Technical bulletin 2018/2

April to June 2018

Prepared for appointed auditors in all sectors
14 June 2018

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 chapters apply to a particular sector.

Technical bulletins are available to appointed auditors from the *Technical reference library* maintained by Professional Support, and are published on the Audit Scotland website so that audited bodies and other stakeholders can access them.

The items on technical developments are intended to highlight the key points that 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 items can be obtained by using the hyperlinks, where available. They are also available to appointed auditors from the *Technical reference library*.

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

Headlines chapter

This chapter provides brief headlines for the items on technical developments and guidance on emerging risks in this technical bulletin, classified by the audit year to which they relate, and referenced to the paragraph number containing the main item.

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Cross-sector chapter

This chapter contains information on the main technical developments in the quarter that are relevant to appointed auditors in all sectors.

Non-financial statements

Remuneration report

Guidance on trade union facility time disclosures

1. The Cabinet Office has issued supporting guidance on The Trade Union (Facility Time Publication Requirements) Regulations 2017. The regulations apply from 1 April 2017 and require public sector employers to collect and publish a range of information on trade union (TU) facility time in respect of their employees who are TU representatives.

2. The requirements apply to bodies listed in schedule 1 of the regulations which includes local authorities, health boards and central government bodies. Bodies which have fewer than 50 full time equivalent employees are exempt.

3. The information that bodies are required to collate and publish is summarised in the following table:

Required information to be disclosed	Comments
Number of employees who were relevant TU officials during the year	Bodies should report the total number of employees who were a TU official at any point during the year, including any for only part of the year.
The number of employees who were relevant TU officials during the year as a percentage of their working hours spent on facility time	Facility time is the provision of paid or unpaid time off from an employee's normal role to undertake TU duties and activities. The percentage of working hours should be reported in the following bandings: a)0%, b)1 – 50%, c) 51-99% or d)100%.
Percentage of the total pay bill spent on facility time	The total cost of facility time as a percentage of the total pay bill, including the gross amount spent on wages, pension contributions, and national insurance contributions.
Time spent on paid trade union activities as a percentage of total paid facility time hours	This relates to the time taken off for TU activities in respect of which a TU representative receives wages from the relevant public sector employer as a percentage of total facility time (i.e. duties and activities).

4. Relevant bodies are required to publish this information

- on websites (both their own and one central one maintained by the Government) before 31 July each year
- in the remuneration and staff report (or equivalent) in their annual report and accounts. This should not be in the audited part of the report.

Local authority chapter

This chapter contains information on the main technical developments in the quarter and guidance from Audit Scotland's Professional Support on any emerging risks that are relevant to appointed auditors in the local authority sector.

Financial statements

2018/19 accounting code

5. The CIPFA/LASAAC Local Authority Code Board (CIPFA/LASAAC) has issued the 2018/19 edition of the Code of practice for local authority accounting in the UK (2018/19 accounting code). The main changes in the 2018/19 accounting code are as follows
   - Section 2.7 has been revised following the adoption of *IFRS 15 Revenue from contracts with customers*, with additional guidance on the principles of revenue recognition added to section 2.1.
   - Section 3.4 has been amended in respect of segmental reporting requirements.
   - Chapter 7 has been fully revised to reflect the adoption of *IFRS 9 Financial instruments*.
   - Sections 5.2 and 8.1 have been amended to remove the requirement to disclose an analysis of debtors and creditors over public sector bodies.

6. Auditors should assess whether local authorities are making the necessary preparations to be able to comply with the requirements in the 2018/19 accounting code. The following paragraphs provide a brief synopsis of each change.

Revenue recognition

7. Section 2.7 of the accounting code requires local authorities to account for revenue recognition in accordance with IFRS 15. There are no interpretations or adaptations of the standard for the local authority context. Section 2.7 applies to a contract only if the counterparty to the contract is a 'service recipient'. The accounting code contains the following key definitions:

Term	Definition
Service recipient	A party that has contracted with a local authority to obtain goods or services that are an output of the authority's normal operating activities in exchange for consideration.
Contract	An agreement between two or more parties that creates enforceable rights and obligations.

