Technical bulletin 2018/1

January to March 2018

AUDIT SCOTLAND

Prepared for appointed auditors in all sectors
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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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40. Auditors appointed by the Auditor General for Scotland or the Accounts Commission are responsible for giving an opinion on the financial statements and reporting on other related matters. Audit Scotland provides technical support to appointed auditors in respect of these responsibilities to inform their professional judgement.

108. Audit Scotland provides technical support and guidance to all appointed auditors. While appointed auditors act independently, and are responsible for their own conclusions and opinions, Audit Scotland has a role in ensuring that those conclusions and opinions are reached on the basis of informed judgement.

An element of the technical support and guidance to appointed auditors referred to in the above extracts from the Code of audit practice is technical bulletins provided by Audit Scotland's Professional Support.

The purpose of technical bulletins is to provide appointed auditors with

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

This technical bulletin applies to appointed auditors in all sectors, though some sections apply to a particular sector.

Technical bulletins are available to appointed 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.

The articles on technical developments are intended to highlight the key points that Audit Scotland's Professional Support considers appointed auditors require to be aware of. It may still be necessary for auditors to read the source material if 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*.

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

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 they relate, 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 in the quarter that are relevant to all sectors.

It should be read by all external auditors. Information on developments, and guidance from Professional Support on any emerging risks, in the quarter that are relevant to only one sector are covered in the relevant sector-specific chapter.

Auditing developments

Updated review on materiality

1. The Financial Reporting Council (FRC) has issued an updated audit quality thematic review on materiality. The review explains the concept of audit materiality and how the major accountancy firms determine it in practice.
2. International standards on auditing in the UK (ISAs (UK)) define information to be material if its misstatement could influence the economic decisions of users. Materiality is therefore assessed by auditors quantitatively and qualitatively, and that assessment drives the scope, nature and extent of the auditor's work.
3. The majority of the key messages in the previous 2013 report have been addressed by the firms. These include an increased emphasis on the application of judgment when determining overall materiality, and demonstrating the consideration of risk in setting performance materiality.
4. Some key messages from this most recent review include the following
   - Three firms have introduced guidance to reduce performance materiality in the first year of audits to reflect the increased risk.
   - Where adjusted profit is used as the benchmark for setting overall materiality, auditors should explain why they have made the adjustments and how that benchmark responds to the needs of the users of the financial statements.
   - Some audit teams base materiality benchmarks on a rolling average basis to eliminate volatility.
   - Guidance on setting component materiality and how it relates to overall materiality would be helpful.
   - Firms should consider how they can better explain the concept of performance materiality in their reports.

Other developments

Financial management

Revised treasury management code

5. The Chartered Institute of Public Finance and Accountancy (CIPFA) has issued a revised Treasury management in the public services: Code of practice and cross-sectoral guidance notes (treasury management code) to apply from 2018/19. The treasury management code provides a framework for effective treasury management in public sector bodies. 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.
6. The main changes in this edition are
    - the extension to include non-financial asset investments that are not part of treasury management activity, e.g. investment property
    - clarification in the guidance notes that approval and ongoing monitoring of the detail of the treasury management strategy should be permitted where this facilitates more active discussion of the strategy. It should be performed by those with the most appropriate skills and knowledge, but overall responsibility for treasury management remains with the full board/council and a compliant capital strategy must be approved by them.

Professional Support contact for cross-sectoral chapter

7. The contact in Audit Scotland's Professional Support for this chapter is Paul O'Brien, Senior Manager (Professional Support) - 0131 625 1795 or pobrien@audit-scotland.gov.uk.

Local authority chapter

Introduction

This chapter contains information on the main technical developments, and guidance from Audit Scotland's Professional Support on an emerging risk, 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.

Guidance from Professional Support

Technical guidance notes

Audit of 2017/18 annual accounts

8. Audit Scotland's Professional Support has published a module of technical guidance note 2017/10(LA) to provide guidance to all appointed external auditors on performing the audit of 2017/18 integration joint board (IJB) annual accounts.

9. The module provides guidance on applying the other modules of the technical guidance note to IJB accounts, including further supplementary guidance.

10. Auditors should use the module when auditing the 2017/18 IJB annual accounts.

Guidance on emerging risks

Treatment of grant funding

11. Finance circular 4/2018 advises that the total overall funding package for 2018/19 includes an additional £159.5 million of general revenue grant. £34.5 million of this sum is being paid as a redetermination of the 2017/18 funding to be paid on 28 March 2018.

12. Audit Scotland is aware of uncertainty and differing views over whether the £34.5 million should be recognised as
    - income in 2017/18; or
    - grant received in advance (i.e. a liability) at 31 March 2018, with recognition as income deferred to 2018/19.

13. Auditors should assess whether the grant has been accounted for in accordance with the *Code of practice on local authority accounting in the UK* (accounting code). In making this assessment, auditors should note that the accounting code adapts *IAS 20 Accounting for government grants* and requires grants to be recognised immediately as income, unless there are any conditions relating to initial recognition that the authority has not satisfied.

14. Finance circular 4/2018 does not include any such conditions or stipulate that the grant may only be spent in 2018/19. Professional Support has confirmed with the Scottish Government that there are no conditions attached to the grant set out elsewhere, and authorities are free to spend it from the date of receipt. On that basis, Professional Support considers that the accounting code requires the £34.5 million grant to be recognised as income in 2017/18.

