Technical bulletin 2017/3

July to September 2017

AUDIT SCOTLAND

Prepared by Audit Strategy

12 September 2017

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.

Contents

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.

Cross sector chapter	Paragraphs
2016/17 audit year	
Technical developments	
CIPFA has published a guide to help public bodies better understand their balance sheets	8-12
The IAASB has issued a report on professional scepticism	6-7
2018/19 audit year	
Technical developments	
FRC has issued revised guidance on bank confirmations	1-2
FRC has issued a revised version of ISA (UK) 250 on laws and regulations	3-5
CIPFA has issued a consultation paper that proposes changes to the treasury management code	13-16

Local authority chapter	Paragraphs
2016/17 audit year	
Technical developments	
PSAA has issued modules 4 and 5 of 2016/17 HBCOUNT	37
Accounts Commission has issued a report on equal pay	47
Treasury has issued guidance on completing 2016/17 WGA returns	43
Audit Strategy has published a technical guidance note on reviewing 2016/17 WGA returns	44-46
2017/18 audit year	
Technical developments	
The DWP has issued two funding circulars	38

Local authority chapter	Paragraphs
CIPFA has issued the 2017/18 disclosure checklist	35-36
2018/19 audit year	
Technical developments	
CIPFA/LASAAC has issued a consultation draft of the 2018/19 accounting code	18-34
CIPFA has issued a consultation paper of proposed changes to the prudential code	39-42

Central government chapter	Paragraphs
2016/17 audit year	
Technical developments	
The Scottish Government has issued amendments to the SPFM	49-50
Treasury has issued guidance on completing 2016/17 WGA returns	51
Audit Strategy has published a technical guidance note on reviewing 2016/17 WGA returns	52-54

Health chapter	Paragraphs
2016/17 audit year	
Technical developments	
Audit Scotland has issued a report on workforce planning	56

Further education chapter	Paragraphs
2016/17 audit year	
Technical developments	
Audit Strategy has issued a technical guidance note on auditing the 2016/17 annual report and accounts	58-63

Further education chapter	Paragraphs
Audit Strategy has issued a technical guidance note on the 2016/17 independent auditor's reports	64-68
The Auditor General has issued the 2017 overview report	69-70
The SFC has issued the 2016/17 accounts direction	71-76
The SFC has issued the 2016/17 guidance notes	77-78
The SFC has issued the 2016/17 guidance on the early retirement provision	79-80

Fraud and irregularity chapter	Paragraphs
Audit Strategy has provided a summary of reported fraud cases	82-83

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

Revised guidance on bank confirmations

1. The Financial Reporting Council (FRC) has decided to withdraw practice note 16 on bank confirmations and replace it with limited amendments to the following two auditing standards
   - ISA (UK) 330 The auditors response to assessed risks has been amended to add application material in respect of bank confirmation letters. It states that, depending on their risk assessment, auditors should consider whether confirmation is needed in relation to additional information (e.g. information about guarantees), as well as balances and other banking arrangements. The amendments are intended to encourage auditors to apply their professional judgement as to when a confirmation report is required.
   - A footnote has been added to ISA (UK) 500 External confirmations to advise that templates that can be used to obtain bank confirmations are available from the British Bankers' Association website.
2. The changes will be effective for audits of periods commencing on or after 15 December 2017, although early adoption permitted.

Revised standard on laws and regulations

3. The FRC has issued a revised version of ISA (UK) 250 Section A Consideration of laws and regulations effective for audits for periods commencing on or after 15 December 2017.
4. The revisions, which are limited in scope, reflect changes made to the international code of ethics which provide a framework to support reporting by accountants where they identify non-compliance with laws or regulations in the course of their work. The International Auditing and Assurance Standards Board (IAASB) has made minor changes to align ISA 250 with the requirements of the revised ethics code.
5. The changes made by the FRC help to improve the clarity of the ISA (UK), e.g. the definition of non-compliance has been amended to cover a broader range of instances that are contrary to the prevailing laws or regulations. This is supported by application material on laws and

regulations that deal with fraud, corruption and bribery and money laundering, terrorist financing and proceeds of crime.

