 for long term trade receivables, contract assets which do contain a significant financing component, and lease receivables will be withdrawn. This means bodies will always recognise a loss allowance at an amount equal to lifetime expected credit losses. Bodies will be required to utilise the simplified approach to impairment for relevant assets.

74. The accounting policy choice which allows bodies to apply the hedge accounting requirements of IAS 39 will not be available, and bodies will be required to apply IFRS 9.

75. The option to restate prior periods where that is possible without the use of hindsight has been withdrawn. Any difference between the previous carrying amount and the opening carrying amount at the date of initial application will be required to be recognised in the opening retained earnings

76. When considering the disclosures in 2016/17 on standards issued but not yet effective, bodies should be considering

- whether the impact of IFRS 9 is material to the financial statements
- how financial instruments are likely to be classified and measured under IFRS 9
- how the existing disclosures of financial instruments will change.

IFRS 15

77. IFRS 15 recognises revenue to depict the transfer of promised goods or services to the customer in an amount that reflects the consideration to which the entity expects to be entitled to, in exchange for those goods or services.

78. The following interpretations to IFRS 15 have been proposed

- Where revenue that is not classified as a tax but is still received by government through legislation, the contract will be considered to be that legislation.
- Where bodies, with the approval of the Scottish Government, are allowed to keep tax as revenue, it should be accounted for under IFRS 15.
- All bodies are required to restate prior periods in accordance with IAS 8 with the cumulative effect of initially applying IFRS 15 recognised as an adjustment to the opening balance of retained earnings.

79. When considering the disclosures to the financial statements on standards issued but not yet effective, bodies should be considering

- the proportion of its revenue that will be within the scope of IFRS 15 and whether this is material to the financial statements
- whether the body has correctly classified all its income as revenue or tax
- whether applying IFRS 15 will materially change the revenue recognition points
- how the existing disclosures of revenue will change.

IAS 16

80. IFRS 16 removes the distinction between operating and finance leases and introduces a single lessee accounting model. Bodies should be considering

- the operating leases commitments currently held and whether these are material to the financial statements
- the nature of the assets being leased and whether they may be classed as short term or low value leases?

Health chapter

Introduction

This chapter contains information on the main technical developments, and guidance from Audit Strategy on any emerging risks, in the quarter that are relevant to the health sector.

It should be read by external auditors with appointments in the health sector. Auditors should also read the central government sector and cross-sectoral chapter.

Guidance from Audit Strategy on emerging risks

NHS injury cost recovery scheme

81. Audit Strategy has become aware of an emerging risk in respect of the *Injury cost recovery* (ICR) scheme. Under the ICR scheme, the cost of NHS treatment costs can be recovered where personal injury compensation is paid (e.g. after a road traffic accident) primarily from an insurance company or third party compensator.

82. The Department of Health's Guidance on the application of the NHS injury cost recovery scheme for 2016/17 sets out the process to recover costs and how this should be recorded in the financial statements. Day to day operation of the scheme is undertaken by the Cost Recovery Unit (CRU) of the Department of Work and Pensions. The CRU notify boards of claims using form NHS2, which asks for basic treatment details. The form is used to calculate how much is payable, using an average tariff system.

83. Boards will know on completion of the NHS2 details how much they are due to receive when the claim is settled (net of impairment for non-payment equal to 22.94%). They should recognise income and a debtor at the point the form has been received and they have confirmed that treatment has been provided. Initially this should be recognised in long term debtors and transferred to short term debtors after one year. A risk has emerged that not all boards have made the necessary accrual and instead account for recovery on receipt.

84. Auditors should confirm that their boards have properly recognised a debtor at 31 March 2017 for expected recoveries under the scheme.

Auditing developments

Review of central work on CNORIS

85. Audit Strategy has undertaken a review of the work carried out by the NHS Central Legal Office (CLO) relating to the *Clinical negligence and other risks indemnity scheme* (CNORIS). The objective of the review was to establish the extent to which the information prepared using the work of the CLO, as a management expert under *ISA (UK&I) 500 Audit evidence*, can be used as audit evidence.