Accounting developments

General accounting

Guidance on closing 2017/18 financial statements

15. CIPFA has issued Bulletin 01 Closure of the 2017/18 financial statements to

- provide further guidance and clarification to complement the guidance notes on the 2017/18 accounting code
- look further ahead to some future developments.

16. Auditors may wish to refer to this bulletin when auditing the 2017/18 local authority annual accounts. The main subjects applicable to Scottish local authorities on which the bulletin provides guidance are

- the new *Apprenticeship levy*
- accounting standards issued but not yet adopted
- the going concern basis of accounting
- a review of *Telling the story* changes
- the application of new international financial reporting standards (i.e. IFRSs 9, 15 and 16).

Apprenticeship levy

17. Paragraphs 7 and 8 of the bulletin explain that the *Apprenticeship levy*, introduced by the UK Government from 1 April 2017, is payable through the pay as you earn system along with income tax and national insurance and should therefore be accounted for in a similar manner. It is therefore an employee expense and should be recognised as such in accordance with the requirements of section 6.2 of the accounting code.

18. Paragraph 9 does not apply to Scottish bodies as the method of disbursing the income in Scotland is different to England.

Accounting standards issued but not yet adopted

19. The bulletin lists the following standards that have been issued (but not adopted until the 2018/19 accounting code) that may be relevant for additional disclosures in the 2017/18 financial statements

- *IFRS 9 Financial instruments*
- *IFRS 15 Revenue from contracts with customers*

- *Amendments to IAS 12 Income taxes: Recognition of deferred tax assets for unrealised losses*
- *Amendments to IAS 7 Statement of cash flows: disclosure initiative*.

20. The bulletin highlights that comparative amounts are not to be restated on the introduction of IFRS 9 and IFRS 15 and therefore there is no requirement to provide financial information relating to their impact for the 2017/18 year in the 2017/18 financial statements.

Going concern basis of accounting

21. Paragraph 23 of the bulletin sets out CIPFA's view that, because the 2017/18 accounting code requires local authorities to use the going concern basis of accounting, authorities are not required to apply paragraph 25 of *IAS 1 Presentation of financial statements* which would otherwise require management to make an assessment of the authority's ability to continue as a going concern.

22. However, auditors should note that ISA (UK) 570 states that the preparation of the financial statements requires management to assess a body's ability to continue as a going concern even if the financial reporting framework does not include an explicit requirement to do so.

Review of Telling the story changes

23. Paragraph 36 of the bulletin draws attention to the following changes to the 2018/19 accounting code as a result of an early review of the *Telling the story* changes that were made to the 2016/17 accounting code

- The comprehensive income and expenditure statement (CIES) will no longer be required to meet the reporting requirements of *IFRS 8 Operating segments.*
- Additional columns may be added to the expenditure and funding analysis note.

24. Paragraph 37 invites any comments on whether the *Telling the story* changes have achieved their objectives to be sent to financial.reporting@cipfa.org by 28 April 2018.

IFRS 9

25. The bulletin summarises the debate on the impact from 2018/19 of *IFRS 9 Financial instruments* on collective investment vehicles which are expected to be classified to fair value through profit or loss (i.e. fair value gains and losses will be chargeable to the surplus or deficit on the provision of services as they arise). The debate has centred on whether collective investment vehicles qualify for the presentation election under IFRS 9 to be reclassified to fair value through other comprehensive income (which would mean movements in fair value being charged to the financial instruments revaluation reserve).

26. In order to qualify for the presentation election, the investment would need to meet the definition of an equity instrument. This would not be case if the instrument is 'puttable' (i.e. the holder has the right to demand repurchase or repayment of the principal).

IFRS 15

27. In respect of the application of *IFRS 15 Revenue from contracts with customers* from 2018/19, the bulletin

- advises that the standard should not have a substantial effect for local authorities with relatively predictable income streams but it may have an impact on authorities where the consideration is variable or when income is recognised over time
- encourages authorities to focus on the materiality of the information when meeting the standard's substantially increased disclosure framework.

IFRS 16

28. The bulletin explains that a consultation paper (referred to in technical bulletin 2017/4) on the application of *IFRS 16 Leases*, which is expected to be adopted by the 2019/20 accounting code, will be issued shortly. CIPFA is also considering other ways of assessing the impact of the standard.

Employee benefits

Revised guidance on untaken holiday accrual

29. The Scottish Government Local Government Finance Division (SGLGFD) has issued Finance circular 2/2018 Accounting for short term accumulating paid absences which contains revised guidance on the untaken holiday accrual which replaces finance circular 3/2010 from 2017/18. Part 1 provides background and commentary, while part 2 sets out statutory guidance on proper accounting practices.

30. The revisions to the guidance are summarised in the following table:

Revision	Timescale	Further comment
Removal of the statutory adjustment for flexi-leave and time off in lieu	From 1 April 2021	The statutory adjustment will be restricted to annual leave. Any balance on the employee statutory adjustment account at 31 March 2020 relating to flexi-leave or time of in lieu should be transferred to the general fund.
Allowing the statutory adjustment to be up to, rather than equal to, the accounting charge	From 1 April 2017	A sum up to any accounting charge made to the CIES for untaken holiday at the year end may be transferred to the employee statutory adjustment account as a statutory adjustment. The amount should be transferred back in the following year.

31. Auditors should refer to this guidance when auditing the untaken holiday accrual in the 2017/18 annual accounts.

Capital grants

Revised guidance on capital grants

32. The SGLGFD has issued Finance circular 3/2018 Accounting for capital grants, contributions and donated assets which contains revised guidance on accounting for capital grants, contributions and donated assets. Part 1 provides background and commentary, while part 2 sets out statutory guidance on proper accounting practices.