New report on professional scepticism

6. The IAASB has issued Toward enhanced professional scepticism which is aimed at enhancing the exercise of professional scepticism when carrying out an audit.

7. Key observations in the report include
   - Strong business acumen (e.g. a sufficient knowledge of the audited body's business model) and professional competencies, in addition to a sufficient understanding of relevant standards and legislation, enable robust professional scepticism.
   - Professional scepticism can be impeded by tight financial reporting deadlines, resource constraints, a firm's tone at the top, incentive systems, local culture and a range of cognitive biases. Heightening awareness of these and other factors is the first step to mitigate their impact.
   - Personal traits play a role in the exercise of professional scepticism (e.g. confidence; an inquisitive nature; an individual's response to stress, time pressures, or conflict; knowledge; practical experience; and cultural background. In consideration of these factors, standards might be improved by including more guidance about how an awareness and understanding of personal traits and biases can enhance the exercise of professional scepticism.
   - Education and training can raise awareness and develop the needed attitude. It is critical to reinforce and monitor the application of professional scepticism, including through setting the right tone at the top.

Other developments

Financial management

Guidance on balance sheet management

8. The Chartered Institute of Public Finance and Accountancy (CIPFA) has published Balance sheet management in the public services to help public bodies better understand their balance sheets, as well as the issues and challenges associated with managing them effectively.

9. The publication explains that the objective of balance sheet management in the public services is to support service delivery. A body that manages its assets and liabilities well is better placed to deliver effective financial management and robust accounting and financial reporting.

10. It therefore defines balance sheet management as the active assessment and management of all the organisational, operational and financial activities and transactions that determine or influence balance sheet values to promote effective stewardship of public money and value for money in use of resources.

11. This definition goes beyond balance sheet values in isolation to reflect the operational and financial activities that ultimately lead to those values. It presents a framework for analysing the wide range of functions and activities that have balance sheet management implications, and for assessing a body's performance against benchmarks of good practice. This assessment is conducted across the categories of

- governance, risk and controls
- accounting and external reporting
- financial management and decision-making
- operational management.

12. The publication covers the following

- Chapter 2 introduces the types of issue that need to be considered in the context of public sector balance sheets.
- Chapter 3 introduces an approach whereby public sector bodies can self-assess their current practices related to balance sheet management and identify and implement improvements.
- Chapter 4 includes an analysis tool to help understand more about the nature and characteristics of the body's balance sheet, highlighting areas of particular financial or operational significance. It also includes a detailed self-assessment tool to compare current balance sheet practices against good practice.

Proposed changes to treasury management code

13. CIPFA has issued a consultation paper that proposes changes to the *Treasury management in the public services: Code of practice and cross-sectoral guidance notes* from 2018/19. The proposals are based on the comments offered in response to the initial request for views in April 2017.

14. The treasury management code provides a framework for effective treasury management in public sector organisations. It defines treasury management as

- the management of a body's investments and cash flows, banking, money market and capital market transactions
- the effective control of the risks associated with those activities
- the pursuit of optimum performance consistent with those risks.

15. The consultation paper proposes to

- change the indicator on principal invested for longer than 364 days to principal invested over 365 days in line with financial reporting definitions
- remove the interest rate exposure indictor and require the treasury management strategy to state how interest rate exposure is managed and monitored
- extend the indicator on maturity structure of borrowing to cover variable as well as fixed rate debt

- clarify that the code covers all investments held primarily for financial returns, and that this may include some service investments. The annex to the consultation document contains an extract of the substantive changes proposed to the code
- allow some reporting of detailed indicators and monitoring information to a committee or sub-committee whilst making clear that responsibility remains with the board/full council. The key changes are set out in the annex.

16. Responses should be submitted to matthew.allen@cipfa.org by 30 September 2017.

Audit Strategy contact for cross-sector chapter

17. 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.

Accounting developments

General accounting

Consultation on 2018/19 accounting code

18. The CIPFA/LASAAC Local Authority Code Board has issued a consultation paper with proposed amendments to the 2018/19 *Code of practice on local authority accounting in the UK* (the draft code). It comprises an invitation to comment as well as extracts from the draft code with the proposed amendments set out.