86. Audit Strategy has also evaluated the appropriateness of the methodology adopted by the Scottish Government to establish the total national liability for CNORIS. The review focused on the estimation of the liability as at 31 March 2017.

87. Audit Strategy has provided auditors with the outcome of the above reviews.

Accounting developments

Performance reports

Good practice note

88. Audit Strategy has issued a good practice note to assist boards in improving the presentation of their performance reports. The note is based on a review of all the territorial health boards' 2015/16 performance reports to identify instances of good practice and areas for improvement.

89. The note sets out some key messages including recommending that boards

- make more use of infographics, charts and graphs
- tailor the disclosure on their purpose and activities to reflect each board's corporate priorities
- ensure that explanations of complex areas are not written in overly technical terms
- use case studies or examples where this can help provide the user with a better insight into performance.

Auditor action checklist

	Yes/No/N/A	Initials/date	W/P ref
1 Have you carried out the action recommended at paragraph 84 in respect of the NHS cost recovery scheme?			

Audit Strategy contact for health chapter

90. The contact Audit Strategy for this chapter is Neil Cameron, Manager - Central Government and Health (Technical) - 0131 625 1797 or ncameron@audit-scotland.gov.uk.

Fraud and irregularities

Introduction

This chapter contains a summary of fraud cases and other irregularities arising at audited bodies that have recently been reported by auditors to Audit Strategy.

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

Expenditure

Contract awards

91. Two council employees colluded with contractors resulting in over £10,000 of work to council houses being unfairly or unnecessarily awarded.

Key features

The two employees

- deliberately awarded the majority of work to one painting contractor rather than ensuring the fair allocation to all contractors on the council framework agreement
- instructed unnecessary works to be carried out
- approved payments for works which had not been undertaken.

The fraud was discovered when another contractor in the framework agreement made a complaint about the unfair allocation of works.

The fraud was possible as the supervisor, who was not involved in the collusion, failed to properly monitor the level of variances in the works awarded and failed to identify that additional work was being approved without the necessary authority being given.

Both employees have been suspended and a disciplinary investigation has commenced. The supervisor has been suspended due to their poor performance.

Changes have been made within the building maintenance depot to ensure policies and procedures are being followed and the allocation of works to contractors is fair.

Social care overpayments

92. A council continued to pay over £5,000 to a residential care home after the death of the resident.

Key features

The council's system was reliant on care homes submitting a weekly return which included notification of changes to service users' circumstances. The council's internal control failed to identify that the care home in question had not submitted a return for the week in which the resident died.

The overpayment was identified under the *National fraud initiative* when a data match between private residential care home and deceased person records highlighted that the payments to the care home were continuing after the resident had died.

All amounts overpaid have since been recovered.

Checks are now in place to ensure all care home returns are received each week.

Change of bank details

93. A third party attempted to defraud £2.35 million from a council by redirecting payments for a legitimate supplier.

Key features

The fraudster sent a forged letter to the council purporting to be from the supplier requesting a change in bank details. The council updated the bank details, and made two payments to the new bank account.

The fraud was discovered when the bank subsequently rejected the BACS payments and returned the money to the council.

The fraud was possible as officers did not confirm the amended bank details with the supplier.

Income

Cash misappropriation

94. A clerical assistant in a council education service embezzled over £5,000 over an eight month period.

Key features

The perpetrator carried out the fraud both by failing to bank cash income and withdrawing cash to pay for authorised services but not making the payments.

The fraud was possible due to a lack of segregation of duties, and poor financial monitoring and physical cash controls.

The fraud was discovered when a supplier queried why transport costs were not paid as expected. This prompted an investigation by internal audit.

The employee was dismissed and reported to the police.

False refunds

95. An officer defrauded almost £11,000 from a council by creating false refunds for personal gain.

Key features

The officer fraudulently processed electronic and cash refunds over a four year period.

The fraud was possible due to inadequate access controls to the cash receipting system which allowed staff to use the log in details of colleagues. It was not possible to identify which member of staff had processed a particular refund.