33. The finance circular from the Scottish Government setting out the guidance replaces finance circular 6/2010 from 2017/18. The guidance has been revised to

- include grants to third parties for capital projects
- clarify how capital grants, contributions and donated assets should be reported in the annual accounts.

34. The guidance applies to capital grants, contributions and donated assets where the recognition criteria have been met, and they have been recognised in the CIES. The guidance distinguishes between a capital grant used to fund

- an authority's capital expenditure
- a third party's capital expenditure.

35. The treatment for each type of grant, including where the grant has not been used by the year end, is summarised in the following table:

Requirement	Used to fund authority's capital expenditure	Used to fund third party's capital expenditure	Unused by year end
CIES presentation (in current year)	Credit to taxation and non-specific grant income line	Credit grant received to service income Debit grant paid to service expenditure	Credit to taxation and non-specific grant income line
Statutory adjustment (in current year)	Debit general fund Credit capital adjustment account	N/A	Debit general fund Credit capital grants unapplied account
CIES presentation (in future year when unused grant finally used)	N/A	Debit grant paid to service expenditure	N/A

Requirement	Used to fund authority's capital expenditure	Used to fund third party's capital expenditure	Unused by year end
Statutory adjustment (in future year when unused grant finally used)	Debit capital grants unapplied account Credit capital adjustment account	Debit capital grants unapplied account Credit general fund	N/A

36. Donated assets should be treated in the same way as capital grants used to fund an authority's capital expenditure.

37. The statutory adjustments should be reported in the movement in reserves statement and analysed clearly either on the face of the statement or in a note.

38. Auditors should refer to this guidance when auditing capital grants, contributions and donated assets in the 2017/18 annual accounts.

Pension funds

Revised guidance on pension fund annual report

39. The SGLGFD has issued Finance circular 1/2018 Local government pension fund annual report and accounts which contains revised guidance on the local government pension fund annual report and accounts. Part 1 provides background and non-statutory guidance, while part 2 sets out statutory guidance on proper accounting practices.

40. The finance circular from the Scottish Government setting out the guidance replaces finance circular 6/2015 from 2017/18. The only change is that legislative references in the guidance have been updated to refer to *The Local Government Pension Scheme (Scotland) Regulations 2014*.

Financial instruments

New guide on IFRS 9

41. CIPFA has issued IFRS 9 Financial instruments - an early guide for local authority practitioners to provide application guidance on IFRS 9. The guide is intended to assist local authority practitioners in preparation for the adoption of this complex standard in 2018/19.

42. The guidance provides comprehensive coverage of the requirements of the forthcoming provisions, including recognition, measurement, treatment of gains and losses, derecognition and presentation and disclosure in the financial statements, and is intended to help practitioners determine the appropriate treatment for any instrument that they might originate or hold.

43. In addition to the ongoing accounting requirements, the guidance covers in particular

- the new classifications for financial assets and their accounting implications for measurement of fair value and the recognition of gains and losses
- the impact of the change to an expected losses approach to impairment of financial assets (covering all types of investments and debtors)
- the mechanics of making the transition in the 2018/19 financial statements (including the application of transitional provisions and the preparation of relevant disclosure notes).

5. Each of these areas is supported by worked examples and illustrations.

44. Auditors should refer to this guidance when assessing local authorities' preparations for complying with IFRS 9 in 2018/19.

Proposed revisions to statutory guidance

45. The SGLGFD has issued *Accounting for financial instruments - statutory guidance – consultation draft* which contains proposed revisions to the statutory guidance in finance circular 4/2007 on accounting for financial instruments.

46. The statutory guidance allows a local authority to make a statutory adjustment involving the financial instruments adjustment account when accounting for financial instruments in accordance with the accounting code for

- premiums and discounts associated with the refinancing of loans
- soft loans
- stepped interest rate loans.

47. The proposed revisions do not impact on the statutory adjustments but they provide

- more detail on the application of capital receipts to fund premiums
- guidance on how the statutory adjustments should be reported in the annual accounts.

48. The existing statutory guidance allows capital receipts to be used to meet the cost of premiums. If that does not extinguish the premium, local authorities are required to produce a proportionate reduction of all the outstanding annual charges for that premium.

49. The proposed further detail at paragraphs 42 to 46 of the draft statutory guidance includes the following points

- Capital receipts may fund the cost of premiums either as they are incurred or as they are recharged annually back to the general fund.
- Where capital receipts are used to fund the annual charge, the annual charge for deferred premiums should still be made to the general fund as a statutory adjustment, with the capital receipt treated as a transfer between statutory usable reserves (i.e. debit capital receipts, and credit general fund).
- Capital receipts may be used to fund additional charges to the general fund over and above the annual charge.

- Where capital receipts are used to fund a premium incurred when the loan is extinguished, the cost is not transferred to the financial instrument adjustment account. Instead the capital receipts are transferred to the general fund.
- Where only part of the premium cost is funded from capital receipts, an authority may choose to defer the remaining amount by transferring it to the financial instrument adjustment account as a statutory adjustment.
- The transfer from capital receipts requires to be reported in a ‘Transfer to/from other statutory usable reserves’ line in the movement in reserves statement.

50. All statutory adjustments require to be reported as adjustments between the accounting basis and funding basis in the movement in reserve statement. The analysis should clearly identify each statutory adjustment, and the draft guidance provides suggested descriptors for each one at paragraphs 56 to 60.