8. Section 2.7 requires authorities to recognise revenue from contracts with service recipients in accordance with the five steps summarised in the following table:

Step	Action	Further detail
1	Identify the contract with a service recipient	Paragraph 2.7.2.13 sets out criteria that require to be met when identifying the contract. The criteria involve the approval of the contract, each party's rights, payment terms, commercial substance, and the probable collection of the consideration.
2	Identify the performance obligations in the contract	At contract inception, an authority is required to assess the goods or services promised in the contract and identify each promise as a performance obligation. Paragraph 2.7.2.17 gives examples of promised goods and services.
3	Determine the transaction price	The transaction price is the amount of consideration to which an authority expects to be entitled in exchange for transferring promised goods or services to a service recipient. Authorities are required to consider the terms of the contract and their customary business practices to determine the transaction price.
4	Allocate the transaction price to the performance obligations in the contract	Authorities are required to determine the stand-alone selling price at contract inception of the distinct good or service underlying each performance obligation in the contract and allocate the transaction price in proportion to those stand-alone selling prices.
5	Recognise revenue when (or as) the authority satisfies a performance obligation	A performance obligation is satisfied when a promised good or service is transferred to the service recipient. This is the point at which the service recipient obtains control. For each performance obligation identified at step 2, an authority is required to determine at contract inception whether it satisfies the performance obligation over time or at a point in time.

9. When either party to a contract has performed, an authority is required to present the contract in the balance sheet as a contract asset, liability, or receivable as explained in the following table:

Item	Explanation
Contract assets	An authority's right to consideration when that right is conditional on something other than the passage of time, e.g. the authority's future performance
Contract liability	An authority's obligation to transfer goods or services for which the authority has received consideration from the service recipient
Receivables	An authority's right to consideration that is unconditional. This is the case where only the passage of time is required before payment is due

10. Section 2.7.4 of the accounting code sets out the disclosure requirements. The objective of the disclosure requirements is for an authority to disclose sufficient information to enable users to understand the nature, amount, timing and uncertainty of revenue and cash flows arising from contracts with service recipients. To achieve that objective, authorities are required to disclose qualitative and quantitative information on

- its contracts with service recipients
- contract balances
- performance obligations
- significant judgements.

11. Authorities are required to recognise the cumulative effect of initially applying section 2.7 and IFRS 15 as an adjustment to the opening balance of reserves at 1 April 2018.

12. As a result of the adoption of IFRS 15, additional guidance on revenue recognition more generally is provided at paragraphs 2.1.2.31. This includes revenue arising from

- fines and penalties
- bequests and donations
- fees and charges for statutory services.

Segmental reporting requirements

13. There are a number of changes to section 3.4 to amend or clarify segmental reporting requirements. The main changes are summarised in the following table:

Area	Paragraph	Change
Meeting IFRS 8 reporting requirements	3.4.2.38 a)	The primary means of meeting *IFRS 8 Operating segments* reporting requirements will be the expenditure and funding analysis rather than the service segments in the comprehensive income and expenditure statement (CIES).
	3.4.2.93	The expenditure and funding analysis presents a local authority's segmental information.
	3.4.2.39	Transactions between service segments are no longer permitted in the service analysis section of the CIES.
Disclosing reportable segments	3.4.2.94	A local authority is required to disclose factors used to identify its reportable segments, including the basis of organisation.
	3.4.2.97	Where the number of reportable segments increases above ten, the authority should consider whether a practical limit has been reached. Two or more operating segments may be aggregated into a single operating segment if aggregation is consistent with the core principle of IFRS 8, and the segments have similar economic characteristics. A description of the aggregation of the operating segments should be disclosed.
Format of expenditure and funding analysis	3.4.2.99	Additional columns may be added to ensure that local authorities clearly demonstrate the relationship of their segmental analysis, the general fund and the service analysis presented in the CIES. Adjustments other than for differences between accounting and funding may be included in column II where necessary.