The fraud was identified after management identified a suspicious transaction and referred the matter to the council's counter fraud service. On being interviewed the employee admitted to the thefts. Disciplinary action was taken against the employee who was also convicted and sentenced to four months imprisonment. Some of the amount defrauded as been recovered from the employee's final pay and efforts are ongoing to recover the balance owed from the employee's pension.

Reporting procedures have been enhanced and detailed transaction reports are now produced which will immediately highlight any discrepancies. Proper system login processes have been implemented, and employee logins are now monitored.

Banking error

96. The head of an education centre paid incorrectly £6,000 of council cash into the bank account of a third party.

Key features

The employee paid childcare payments received from a debtor into the bank account of a parent rather than to the council's bank account. The issue was highlighted when the council team pursued the apparent non-payment of the debt with the debtor.

An internal audit investigation concluded that the employee had behaved carelessly rather than fraudulently, but nevertheless recommended disciplinary action. A process has been put in place to ensure debts relating to these services are pursued more quickly.

The council has been unable to recover the money to date and the matter has been referred to the police.

Payroll

Manipulation of staff incentive scheme

97. An employee obtained £13,000 by manipulating a staff incentive scheme.

Key features

The employee manually amended the records used for the processing of payroll in relation to the staff incentive scheme to secure payments to which they were not entitled.

The fraud was possible due to a lack of segregation of duties and limited challenge of payment requests. It was identified after an acquaintance of the employee reported concerns to the Head of HR.

Internal control has been improved so that

- dual sign off is now required for payments under the incentive scheme
- payment processing now falls within the remit of the Finance Team supported by a direct reconciliation to system reports
- payment approval is now under the control of the Finance Director.

The employee has been dismissed following a disciplinary hearing, and the matter was reported to Police Scotland.

Equipment and stores

Theft

98. A council building services employee stole plant, equipment and fuel valued at over £87,000 over a nine month period.

Key features

The theft was possible due to weaknesses in stock control, physical security and segregation of duties. It was identified after management received an anonymous tip-off.

The matter was reported to Police Scotland who searched the employee's home address and home storage units and recovered £87,300 worth of plant and equipment.

Following disciplinary action, the employee resigned.

New stock control and fuel issuing processes have been implemented, spot checks are being undertaken, and segregation of duties has been improved.

Cybercrime-malware

99. A third party attempted to misappropriate over £120,000 from a body's bank account by using malware to access the account remotely.

Key features

The perpetrator infected with malware a computer used by the finance team in order to gain access to the body's online bank accounts. This resulted in the transfer over £85,000 internally and an attempted transfer of an additional £35,000 externally.

The fraud was identified as the attempted transfer triggered the banks counter-fraud controls.

The malware attack was possible as anti-virus software recommended by the bank had not been installed on the computer in question as the employee who used it did not make payments.

The relevant anti-virus software has now been installed on all computers where staff have any access rights to the online bank account. There has also been a general increased awareness within the finance team of the potential for malware attacks.

The police have been informed.

Audit Strategy contact for fraud and irregularities chapter

100. The contact in Audit Strategy for this chapter is Anne Cairns, Manager - 0131 625 1926 or acairns@audit-scotland.gov.uk.

Audit Strategy

Audit Scotland's Audit Strategy business group informs the professional judgement of appointed external auditors on technical matters and encourages the proper exercise of professional scepticism to improve the quality of the audit delivered to the Accounts Commission and Auditor General for Scotland. Audit Strategy provides authoritative guidance and practical assistance to support appointed auditors in carrying out their responsibilities under the *Code of audit practice* to

- provide an opinion on audited bodies' financial statements and, where required, the regularity of transactions
- review and report on other information published with the financial statements, including governance statements and remuneration reports
- examine and report on approved grant claims and other returns submitted by local authorities
- review and report on whole of government accounts returns.

Contact details for relevant Audit Strategy staff are included at the end of each chapter.

Feedback on technical bulletins is encouraged and should be sent to

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