Other developments

Financial management

Revised prudential code

51. CIPFA has issued a revised version of the Prudential code for capital finance in local authorities (prudential code) to apply from 2018/19. Local authorities are required by regulation to have regard to the prudential code when exercising their powers to borrow.

52. This revised version of the prudential code includes a new section on determining a capital strategy with a requirement for the section 95 proper officer to report formally on the capital strategy and associated risks. The capital strategy is required to

- 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
- set out the long term context in which capital expenditure and investment decisions are made and gives due consideration to both risk and reward and impact on the achievement of priority outcomes.

53. The revised prudential code also includes a number of changes to the prudential indicators, including the following

- There is no longer an affordability indicator for the estimated incremental impact of capital investment decisions on the council tax.
- The indicator for net debt and the capital financing requirement has been amended to refer to gross debt.
- There is no longer a specific indicator relating to the treasury management code.

Housing benefit

Guidance on 2017/18 subsidy claims

54. The Department for Work and Pensions (DWP) has issued a letter and guidance notes on completing the 2017/18 subsidy claim.

55. The letter contains details of the amounts paid for 2017/18 in respect of administration subsidy and interim benefit subsidy received. The deadlines are
    - 30 April 2018 for authorities to submit the pre-certified claim to the DWP and external auditors
    - 30 November 2018 for the certified claim to be submitted to the DWP.

2017/18 HB COUNT modules

56. Public Sector Audit Appointments has issued the following modules of the 2017/18 HB COUNT approach
    - Module 2 contains a checklist to help auditors ensure that the authority's system is using the correct benefit parameters to calculate benefit entitlement and for the authority to claim the correct amount of subsidy.
    - Module 3 comprises workbooks to be completed for detailed testing, incorporating step-by-step guidance and a test result summary.

57. Module 1 has also been issued and provides an overview of the approach, but this is superseded in Scotland by guidance from Professional Support. Module 4 is an analytical review tool and module 5 is a software diagnostic tool but these have not yet been issued. Module 6 relates only to England.

58. For HB COUNT 2017/18, the key change is in respect of temporary accommodation management costs on which subsidy is no longer paid.

59. An e-learning package setting out the principles of the HB COUNT approach to the certification of HB subsidy claims for 2017/18 has also been issued.

Closure of universal credit live service

60. The DWP has issued HB Urgent bulletin U4/2017: Closure of the gateway to new universal credit live service claims to announce that universal credit live service ceased to take new claims from 1 January 2018.

61. Existing universal credit live service claimants are unaffected. New claimants are being directed to claim legacy benefits, including housing benefit, where appropriate.

2018/19 uprating

62. The DWP has issued HB circulars A10/2017: Housing benefit: uprating 2018/19 (revised) and A1/2018 War pensions: uprating 2018/19 advising of the benefits rates from April 2018.

63. Circular A10/2017 also contains specific advice for local authorities that apply percentage increases to uprate income from other social security benefits. As some of the rates have been uprated by different indices, authorities should consider whether applying standard percentages will result in correct determinations.

Funding

64. The DWP has issued the following circulars in respect of HB funding

- HB circular S2/2018 Universal credit live service closure new burdens payments
- HB circular S3/2018: 2018/19 Housing benefit administration subsidy arrangements for English, Scottish and Welsh local authorities

Auditor action checklist

	Yes/No/N/A	Initials/date	W/P ref
1 Have you carried out the action required at paragraph 10 in respect of module of technical guidance note 2017/10(LA) on IJB annual accounts?			
2 Have you carried out the action recommended at paragraph 13 in respect of the treatment of additional general revenue grant?			
3 Have you carried out the action recommended at paragraph 16 in respect of the CIPFA bulletin?			
4 Have you carried out the action recommended at paragraph 31 in respect of the untaken holiday accrual			
5 Have you carried out the action recommended at paragraph 38 in respect of capital grants, contributions and donated assets?			
6 Have you carried out the action recommended at paragraph 44 in respect of financial instruments?			

Professional Support contacts for local authority chapter

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

Central government chapter

Introduction

This chapter contains technical developments and guidance from Professional Support on emerging risks 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.

Guidance from Professional Support

Technical guidance notes

Auditing 2017/18 annual report and accounts

66. Audit Scotland's Professional Support has published Audit of 2017/18 annual report and accounts (central government) - technical guidance note 2018/1(CG) to provide guidance to all appointed external auditors on performing the audit of 2017/18 central government annual report and accounts.

67. While appointed auditors act independently and are responsible for their own conclusions and opinions, paragraph 108 of the *Code of audit practice* states that Audit Scotland 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 therefore appointed auditors should consider such guidance.

68. The technical guidance note comprises a number of modules. The modules, along with a brief summary of the contents, are set out in the following table:

Module	Content
Overview	Guidance on auditors' overall responsibilities for the annual report and accounts; financial reporting framework that bodies are required to follow; the application of ISAs (UK); presentation of financial statements; and accounting policies, estimates, and prior year errors
1 Property, plant and equipment	Each module highlights the risks of misstatement in each financial statement area, explains the financial reporting requirements applying to that area, and sets out actions for each risk that auditors should undertake to assess whether the body has met those requirements.
2 Provisions, creditors and accruals	
3 Financial instruments	
4 Group financial statements	
5 Other financial statement areas	As for modules 1 to 4 but this module includes a number of financial statement areas including leases, grant in aid, and intangible assets etc
6 Regularity of expenditure and income	This module provides guidance on auditor's responsibilities for the regularity of expenditure and income, and the risks of irregularities. It also sets out test procedures for auditors to carry out.
7 Non-financial statements	This module covers the remuneration and staff report; performance report, governance statement and other non-financial statements. It explains auditors' responsibilities for these statements, sets out the different audit opinions required, highlights the main risks of misstatement, explains the financial reporting requirements applying to each statement, and sets out test procedures that auditors should undertake to assess whether the body has met those requirements.
8 Charitable NDPBs	This module provides guidance on applying the other modules to charitable NDPBs, including further supplementary guidance.