Financial instruments

14. Chapter 7 of the accounting code requires authorities to account for financial instruments in accordance with *IFRS 9 Financial instruments*, as well as *IAS 32 Financial instruments: presentation* and *IFRS 7 Financial instruments: disclosures*, except where the code contains adaptations. The main changes arising from the adoption of IFRS 9 is in respect of the

- classification approach to financial assets
- impairment model.

15. The classification approach to financial assets is based on both

- the authority’s business model for managing the financial assets
- the contractual cash flow characteristics of the financial asset.

16. The three new classifications for financial assets are summarised in the following table:

Measurement classification	Business model	Contractual cash flows
Amortised cost	The business objective is to hold financial assets in order to collect contractual cash flows.	The contractual terms of the financial asset give rise on specified dates to cash flows that are solely payments of principal and interest on the principal amount outstanding.
Fair value through other comprehensive income	The business objective is achieved by both collecting contractual cash flows and selling financial assets.	
Fair value through profit or loss	All financial assets not classified as above (although an authority may make an irrevocable election at initial recognition for particular investments in equity instruments to present subsequent changes in fair value in other comprehensive income).	

17. The key features of the new impairment model are summarised in the following paragraphs.

18. An authority is required to recognise a loss allowance for expected credit losses on a financial asset (unless the counterparty is central government or another local authority). A credit loss is the difference between all contractual cash flows that are due to an authority in accordance with the contract and all the cash flows that the authority expects to receive (i.e. all cash shortfalls), discounted at the original effective interest rate.

19. The general approach to measuring the loss allowance at each reporting date is summarised in the following table:

Significant increase in credit risk since initial recognition?	Measurement of loss allowances	Meaning
Yes	At an amount equal to the lifetime expected credit losses	The expected credit losses that result from all possible default events over the expected life of a financial instrument
No	At an amount equal to 12-month expected credit losses	The portion of lifetime expected credit losses that represent the expected credit losses that result from default events on a financial instrument that are possible within the 12 months after the reporting date

20. The accounting code allows a simplified approach which requires recognition of a loss allowance based on lifetime expected losses from origination. Local authorities are required to apply the simplified approach in two specified cases

- trade receivables
- contract assets that result from transactions within the scope of IFRS 15 that do not contain a significant financing component. An authority has a policy choice to apply either the simplified approach or the general approach where there is a significant financing component.

21. Non-contractual debts, such as council tax and non-domestic rates, are excluded from the scope of IFRS 9. The existing incurred loss model for the impairment of these debts continues to apply.

Debtors and creditors

22. The requirement to analyse debtors and creditors across public sector bodies has been removed. However, paragraph 3.4.2.63 has been amended to require appropriate sub-classifications to be provided in the balance sheet or in the notes.

Expenditure and funding analysis

New good practice note

23. Professional Support has published a good practice note on disclosing the expenditure and funding analysis in the annual accounts. This follows a review of the disclosures in the 2016/17 annual accounts which was the first year of the requirement.

24. Some key messages in the good practice note include the following

- The analysis should be disclosed in a prominent position within the notes.

- The number of operating segments should not be excessive.
- The amount of total adjustments in the expenditure and funding analysis should be consistent with the total adjustments elsewhere in the annual accounts or, where there is a valid reason for a difference, this should be explained.
- A subjective analysis of income and expenditure should be disclosed.
- Service income analysed by operating segment should be disclosed if its reported internally.

25. Local authorities are encouraged to use the findings in this good practice note to assess and enhance their own 2017/18 disclosures. Auditors should confirm that authorities have done so.

Segmental disclosures

New guidance on internal transactions

26. The Local Authority (Scotland) Accounts Advisory Committee (LASAAC) has issued an advisory note on meeting the reporting requirements of *IFRS 8* in 2017/18. The guidance focusses on the treatment of internal recharges that are part of a service manager's controllable budget.