19. The consultation paper
    - sets out areas for consideration on the approach to adopting *IFRS 9 Financial instruments*
    - seeks views on the approach to the disclosure framework under *IFRS 15 Revenue from contracts with customers*
    - proposes changes as a result of narrow scope amendments to international financial reporting standards (IFRS)
    - proposes amendments to debtors and creditors disclosures
    - includes initial issues concerning the application of *IFRS 16 Leases* from 2019/20.

20. Responses should be submitted to code.responses@cipfa.org by 6 October 2017.

Adoption of IFRS 9

21. CIPFA/LASAAC consulted on the approach to the adoption of IFRS 9 last year, and then issued a publication setting out the agreed position. The publication was issued with the 2017/18 Code in order to provide local authorities with time to prepare for the changes. However, CIPFA/LASAAC considers further clarification might be needed in the following two areas
    - Purchased or originated credit-impaired financial assets.
    - Simplified approach for trade receivables, contract assets and lease receivables.

Purchased or originated credit-impaired financial assets

22. IFRS 9 replaces the incurred loss model under IAS 39 with the expected loss model which is intended to provide more useful information about a body's expected credit losses on financial instruments. The guiding principle for the model is that it requires an authority to recognise expected credit losses at all times and to update the amount of expected credit losses recognised at each reporting date to reflect changes in the credit risk of financial instruments. CIPFA/LASAAC has agreed to adopt the provisions on the expected credit loss impairment model without adaptation or interpretation. The approach has been to focus in the code on those provisions in IFRS 9 most likely to apply to local authorities.

23. IFRS 9 defines a financial asset as credit impaired when events that have a detrimental impact on the estimated future cash flows of that financial asset have occurred. CIPFA/LASAAC's view has been that it was unlikely that local authorities would have purchased or originated credit-impaired financial assets (but where these did occur the IFRS 9 would need to be followed). However, a respondent to last year's consultation indicated that some housing rent debtors may be considered to be credit impaired on acquisition. CIPFA/LASAAC are seeking views on whether this is a material and frequent transaction for local authorities. If so, it is proposed that the relevant paragraph of IFRS 9 will be added to the code.

Simplified approach for trade receivables, contract assets and lease receivables

24. IFRS 9 provides a simplified approach which requires recognition of a loss allowance based on lifetime expected losses from origination. Under the code, a local authority

- will be required to apply the simplified approach for trade receivables or contract assets that result from transactions within the scope of IFRS 15 that do not contain a significant financing component
- has a policy choice to apply either the simplified approach or the general approach where there is a significant financing component and for lease receivables. However, the *Government financial reporting manual* (the FReM) is expected to require central government bodies to apply the simplified approach to the transactions.

25. CIPFA/LASAAC notes the advantages of consistency across the public sector and the benefits of reducing the reporting burden but is concerned that the FREM's approach may result in a more significant 'day one' loss for local authorities. It is not, therefore, proposing to change the code's approach but would welcome any comments on the impact of a change.

IFRS 15

26. CIPFA/LASAAC also consulted on the approach to the adoption of IFRS 15 last year, and set out the approach in the same publication covering IFRS 9.

27. The disclosures under IFRS 15 are substantially more detailed than currently required. It requires disclosures to help users understand the nature, amount, timing and uncertainty of revenue and cash flows arising from contracts with customers. However, CIPFA/LASAAC is of the view that local authority income transactions are not normally complex and do not

normally involve substantial recognition or measurement issues. It therefore considered that local authorities should only include the IFRS 15 disclosures if the information relating to the disclosure is material to its financial statements and therefore the approach in the separate publication is to require direct reference to IFRS 15 when this is the case.

28. However, the consultation paper seeks views on alternative approaches including having the code specify the disclosure requirements.