69. 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 perform the audit of central government 2017/18 annual report and accounts.

70. 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 central government site of the *Technical reference library*.

71. Auditors should use the technical guidance note when performing the audit of the 2017/18 central government annual report and accounts.

2017/18 model independent auditor's reports

72. Professional Support has issued [2017/18 Independent auditors report (central government) - Technical guidance note 2018/4(CG)] to provide auditors with the model independent auditor's reports which should be used for the 2017/18 annual report and accounts. The technical guidance note also provides application guidance on their use.

73. 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 exception to using the wording in each model is to tailor the terminology to reflect local circumstances.

74. The model independent auditor's reports have been revised to comply with the new *ISA (UK) 700 Forming an opinion and reporting on financial statements*.

75. 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 Professional Support in advance of finalising the report.

76. Auditors should use this technical guidance note when reporting on 2017/18 audits. They should complete for each report the checklist at Appendix 5 which provides a list of the key auditor actions.

77. The technical guidance note also provides a model auditors report for summary financial statements at Appendix 6.

2017/18 GBS account information

78. Professional Support will obtain information on account balances at 31 March 2018 for central government bodies from the Government Banking Service (GBS) and distribute them to relevant auditors. The GBS has confirmed that the arrangements for obtaining 2017/18 account balances are unchanged.

Accounting developments

General accounting

Revised 2017/18 FReM

79. HM Treasury has issued a revised version of the 2017/18 Government financial reporting manual (the FReM).

80. The most significant changes from the previous version are to chapter 5 which has been amended to improve disclosure requirements and to reflect the introduction of *The Companies, Partnerships and Groups (Accounts and Non-Financial Reporting) Regulations 2016.* These regulations amend the Companies Act and therefore the FReM changes apply in Scotland.

81. The changes are summarised in the following table:

Paragraph	Statement	Additional disclosure requirement
5.2.8	Performance report - overview	Brief description of the business model and environment, organisational structure, objectives and strategies in the statement of the purpose and activities of the organisation
5.2.10	Performance report – performance analysis	Explanatory narrative on the link between key performance indicators, risk and uncertainty Explanation of the relationships and linkages between different pieces of information within the annual report and accounts Non-financial information pertaining to social matters, respect for human rights, anti-corruption and anti-bribery matters Environmental matters including the impact of the body's business on the environment
5.3.28(f)	Staff report	Information relating to employee matters such as other diversity issues, health and safety at work and trade union relationships

82. There has also been a new section added on the *Apprenticeship levy* which was introduced from 1 April 2017. The new requirements are summarised in the following table:

Paragraph	New requirement
8.4.1	Payment of the levy should be accounted for as a tax expense within staff costs.
8.4.2	Income received should be accounted for as grant income and recognised when the associated expense for training services is recognised.

83. Auditors should refer to this version of the FReM when auditing the 2017/18 annual report and accounts.

2017/18 disclosure guide

84. The National Audit Office (NAO) has issued the 2017/18 FReM disclosure guide for financial statements which is designed to ensure that bodies covered by the FReM have prepared their 2017/18 annual report and accounts in the appropriate form and have complied with all disclosure requirements.

85. The guides are cross-referenced to the 2017/18 FReM, individual financial reporting standards, and the *Companies Act 2006.* Auditors will need to generate a tailored checklist by selecting the criteria that are material to their audited body.

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

- consider requesting that the body completes the NAO's 2017/18 disclosure guide for the financial statements
- investigate the reasons for any non-compliance that the guide highlights
- assess whether the body's responses in the checklist are consistent with auditor's knowledge..

87. The NAO has also issued the *2017/18 FReM disclosure guide for annual reports*. Professional Support has amended this guide for application to Scottish bodies, and the amended version is available from the *Technical reference library*. Auditors should consider requesting that the body completes the (amended) disclosure guide. However, auditors should use and complete the checklists in module 7 of technical guidance note 2018/1(CG) for the purposes of their opinions on the performance report and governance statement.

2018/19 FReM

88. Treasury has issued the [2018/19 FReM](). It applies EU adopted IFRS and interpretations in effect for accounting periods commencing on or after 1 January 2018.

89. The two significant changes from 2017/18 are the adoption of

- *IFRS 9 Financial instruments*
- *IFRS 15 Revenue from contracts with customers*.

Application guidance on IFRS 9

90. Treasury has issued [IFRS 9 Financial instruments: Public sector application guidance]() to support the adoption of IFRS 9 in the 2018/19 FReM. IFRS 9 produces a more principles-based approach to the accounting for financial instruments, including their classification and measurement. Some key features are summarised in the following table:

Feature	Commentary
Criteria for classifying financial assets	IFRS 9 has moved away from IAS 39's reliance on the terms of an instrument (and whether it is traded or not) and applies a single classification and measurement approach to all types of financial assets based on the • body's business model for managing financial assets • contractual cash flow characteristics of the financial asset.
New measurement categories for financial assets	The new measurement categories for financial assets are as follows • Financial assets measured at amortised cost. • Financial assets measured at fair value through other comprehensive income.