27. In view of the different presentation options adopted in 2016/17, this advisory note is intended to support a consistent approach in 2017/18. The following table summarises the main presentation options for meeting IFRS 8 requirements in 2017/18:

Number	Option	Comments
1	CIES meets IFRS 8 requirements (no elimination of recharges)	Relevant internal recharges are included in service segment lines, and are not eliminated at any stage.
2	CIES meets IFRS 8 requirements (elimination of recharges)	Relevant internal recharges are included in service segment lines, but are eliminated in a separate line on the face of the CIES. A sub total should be shown before the elimination line to demonstrate compliance with IFRS 8.
3	A note meets IFRS 8 requirements	Internal recharges are not included in the CIES. A separate note is disclosed to show service segments inclusive of relevant internal recharges.

28. The advisory note encourages the application of options 2 or 3, and has two accompanying workbooks to provide examples.

29. The advisory note also highlights that options 1 and 2 will not be available from 2018/19 because (as explained in the item on the 2018/19 accounting code) the code has been amended to no longer permit internal recharges to be included in the CIES. The adoption of option 3 in 2017/18 will assist in preparing for the change in 2018/19.

30. Auditors should refer to this guidance when auditing segmental reporting in the 2017/18 annual accounts.

Financial instruments

Clarification statement on LOBOs

31. CIPFA/LASAAC has issued a statement clarifying the required accounting treatment for loan debt contracts with lender option borrower option (LOBO) clauses.

32. Paragraph 7.1.1.2e of the 2017/18 accounting code contains an interpretation of *IAS 39 Financial instruments: Recognition and measurement* that states that options embedded in a LOBO should not be accounted for separately. The statement clarifies that

- the reference to 'options' in that paragraph is related specifically to the call lender and borrower options that characterise LOBO clauses
- local authorities are required to follow IAS 39 in respect of accounting for any embedded derivatives in contracts with LOBO clauses.

33. The interpretation of IAS 39 applies to so called 'vanilla' LOBOs, but does not extend to more complex LOBOs (such as 'inverse floaters' where the interest rate moves inversely with the market).

34. Local authorities should refer to application guidance in IAS 39, as well as the standard itself, when considering whether the contractual terms of these more complex LOBOs represent an embedded derivative and, if so, whether it requires to be separately accounted for.

35. Auditors should refer to this statement when auditing contracts with LOBO clauses during the audit of the 2017/18 annual accounts.

Retirement benefits

2017/18 report on actuarial information

36. PWC has prepared a report to provide support to auditors when assessing the actuaries who produce retirement benefits figures under *IAS 19 Employee benefits* as at 31 March 2018.

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

38. However, the precise scope of the actuary's work is specific to each authority and the report recommends that auditors consider the need for further procedures in relation to a number of areas including

- where an employer has requested different assumptions than those proposed by the actuary (auditors should consider the duration of liabilities when reviewing assumptions). More details can be found in section 3 of the report, with relevant questions to ask in Appendix A
- the reasonableness of cashflow data provided by employers, particularly where there have been significant events such as redundancies, outsourcings and bulk transfers. Further details can be found in section 4 of the report.
- where experience gains or losses exceed 10% of total assets or liabilities.

39. The report includes a number of suggested tests in respect of calculation approach and information provided to the actuary at page 20.

40. Auditors should use this report in relation to IAS 19 amounts and the work of the actuary in relation to 2017/18.

Leases

Consultation paper on adopting IFRS 16

41. CIPFA/LASAAC has issued a consultation paper on proposals for the adoption of *IFRS 16 Leases* in the accounting code from 2019/20. IFRS 16 removes the classifications of operating and finance leases under IAS 17 for lessees. It requires that a lessee recognises assets and liabilities for all leases with a term of more than 12 months unless the underlying asset is of low value. A lessee will recognise a

- right-of-use asset representing its right to use the underlying leased asset
- lease liability representing the lessee's obligation to make lease payments for the asset.

42. IFRS 16 will have a substantial practical impact on local authority annual accounts, and authorities need to ensure that they make effective preparations for its implementation and that they have adequate governance arrangements in place. Auditors should therefore encourage local authorities to contribute to this consultation process. Comments should be sent to code.responses@cipfa.org by 7 September 2018.