Narrow scope amendments to IFRS

29. The proposals in the consultation paper arising from narrow scope amendments to IFRS include

- amendments in respect of *IAS 7 Statement of cash flows (Disclosure initiative)* which will require local authorities to provide disclosures that enable users of the financial statements to evaluate changes in liabilities arising from financing activities
- amendments to *IAS 12 Income taxes (Recognition of deferred tax assets for unrealised losses)* which clarify how to account for deferred tax assets related to debt instruments measured at fair value (these may apply in practice to the group accounts)
- an amendment to *IAS 40 Investment property (Transfers of investment property)* which provides clarification on transfers to or from the investment property classification
- various minor changes from the *Annual improvements to IFRS standards 2014 – 2016 cycle* (outlined in Appendix B to the exposure draft)
- *IFRIC 22 Foreign currency transactions and advance consideration* which sets out the exchange rate to use in reporting foreign currency transactions when payment is made or received in advance.

Proposed amendments to debtors and creditors disclosures

30. The 2017/18 code requires disclosure of an analysis of debtors and creditors across specified groupings of public sector organisations. The equivalent disclosures have been removed from the FReM and therefore CIPFA/LASAAC is proposing to remove them from the code.

Application of IFRS 16

31. Subject to CIPFA/LASAAC's decisions on adoption, IFRS 16 will apply to the 2019/20 code. IFRS 16 specifies the principles for accounting for leases both for the lessee and for the lessor.

32. IFRS 16 introduces a single lessee accounting model whereby all leases (with some exceptions) will be accounted for in a similar way to the current IAS 17 treatment for finance leases. IFRS 16 requires a lessee to recognise

- assets and liabilities for all leases with a term of more than 12 months, unless the underlying asset is of low value
- a right-of-use asset representing its right to use the underlying leased asset
- a liability representing its obligation to make lease payments.

33. CIPFA/LASAAC has established a sub group on leases to consider the approach to applying IFRS 16 and to assist in preparing a further consultation paper for adoption in the Code planned for December 2017.

34. Appendix C to this consultation paper provides a brief outline of IFRS 16 and includes initial issues regarding its application to local authorities including whether
    - the code should include specific provisions on the application on the low value exemption for local authority circumstances
    - the short-term exemption should be mandated by means of an adaptation in the code
    - authorities will be able to measure the lease liability by using the interest rate implicit in the lease or whether they will need to use the incremental borrowing rate and, if so, the practicalities of identifying this rate across an authority's portfolio of leased assets
    - the code should require that the subsequent measurement of the right-of-use asset is to be at current value, where material
    - on transition, there should be full retrospective restatement (i.e. restating preceding year information) or a cumulative catch-up retrospective approach (i.e. adjusting the opening balance of reserves).

2017/18 disclosure checklist

35. CIPFA has issued the disclosure checklist for the 2017/18 annual accounts. The checklist identifies the requirements of the accounting code.

36. When checking that the Code's disclosure requirements have been met in the 2017/18 accounts, auditors should
    - request that the authority completes the 2017/18 disclosure checklist
    - investigate the reasons for any non-compliance that that the checklist highlights.

Other developments

Housing benefit

Certification of 2016/17 subsidy claims

37. Public Sector Audit Appointments (PSAA) has issued the following modules of the 2016/17 HB COUNT approach to the certification of housing benefit subsidy claims
    - Module 4 is the analytical review tool component. It provides a number of useful worksheets including the following two which require to be completed
        - The year-to-year worksheet where 2015/16 claim data is entered manually for comparison against 2016/17 data.
        - The key ratios worksheet that allows comparison with other authorities.
    - Module 5 is the software diagnostic tool. The module contains a control matrix that requires to be completed by auditors when certifying 2016/17 HB subsidy claims.

2017/18 funding

38. The Department for Work Pensions (DWP) has issued the following circulars in respect of various types of HB funding

- S9/2017 Initial payment for real time information bulk data matching initiative 2017/18
- S11/2017 Additional new burdens payments for 2017/18.

Prudential framework

Proposed changes to prudential code

39. CIPFA has issued a consultation paper that proposes changes to the *Prudential code for capital finance in local authorities* from 2018/19. The proposals are based on the initial request for views in April 2017.

40. There is a proposal that the code objective that treasury management decisions are taken in accordance with good professional practice be deleted and the requirement to adopt CIPFA's treasury management code is removed.