Feature	Commentary
	• Financial assets measured at fair value through profit or loss. Financial assets are reclassified between measurement categories only when the body's business model for managing them changes.
Impairment	IFRS 9 contains a forward looking expected loss impairment model and requires the same measurement basis for impairment for all items subject to its impairment requirements. The FReM requires the simplified approach allowed by IFRS 9 which removes the need for an entity to consider whether the credit quality of trade receivables, contract assets and lease receivables has deteriorated significantly since initial recognition. It may, however, result in a higher loss allowance recognised on 'day-1' than under the full impairment model.
Financial liabilities	IFRS 9 carries forward unchanged almost all the accounting requirements in IAS 39 for financial liabilities.
Transitional arrangements	IFRS 9 has been interpreted so that bodies are required to recognise the difference between the carrying amount at 31 March 2018 and the carrying amount at 1 April 2018 in the opening general fund within taxpayers' equity.

91. Auditors should refer to this application guidance when assessing the progress of central government bodies in preparing to comply with IFRS 9 in 2018/19.

Application guidance on IFRS 15

92. Treasury has issued IFRS 15 Revenue from contracts with customers: Public sector application guidance to support the adoption of IFRS 15 in the 2018/19 FReM. IFRS 15 applies to revenue relating to the sale of goods and services.

93. The core principle of IFRS 15 is that a body should recognise revenue for the transfer of goods or services to customers at an amount that reflects the expected price. A body recognises revenue in accordance with that core principle by applying the five steps set out in the following table:

Step	Action
1	Identify the contract(s) with a customer. The FReM has extended the definition of a contract to include legislation which enables a body to obtain revenue that is not classified as taxation.
2	Identify the performance obligations in the contract.
3	Determine the transaction price.
4	Allocate the transaction price to the performance obligations in the contract.
5	Recognise revenue when (or as) the entity satisfies a performance obligation.

94. Application of this model will depend on the facts and circumstances presented in a contract with a customer and will require the exercise of judgement.

95. The standard also includes disclosure requirements regarding the nature, amount, timing and uncertainty of revenue and cash flows arising from the entity's contracts with customers.

96. On transition, bodies are required to recognise the difference between the carrying amount at 31 March 2018 and the carrying amount at 1 April 2018 in the opening general fund within taxpayers' equity.

97. Auditors should refer to this application guidance when assessing the progress of central government bodies in preparing for complying with this standard in 2018/19.

Remuneration and staff report

Preparation guidance for 2017/18

98. The Cabinet Office has issued EPN 536 2017/18 Disclosure of salary, pension and compensation information to provide guidance on the preparation of the pay pension and compensation disclosures in the remuneration and staff report for 2017/18. Example disclosures are provided at Annex 13C.

99. There are no significant changes to the remuneration disclosures set out from 2016/17. However, this guidance does not reflect the application of the FReM's requirements to Scottish bodies and therefore auditors should refer to module 7 of technical guidance note 2018/1(CG).

100. Auditors should refer to this guidance when auditing the remuneration and staff report in the 2017/18 annual report and accounts.

Provisions

2017/18 discount rates

101. Treasury has issued PES(2017)10 to announce the discount rate for post-employment benefits liabilities, general provisions and financial instruments as at 31 March 2018.

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

Use	Rate from 31 March 2018
Real rate used for valuing unfunded pension scheme liabilities and early departure provisions	0.10%
Nominal rate for unwinding discount on liabilities (interest costs)	2.55%
Rate used for funded pension schemes	Based on returns from AA corporate bonds at 31 March

103. The real discount rates to be applied to provisions recognised in accordance with IAS 37 as at 31 March 2018 are set out in the following table:

Category	Period	Percentage
Short term	Within 5 years	Minus 2.42%
Medium term	Between 5 and 10 years	Minus 1.85%
Long term	More than 10 years	Minus 1.56%

104. The financial instrument discount rates to be applied at 31 March 2018 are set out in the following table:

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

105. Auditors should refer to this paper when reviewing the discount rates applied to provisions in 2017/18 financial statements.

Auditor action checklist

	Yes/No/N/A	Initials/date	W/P ref
1 Have you carried out the action required by paragraph 71 in respect of technical guidance note 2018/1(CG)?			
2 Have you carried out the action required by paragraph 76 in respect of 2017/18 model independent auditor's reports?			
3 Have you carried out the action recommended at paragraph 83 in respect of the 2017/18 FReM?			
4 Have you carried out the action recommended at paragraph 91 in respect of IFRS 9?			
5 Have you carried out the action recommended at paragraph 97 in respect of IFRS 15?			
6 Have you carried out the action recommended at paragraph 100 in respect of the remuneration and staff report?			
7 Have you carried out the action recommended at paragraph 105 in respect of 2017/18 discount rates?			

Professional Support contacts for central government chapter

106. The contacts in Professional Support for this chapter are

- Neil Cameron, Manager (Professional Support) - 0131 625 1797 or ncameron@audit-scotland.gov.uk.
- Helen Cobb, Senior Adviser (Professional Support) - 0131 625 1901 or hcobb@audit-scotland.gov.uk.

Health chapter

Introduction

This chapter contains information on the main technical developments, and guidance from Professional Support 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 chapters.