43. The following table summarises some of the main questions included in the consultation along with a brief explanation of each one:

Do you agree with the proposal to mandate the recognition exemption for short-term leases?
IFRS 16 permits entities to not apply its requirements for short-term leases, i.e. those that, at the commencement date, have a lease term of 12 months or less. CIPFA/LASAAC is proposing to mandate this exemption.

Do you agree with the proposed approach to low value assets?
IFRS 16 also permits entities to not apply its requirements for leases where the underlying asset is of low value. IFRS 16 confirms that the assessment of the value of the underlying asset is based on when it is new, regardless of its age at the time of being leased. The application guidance provides examples of what might typically be low value assets including laptops, tablet computers and small items such as office furniture and telephones. CIPFA/LASAAC is proposing to allow authorities to use this exemption.
Do you agree with the proposed approach to identifying a lease?
IFRS 16 defines a lease as a contract, or part of a contract, that conveys the right to use an asset (the underlying asset) for a period of time in exchange for consideration. At the inception of the contract, IFRS 16 requires a local authority to assess whether the contract is (or contains) a lease. This is the case if the contract conveys the right to control the use of an identified asset. The key issues to be considered when making this assessment include the following • The underlying asset must be explicitly or implicitly specifically identified in the contract. • A local authority does not have the 'right to use the asset' if the supplier has the substantive right to substitute the asset throughout the period of use. • To assess whether the local authority controls the use of the asset, it must assess whether the contract conveys throughout the period of use the right to obtain substantially all the economic benefits and service potential from the use of the asset and the right to direct the use of the identified asset. CIPFA/LASAAC do not propose adapting or interpreting IFRS 16 in relation to the identification of the lease.
Do you agree with the proposed approach to the initial measurement of the right-of-use asset and the lease liability?
At initial recognition, the right-of-use asset is measured at cost. Cost is related to the initial measurement of the lease liability with a number of potential adjustments including any lease payments made at or before the commencement date. At the commencement date, the lease liability is initially measured at the present value of the lease payments payable over the lease term.
Do you have any commentary on the approach to determining the interest rate implicit in the lease or the authority's incremental borrowing rate?
The lease liability is discounted at the rate implicit in the lease. If that cannot be readily determined, the lessee is required to use its incremental borrowing rate. Indications from the private sector are that it will be difficult to identify the interest rate implicit in the lease, and

therefore the incremental borrowing rate will need to be used. It is likely that this will also be the case for local authorities.

Which approach to the subsequent measurement of the right-of-use asset do you consider best?

The consultation paper sets out the following three options for the subsequent measurement of the right-of-use asset

- Longer-term property leases (e.g. 25 years) should continue to be measured at current value while short-term property leases are measured at depreciated historical cost as a proxy on a rebuttable presumption that this materially represents the current value of the asset.
- Right-of-use assets are measured at current value if the required information is available without undue cost or effort.
- The cost model in IFRS 16 is adopted as a proxy for the revaluation model.

Do you agree with the proposed approach to the subsequent measurement of the lease liability?

After the commencement date, subsequent measurement of the lease liability requires that a lessee

- increases the carrying amount to reflect interest on the lease liability
- reduces the carrying amount to reflect the lease payments made
- remeasures the carrying amount to reflect any reassessment (e.g. change in lease term, revised discount rate) or lease modifications (i.e. change in the scope of the lease), or to reflect revised in-substance fixed lease payments.

Subsequent measurement of lease liabilities is measured using the effective interest rate method so that the carrying amount of the lease liability is measured at amortised cost and interest expense is allocated over the lease term.

CIPFA/LASAAC is of the view that there are no specific local government circumstances requiring an interpretation or adaptation to IFRS 16.

Do you agree with the proposed approach to accounting for concessionary leases for lessees?