41. There is also a proposal to introduce a requirement to report on the overall capital strategy to full council. It is proposed that

- the capital strategy should demonstrate that the authority takes capital expenditure and investment decisions in line with service objectives and properly takes account of stewardship, value for money, prudence, sustainability and affordability
- the strategy should set out the long term context in which capital expenditure and investment decisions are made and give due consideration to both risk and reward and impact on the achievement of priority outcomes
- a principles based approach is taken, highlighting key areas to be covered. The proposed wording is contained within the annex to the paper
- the Chief Finance Officer should report explicitly on the deliverability, affordability and risk associated with the capital strategy.

42. Responses should be submitted to matthew.allen@cipfa.org by 30 September 2017.

Whole of government accounts

2016/17 guidance

43. HM Treasury has issued guidance on completing the 2016/17 returns for whole of government accounts (WGA). External auditors are required to review the returns for bodies above a prescribed threshold and report the results of their review to the National Audit Office (NAO) in an assurance statement.

44. The prescribed threshold for 2016/17 is where either gross assets (excluding property, plant and equipment, heritage assets, intangibles, investment properties, and assets held for sale), or gross liabilities (excluding pension liabilities), or gross income or gross expenditure is above £350 million.

45. Audit Strategy has issued Technical guidance note 2017/9(LA) to provide guidance for auditors on reviewing and reporting on the 2016/17 WGA returns of local authorities above the threshold. The approach set out in the technical guidance note has been agreed with the NAO.

46. The changes in the content of the technical guidance note compared with 2015/16 are as follows

- Re-ordering and minor re-wording of certain tests.
- A new requirement for the ISA 260 report (or annual audit report where combined) to be submitted to the NAO.
- Auditors are no longer required to submit a scanned version of the assurance statement and unadjusted errors schedule.

Equal pay

Accounts Commission report

47. The Accounts Commission has published a report on Equal pay in Scottish councils. Key messages include

- Councils have made £232 million of compensation payments to 50,000 workers who had historically been unfairly paid. Exhibit 2 shows an analysis of the 29 councils which provided data.
- Between 2004/05 and September 2016, around 70,000 equal pay claims have been lodged against councils. Exhibit 3 shows the number of claims each year and exhibit 4 analyses the total number over each council.
- The cost of compensation agreements and settling claims, along with legal fees, amounts to around £750 million. Exhibit 5 analyses this total over each council.
- There are almost 27,000 live equal pay claims. Exhibit 7 shows the number of 'live' claims as a percentage of all claims lodged against each council.

Audit Strategy contacts for local authority chapter

48. 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.

General developments

Finance guidance notes

Changes to SPFM

49. The Scottish Government Financial Management Directorate announced amendments to the following sections of the Scottish public finance manual in finance guidance note 2017/6
    - Accountability
    - Annual accounts
    - Tax planning and tax avoidance.

50. The section on annual accounts has been amended to emphasise that
    - a public body's board has a role in approving the body's annual accounts and ensuring that the Minister is provided with the annual report and accounts to be laid before the Scottish Parliament
    - the Chief Executive as the Accountable Officer of the public body is responsible for signing the accounts and ultimately responsible to the Scottish Parliament for their actions.

Whole of government accounts

2016/17 guidance

51. HM Treasury has issued guidance on completing the 2016/17 returns for whole of government accounts (WGA). External auditors are required to review the returns for bodies above a prescribed threshold and report the results of their review to the National Audit Office (NAO) in an assurance statement.

52. The prescribed threshold for 2016/17 is where either gross assets (excluding property, plant and equipment, heritage assets, intangibles, investment properties, and assets held for sale),

or gross liabilities (excluding pension liabilities), or gross income or gross expenditure is above £350 million.

53. Audit Strategy has issued Technical guidance note 2017/8(CG) to provide guidance for auditors on reviewing and reporting on the 2016/17 WGA returns of central government bodies above the threshold. The approach set out in the technical guidance note has been agreed with the NAO.

54. The changes in the content of the technical guidance note compared with 2015/16 are as follows

- Re-ordering and minor re-wording of certain tests.
- A new requirement for the ISA 260 report (or annual audit report where combined) to be submitted to the NAO.
- Auditors are no longer required to submit a scanned version of the assurance statement and unadjusted errors schedule.

Audit Strategy contact for central government chapter

55. 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.

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.