Guidance from Professional Support

Technical guidance notes

Audit of 2017/18 annual report and accounts

107. Audit Scotland's Professional Support has published Audit of 2017/18 annual report and accounts (health boards) - technical guidance note 2018/2(H) to provide guidance to all appointed external auditors on performing the audit of 2017/18 health board annual report and accounts.

108. While appointed auditors act independently and are responsible for their own conclusions and opinions, paragraph 108 of the *Code of audit practice* states that Audit Scotland 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 therefore appointed auditors should consider such guidance.

109. The technical guidance note comprises a number of modules. The modules, along with a brief summary of the contents, are set out in the following table:

Module	Content
Overview	Guidance on auditors' overall responsibilities for the annual report and accounts; financial reporting framework that boards are required to follow; the application of ISAs (UK); presentation of financial statements; and accounting policies, estimates, and prior year errors.
1 Property, plant and equipment	Each module highlights the risks of misstatement in each financial statement area, explains the financial reporting requirements applying to that area, and sets out actions for each risk that auditors should undertake to assess whether the board has met those requirements.
2 Provisions, creditors and accruals	
3 Other financial statement areas	As for modules 1 and 2 but this module includes a number of financial statement areas including leases, capital grants, and intangible assets etc
4 Regularity of expenditure and income	This module provides guidance on auditor's responsibilities for the regularity of expenditure and income, and the risks of irregularities. It also sets out test procedures for auditors to carry out.
5 Non-financial statements	This module covers the remuneration and staff report; performance report, governance statement and other non-financial statements. It explains auditors' responsibilities for these statements, sets out the different audit opinions required, highlights the main risks of misstatement, explains the financial reporting requirements applying to each statement, and sets out test procedures that auditors should undertake to assess whether the board has met those requirements.

110. 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 perform the audit of health 2017/18 annual report and accounts.

111. 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 health site of the *Technical reference library*.

112. Auditors should use the technical guidance note when performing the audit of the 2017/18 health annual report and accounts.

2017/18 model independent auditor's reports

113. Professional Support has issued 2017/18 independent auditor's report (health boards) - Technical guidance note 2018/3(H) to provide auditors with the model independent auditor's reports which should be used for the 2017/18 annual report and accounts. The technical guidance note also provides application guidance on their use.

114. In the interests of consistency, auditors are required to use the relevant model report in appendices 1 to 2 of the technical guidance note as a condition of their audit appointment. The only exception to using the wording in each model is to tailor the terminology to reflect local circumstances.

115. The model independent auditor's reports have been revised to comply with the new *ISA (UK) 700 Forming an opinion and reporting on financial statements*.

116. 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 Professional Support in advance of finalising the report.

117. Auditors should use this technical guidance note when reporting on 2017/18 audits. They should complete for each report the checklist at Appendix 3 which provides a list of the key auditor actions.

118. The technical guidance note also provides an assurance statement for the consolidation schedules at Appendix 4. Auditors should complete the auditor action checklist at Appendix 5.

Review of central work on CNORIS

119. Professional Support will be undertaking a review of the work carried out by the NHS Central Legal Office (CLO) relating to the *Clinical negligence and other risks indemnity scheme* (CNORIS). The objective of the review is to establish the extent to which the information prepared using the work of the CLO, as a management expert under *ISA (UK) 500 Audit evidence*, can be used as audit evidence.

120. Professional Support will also evaluate the appropriateness of the methodology adopted by the Scottish Government to establish the total national liability for CNORIS. The review will focus on the estimation of the liability as at 31 March 2018 with a view to assessing the reliability of the methodology used for 2017/18.

121. Professional Support will then provide auditors with the outcome of the reviews to

- inform auditors' evaluation of the relevance and reliability of the information prepared by the CLO as audit evidence
- provide assurance on the methodology used in the preparation of the CNORIS figures as at 31 March 2018 which are provided to NHS boards.

Accounting developments

General accounting

2017/18 accounts manual

122. The Scottish Government Health and Social Care Directorate (SGHSCD) has issued the *2017/18 NHS board manual for annual report and accounts* to complement the guidance contained in the 2017/18 FReM.

123. There have been significant presentational changes to the financial statements and some further changes to the performance report and remuneration and staff report. The main changes included in the accounts manual compared with 2016/17 are summarised in the following paragraphs. Auditors should refer to the manual when auditing health boards' 2017/18 annual report and accounts.

Financial statements

124. The presentation of the SoCNE has been amended to improve clarity and compliance with the FReM and accounting standards. The changes on page 36 of the manual include the following

- Staff costs are now presented on the face of the SoCNE as a material expenditure item.
- Other operating expenditure categories are presented as
  - independent primary care services
  - drugs and medical supplies
  - other healthcare expenditure.
- Operating income is presented as a single line on the face of the SoCNE.

125. The categories of expenditure included within the guidance on pages 38 to 39 have been reordered to reflect the presentation of the summary of resource outturn in the accounts template.

126. The statement of cash flows guidance on pages 43 to 46 has been amended to clarify that the net expenditure should include associates and joint ventures accounted for on an equity basis. These will then be removed as part of the adjustments for non-cash transactions

127. The guidance on the statement of changes in taxpayers' equity on page 48 has been amended to remove the line relating to transfer of non-current assets from other bodies which will now be included the movement on the revaluation reserve.