CIPFA/LASAAC is proposing that the right-of-use asset for leases at below market terms (i.e. concessionary leases) should be measured at fair value on initial recognition on the basis that measurement at cost would lead to an understatement. It is also proposing that the subsidy from the lessor to the lessee should be recognised as

- income; or
- a liability where a present obligation exists (as the obligation is satisfied, the liability is reduced, and income recognised).

Do you agree with retaining the finance and operating lease distinction for lessors?
The lack of symmetry between the lessee and lessor accounting models may cause practical issues. CIPFA/LASAAC is interested in establishing the extent of leasing arrangements between local authorities.

Do you agree with the proposed approach to retrospective transition?
IFRS 16 offers entities the option of applying a practical expedient on the definition of a lease. An entity is not required to reassess whether a contract is, or contains, a lease at the date of initial application. Instead, the entity is permitted • to apply IFRS 16 to contracts that were previously identified as leases applying IAS 17 and *IFRIC 4 Arrangements containing a lease* • not to apply IFRS 16 to contracts that were not previously identified as containing a lease applying IAS 17 and IFRIC 4. CIPFA/LASAAC is proposing to mandate the use of this practical expedient. IFRS 16 provides for two approaches to transition, i.e. full retrospective restatement or recognising the cumulative effect of initially applying the standard at the date of initial application as an adjustment to reserves (i.e. preceding year information is not restated). CIPFA/LASAAC is proposing to mandate the second option.

Do you agree with the proposed transitional approach to measuring the right-of-use asset for those previously classified as operating leases?
For leases previously classified as operating leases, IFRS 16 offers the lessee the choice of measuring the right-of-use asset at • its carrying amount as if IFRS 16 had been applied since the commencement date, or • an amount equal to the lease liability adjusted by the amount of any prepaid or accrued lease payments relating to that lease before the date of initial application. CIPFA/LASAAC is proposing to use the second option as it is of the view that it is easier to estimate and more understandable for the users of the financial statements.

Non-financial statements

Annual governance statements

Revised guidance on audit committees

44. The Chartered Institute of Public Finance and Accountancy (CIPFA) has published revised guidance on the function and operation of audit committees in local authorities.

45. The guidance incorporates a revised position statement on audit committees. It emphasises the importance of audit committees being in place in all principal local authorities and also recognises that audit committees are a key component of governance.

46. The purpose of an audit committee is to provide to those charged with governance independent assurance on the adequacy of the risk management framework, the internal control environment and the integrity of the financial reporting and annual governance processes.

47. There have been a number of significant developments in governance and audit practice since the previous 2013 edition of the guidance which have emphasised the importance of audit committees to adapt their remit, notably the introduction of annual governance statements. Key developments include

- the new good governance framework
- updates to the *Public sector internal audit standards*
- the *Code of practice on managing the risk of fraud and corruption*.

48. The core functions of an audit committee include

- being satisfied that the authority's annual governance statement properly reflects the risk environment and any actions required to improve it, and demonstrates how governance supports the achievements of the authority's objectives
- considering the effectiveness of the authority's risk management arrangements and the control environment
- considering the reports and recommendations of external audit and inspection agencies and their implications for governance, risk management or control
- reviewing the financial statements, external auditor's opinions and reports to members, and monitoring management action in response to the issues raised by external audit.

49. Auditors should refer to this guidance when considering a local authority's annual governance statement.

Independent auditor's report

2017/18 model reports

50. Professional Support has published 2017/18 Independent auditors report (local authorities) - Technical guidance note 2018/5(LA) to provide auditors with the model independent auditor's reports which should be used for the 2017/18 annual accounts. The technical guidance note also provides application guidance on their use.

51. In the interests of consistency, auditors are required to use the relevant model report in appendices 1 to 5 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.

52. 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*.

53. 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.

54. Auditors should use this technical guidance note when reporting on 2017/18 audits. They should complete for each report the checklist at Appendix 6 which provides a list of the key auditor actions.