Auditing developments

NHS workforce planning report

56. Audit Scotland has issued NHS workforce planning which is the first in a two-part audit on the NHS workforce. It focuses on the overall planning arrangements looking at how well placed the NHS workforce is to meet the current and future demands of the Scottish population. The key messages include

- Between 2011/12 and 2016/17, spending on NHS staff increased by 11%.
- Most NHS territorial boards overspent against their pay budget in 2016/17, with agency staff costs increasing in real terms by 107% in six years.
- There are urgent workforce challenges facing the NHS and improving workforce planning is critical to addressing these pressures.

Audit Strategy contact for health chapter

57. 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.

Further education chapter

Introduction

This chapter contains information on the main technical developments in the quarter that are relevant to the further education sector.

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

Auditing developments

Technical guidance notes

Audit of 2016/17 annual report and accounts

58. Audit Strategy has published Audit of 2016/17 annual report and accounts (further education) - technical guidance note 2017/6(FE) to provide auditors with guidance on performing the audit of the 2016/17 further education annual report and accounts.

59. The technical guidance note comprises
    - an overview module including the financial reporting framework, key auditing standards, and presentation of financial statements
    - modules 1 to 4 on financial statement areas, e.g. tangible fixed assets, retirement benefits
    - module 5 on the regularity of expenditure and income
    - module 6 on the performance report, governance statement, and remuneration and staff report. This module has been updated to provide guidance on the new opinions referred to later at paragraph 65

60. The modules highlight the main risks of misstatement in each area, explain the correct treatment, and set out actions for auditors to assess whether the body has followed the required treatment. Following extensive consultation with all auditors, the technical guidance note represents an agreed position on a range of complex technical issues and is a key document as auditors plan and perform the audit of colleges' 2016/17 annual report and accounts.

61. For the purposes of the Audit Scotland website, all the modules have been combined into one document. The individual modules are also available from the relevant subject pages on the further education site of the *Technical reference library*. There is also a module containing a summary of the risks of misstatement available as a word document which auditors may use to satisfy themselves that their audit programmes adequately address the highlighted risks.

62. While auditors are responsible for their own conclusions and opinions, consistency in similar circumstances is important. Auditors should read the technical guidance note so they are familiar with the guidance provided. It is important that auditors follow the actions set out, subject to local judgements on materiality, to ensure that all auditors adopt a consistent approach to common risks.

63. Auditors should use the technical guidance note when performing the audit of the 2016/17 further education annual report and accounts.

2016/17 model independent auditor's reports

64. Audit Strategy has issued 2016/17 Independent auditor's report (further education) - technical guidance note 2017/7(FE) to provide auditors with the model independent auditor's reports which should be used for the 2016/17 annual report and accounts. The technical guidance note also provides application guidance on their use.

65. In the interests of consistency, auditors are required to use the relevant model report in the appendices to the technical guidance note as a condition of their audit appointment. The only exception is any amendments required to tailor the terminology to reflect local circumstances.

66. The model independent auditor's reports for 2016/17 have been amended to

- comply with the new ISA (UK) 700, which contains a revised structure for the independent auditor's report
- include new opinions in respect of whether the performance report and governance statement have been prepared in accordance with the accounts direction.

67. 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 Audit Strategy in advance of finalising the report.

68. Auditors should use this technical guidance note when reporting on the audit of the 2016/17 annual reports and accounts. They should complete the checklist at Appendix 3 which provides a list of the key auditor actions.

Reports on sector

2015/16 overview

69. The Auditor General for Scotland has issued Scotland's colleges 2017 to provide an overview the college sector in Scotland.

70. The report states that Scotland's college sector remains financially stable but faces financial challenges as the underlying deficit has increased and colleges hold less cash than in the previous year.

Accounting developments

General accounting

2016/17 accounts direction

71. The Scottish Funding Council (SFC) has issued their accounts direction for colleges for 2016/17. The direction requires colleges to comply with the 2015 Statement of recommended practice: Accounting for further and higher education (the 2015 SORP) in preparing their financial statements.