Notes

128. The main changes to the notes are summarised in the following table:

Note	Pages	Change
Note 2	68 and 69	Revised note consolidates the previous note 3 (other operating expenditure) and note 18 (movement in working capital) to provide a single note to the cash flow statement
Note 3	70 to 73	New note which supports the changes to the categories of expenditure disclosed in the SoCNE and consolidates the previous notes 3 to 7 into a single expenditure note
Note 4	74 to 76	Note amends the previous note 8 on operating income to provide clearer income categories

Note	Pages	Change
Note 7	83	Donated assets are no longer presented separately from other property, plant and equipment assets. A line for transfers to and from other NHSScotland bodies has been added.
Note 9	94	Guidance on the operation of the NHS injury cost recovery scheme has been added.
Note 13	106	Clarification added that NHS Central Legal Office fees and outlays should not be included in the provision for CNORIS.
Note 20	118 to 119	Guidance on the required disclosure for 2017/18 to explain the changes in the presentation of the SoCNE.

Performance report

129. Pages 7 and 8 have been amended as a result of changes to the presentation of the financial reporting section. The memorandum for in year outturn has an additional line to present the reported (deficit)/surplus in the financial year which is taken from the financial performance disclosure. Additional explanation has been provided to clarify the requirements of the disclosure.

Remuneration and staff report

130. Guidance on page 19 has been amended to clarify that where a director has been in post for only a part of the year, the date of appointment/resignation and the full year equivalent figures are required in the remuneration table.

Other changes

131. This version of the accounts manual does not reflect the changes in the revised version of the 2017/18 FReM explained in the central government chapter. However, a revised version of the accounts manual which reflects those changes will be issued shortly.

Guidance on 2017/18 funding for large hospital services

132. The SGHSCD has issued guidance on accounting for funding set aside for large hospital services in 2017/18.

133. Health boards and integration joint boards (IJBs) are required to agree a figure for the sum set aside to be included in their respective annual accounts. Where the required arrangements were not in place in 2016/17, IJBs were allowed to use the budget made available by the health board.

134. The guidance sets out the arrangements available for the 2017/18 annual accounts. It is expected that health boards and IJBs should have made sufficient progress to be able to agree a figure for the sum set aside to be included in their respective annual accounts.

135. However, in the absence of a local arrangement, data is available from NHS National Services Scotland that should allow the preparation of reliable accounting estimates.

136. Auditors should refer to this guidance when auditing the set aside amount in NHS boards' 2017/18 annual report and accounts.

Property, plant and equipment

2017/18 capital accounting manual

137. The SGHSCD has issued the *2017/18 NHS capital accounting manual* (CAM) to interpret the accounting guidance contained in the 2017/18 FReM on capital accounting issues in the NHS.

138. There are no significant changes from the 2016/17 CAM.

139. Auditors should refer to the CAM when auditing property, plant and equipment in 2017/18 annual report and accounts.

Auditor action checklist

	Yes/No/N/A	Initials/date	W/P ref
1 Have you carried out the action recommended at paragraph 112 in respect of technical guidance note 2018/2(H)?			
2 Have you carried out the action required by paragraphs 117 and 118 in respect of 2017/18 model independent auditor's reports?			
3 Have you carried out the action recommended at paragraph 123 in respect of the 2017/18 NHS board manual for annual report and accounts?			
4 Have you carried out the action recommended at paragraph 136 in respect of the large hospital services set aside?			
5 Have you carried out the action recommended at paragraph 139 in respect of the 2017/18 capital accounting manual?			

Professional Support contact for health chapter

140. The contact in Professional Support for this chapter is Neil Cameron, Manager (Professional Support) - 0131 625 1797 or ncameron@audit-scotland.gov.uk.

Fraud and irregularities

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

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

Income

School fund income

141. An administrative assistant in a school misappropriated £6,000 by failing to bank school fund income.

Key features

The fraud was possible due to reconciliations and spot checks of accounts and cash balances not being carried out.

The fraud was identified during an internal audit investigation following a theft from the school safe. The administrative assistant denied any involvement in the theft, but admitted failing to bank school fund income.

Regular spot checks and bank reconciliations signed off by the head teacher have been introduced.

A report has been made to the Procurator Fiscal.

Non domestic rates income

142. A limited company defrauded over £18,600 in business rates relief through the submission of fictitious lease agreements and applications for small business bonus.

Key features

The limited company rented four industrial units. A professional rating practitioner advised the company to report to the council that three of the units had been sub-let to other companies that were under the control of the Directors of the limited company. The liability for business rates was then reduced, and transferred to the names of the different companies. This entitled all of the businesses to receive a small business bonus, reducing the rates liability to zero.

The fraud was identified when a member of the business rates team became suspicious and referred the case to the council fraud team. Subsequent enquiries established all leases were fictitious. The rating practitioner was sentenced to a four year prison term relating to charges involving fraud and violence.

The fraud was possible due to council officers failing to identify inconsistencies in documentation. For example, an examination of

- the lease agreements would have identified substantial errors such as the leases being dated prior to the limited company leasing the premises
- publically available Companies' House records would have revealed that the company registration number on the lease did not relate to the named companies and the people named as Directors were not recorded as Directors with Companies House.

Employees involved with the administration of business rates have been made aware of the weaknesses identified and a fraud awareness session relating to business rates is being developed for these employees.

Recovery action will be instigated to recover the full business rates liability from the limited company.

Auditor action checklist

	Yes/No/N/A	Initials/date	W/P ref
1 Have you considered whether the weaknesses in internal control that facilitated each fraud may apply at your audited bodies?			

Professional Support contact for fraud chapter

143. The contact in Professional Support for this chapter is Anne Cairns, Manager (Professional Support) on 0131 625 1926 or acairns@audit-scotland.gov.uk