Statutory objections

2017/18 guidance

55. Professional Support has issued module 12 of technical guidance note 2017/10(LA) to provide information and guidance on statutory objections to the 2017/19 unaudited annual accounts. Statutory objections refer to the right of interested persons under section 101 of the *Local Government (Scotland) Act 1973* to inspect and to object to the unaudited annual accounts.

56. Module 12 provides auditors with guidance on dealing with any objections they receive, including cases where a hearing is required. There are no changes in statutory requirements in 2017/18. However, the module has been enhanced to provide auditors with more practical guidance. The guidance sets out

- considering whether a submission received meets the criteria for being treated as a statutory objection
- the actions required where the submission can be accepted as a valid objection
- the actions required where the submission is not a valid objection.

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

Grant claims and returns

Technical guidance notes

58. Professional Support has published Certification of 2017/18 approved local authority grant claims and returns - Technical guidance note TGN/GEN/18 to provide general guidance to auditors on the certification of 2017/18 local authority grant claims and returns and to explain the approach and procedures to be adopted. The technical guidance note

- explains the arrangements for the certification of grant claims and other returns
- provides a list of grant claims and other returns which external auditors are required to certify in 2017/18 under their audit appointment
- considers the roles and responsibilities of Professional Support, grant-paying bodies, local authorities, and appointed auditors

- sets out the overall approach to be adopted by auditors
- provides guidance on auditor reporting.

59. Professional Support also separately publishes a technical guidance note on each significant approved claim to provide auditors with specific guidance on certifying that claim. The following have been published to date for 2017/18

- Auditor certification of the 2017/18 housing benefit subsidy claim - technical guidance note TGN/HBS/18
- Auditor certification of the 2017/18 Bellwin scheme claims - technical guidance note TGN/BEL/18
- Auditor certification of 2017/18 education maintenance allowances grant claim - technical guidance note TGN/EMA/18.

60. Auditors should follow these technical guidance notes when reviewing and reporting on 2017/18 grant claims.

Housing benefit subsidy claim

Guidance on new regulations

61. The Department for Work and Pensions (DWP) has issued HB circular A2/2018: The Universal Credit (Miscellaneous Amendments, Saving and Transitional Provision) Regulations 2018 to

- announce changes on how housing costs are funded for temporary accommodation cases
- introduce a transition to universal credit housing payment which extends the end date of housing benefit (HB) when a claimant migrates to universal credit.

Guidance on immigration status evidence

62. The DWP has issued HB circular U1/2018: 'Windrush generation': information for local authorities on the handling of HB cases to clarify how local authorities should treat claimants unable to evidence their immigration status.

2018/19 uprating

63. The DWP has re-issued HB circular A10/2017: Housing benefit: uprating 2018-19 (3rd revision) to announce corrections to the previously announced benefits rates from April 2018.

Funding

64. The DWP has issued the following circulars in respect of HB funding in 2017/18 and 2018/19

- HB circular S4/2018: Final new burdens payment 2017/18 for the real time information bulk data matching initiative
- HB circular S5/2018 Additional new burdens funding to meet the costs of implementing welfare reform changes in 2018/19

- HB circular S6/2018 Payment of new burdens relating to the Single Fraud Investigation Service for 2018/19
- HB circular S9/2018: Transition to universal credit housing payments and removal of temporary accommodation from universal credit new burdens payments.
- HB circular S10/2018: Payment for the verify earnings and pension alerts service 2018.

Specific bodies

Integration joint boards

Revised guidance

65. LASAAC has published revised guidance on accounting for health and social care integration for 2017/18. This guidance is intended to support financial reporting in both integration joint board (IJB) and council annual accounts.

66. There are no significant amendments in this further revision but the opportunity has been taken to refresh the guidance and ensure it stays up-to-date. Clarification has been added, however, that the guidance is intended to be mandatory.

67. Auditors should refer to this guidance when auditing the 2017/18 annual accounts of IJBs and councils.

New good practice note

68. Professional Support has published a good practice note on IJB annual accounts. This follows a review of the disclosures in the 2016/17 annual accounts which were chosen for review as that was the first full year of operation.