72. Specific mandatory disclosure requirements for colleges are set out at Appendix 2. Colleges are required to include a performance report and accountability report in their annual report and accounts in accordance with the 2016/17 Government financial reporting manual. The main changes in the 2016/17 accounts direction are summarised in the following paragraphs.

73. The requirements for the performance report have been amended to require
    - a short explanation of the purpose of the overview section
    - an analysis of how the cash budget allocation previously earmarked for depreciation was spent. This is referred to as the 'cash budget for priorities' in the direction and the analysis should take the form of a table showing the expenditure under each heading and the impact on the operating position. An illustrative form of wording is provides at Appendix 5 of the accounts direction
    - details of the underlying operating position. A template for calculating the underlying operating position is provided at Appendix 7 of the accounts direction.

74. The requirement to disclose expenditure on consultancy and off payroll arrangements in the remuneration and staff report has been removed.

75. There is a new requirement to include a statement at the foot of the statement of comprehensive income that explains that the SORP does not permit non-cash allocations for depreciation to be recognised as income in the statement of comprehensive income. A new note is required which provides further explanation and sets out the operating position adjusted for the non-cash allocation for depreciation. An illustrative form of words is provided at paragraph 1 of Appendix 6 to the accounts direction.

76. In preparing their governance statement colleges are required to give due regard to the guidance contained in Appendix 3 and the specific requirements of the Scottish public finance manual.

Guidance on 2016/17 financial statements

77. The SFC has issued Detailed notes for guidance on completion of the 2016/17 financial statements which are designed to supplement the accounts direction for 2016/17. The guidance covers key disclosures in the financial statements, including model disclosure notes set out at Annexes A to E.

78. There have been no significant changes in the guidance notes from 2015/16.

Provisions and contingencies

Guidance for early retirement provision

79. The SFC has issued Guidance for early retirement provision spreadsheet completion to advise that the suggested net interest rate for early retirement pension calculations in 2016/17 has been changed to 0.00%.

80. Auditors should confirm their colleges have used an appropriate discount rate when calculating their early retirement provision, and have paid due regard to the rate suggested by the SFC.

Auditor action checklist

	Yes/No/N/A	Initials/date	W/P ref
1 Have you used the technical guidance note referred to at paragraph 62 when performing the audit of the 2016/17 further education annual report and accounts?			
2 Have you used the technical guidance note referred to at paragraph 67 when reporting on the audit of the 2016/17 further education annual report and accounts?			
3 Have you carried out the action recommended at paragraph 79 in respect of the early retirement provision?			

Audit Strategy contacts for further education chapter

81. The contacts in Audit Strategy for this chapter are

- Neil Cameron, Manager - Central Government and Health (Technical) - 0131 625 1797 or ncameron@audit-scotland.gov.uk.
- Helen Cobb, Technical Adviser (Central Government, Health and Further Education) - 0131 625 1901 or hcobb@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

Invalid funding application

82. An unknown third party defrauded £38,000 from a non-departmental corporate body by submitting false applications for funding available to small businesses to be used for training.

Key features

The fraud was possible due to a lack of segregation of duties and weaknesses in the documentation of due diligence checks on funding claims. The fraud was identified by an employee who noticed similarities between different claims.

Internal audit carried out a 100% check on the claims and made recommendations to improve the controls in place including the need for

- the documentation of due diligence checks
- supporting evidence for all claims to be maintained
- process maps and operating procedures to be updated, with training to be provided
- updating the fraud policy.

Consideration is also being given to reviewing expenditure controls in other similar funding schemes.

Fraudulent cheque

83. A third party defrauded £17,500 from a council by presenting a fraudulent cheque for payment through the automated banking system.

Key features

A council employee identified that a cheque had been debited to the council's bank account, which the council had not issued.

After contacting the back it was identified that the cheque was forged. The unusual element was that the forged cheque was sophisticated enough to be machine readable and was able to be processed automatically.

The bank agreed to credit the bank account resulting in no financial loss to the council.

The matter has been reported to the bank's fraud section and Police Scotland.

Audit Strategy contact for fraud and irregularities chapter

84. 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

pobrien@audit-scotland.gov.uk

Audit Strategy
Audit Scotland
Level 4, 102 West Port
EDINBURGH
EH3 9DN

12 September 2017