69. Some recommendations for improvements in the good practice note include the following
    - More reporting of performance including explanations for actions required to address any issues.
    - Descriptions of the risks and uncertainties should be specific to each IJB.
    - Disclosures should be both relevant and material.
    - Jargon should be avoided or, if that is not possible, explanations in plain language should be provided.

70. IJBs are encouraged to use the findings in this good practice note to assess and enhance their own 2017/18 annual accounts. Auditors should confirm that their IJBs have done so.

Annual accounts signatories

71. An auditor has sought clarification over signing the management commentary, annual governance statement and remuneration report in the IJB annual accounts when the chief officer is not available.

72. Regulation 10(4) of The Local Authority Accounts (Scotland) Regulations 2014 states that where a local authority does not have a chief executive, the statements are to be signed by 'such other person as it nominates for that purpose'. The term 'chief executive' is defined in the regulations as a person designated by a local authority as the head of its paid service by virtue of section 4 of the *Local Government and Housing Act 1989*. Section 4 applies to a council constituted under section 2 of the *Local Government etc. (Scotland) Act 1994*, but does not extend to joint boards.

73. It is for the IJB to nominate a person to sign the statements instead of a chief executive. While it makes sense for it normally to be the chief officer, this is not a requirement, and an IJB can nominate another individual.

Auditor action checklist

	Yes/No/N/A	Initials/date	W/P ref
1 Have you carried out the action recommended at paragraph 6 in respect of the 2018/19 accounting code?			
2 Have you carried out the action recommended at paragraph 25 in respect of good practice in expenditure and funding analysis disclosures?			
3 Have you carried out the action recommended at paragraph 30 in respect of segmental reporting?			
4 Have you carried out the action recommended at paragraph 35 in respect of LOBOs?			
5 Have you carried out the action recommended at paragraph 40 in respect of actuarial information?			
6 Have you carried out the action recommended at paragraph 42 in respect of the consultation on leases?			
7 Have you carried out the action recommended at paragraph 49 in respect of audit committees?			
8 Have you carried out the action required at paragraph 54 in respect of model independent auditor's reports?			
9 Have you carried out the action required at paragraph 57 in respect of statutory objections?			
10 Have you carried out the action required at paragraph 60 in respect of reviewing grant claims?			

	Yes/No/N/A	Initials/date	W/P ref
11 Have you carried out the action recommended at paragraph 67 in respect of IJB accounts?			
12 Have you carried out the action recommended at paragraph 70 in respect of good practice in IJB accounts?			

Professional Support contact for local authority chapter

74. 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

This chapter contains information on the main technical developments in the quarter and guidance from Professional Support on any emerging risks that are relevant to appointed auditors in the central government sector.

Financial statements

Leases

Exposure draft on adopting IFRS 16

75. HM Treasury has issued IFRS 16 Leases : Exposure draft 18(01) on proposals for the *Government financial reporting manual's* (FReM) adoption of *IFRS 16 Leases* from 2019/20. IFRS 16 removes the classifications of operating and finance leases under IAS 17 for lessees. It requires that a lessee recognises assets and liabilities for all leases with a term of more than 12 months unless the underlying asset is of low value. A lessee will recognise a
    - right-of-use asset representing its right to use the underlying leased asset
    - lease liability representing the lessee's obligation to make lease payments for the asset.
76. Auditors should encourage their bodies to contribute to this consultation process. Comments should be sent to frem.consultation@hmtreasury.gsi.gov.uk by 31 July 2018. .
77. The following table summarises some of the main questions included in the consultation along with a brief explanation of each one:

Do you agree with the proposed adaptation for the definition of a contract?
IFRS 16 defines a lease as a contract, or part of a contract, that conveys the right to use an asset (the underlying asset) for a period of time in exchange for consideration. At the inception of the contract, IFRS 16 requires a body to assess whether the contract is, or contains, a lease. This is the case if the contract conveys the right to control the use of an identified asset. Treasury believes the definition of the contract should be adapted so that it includes intra-government agreements that are not technically legally enforceable, but in substance would be considered a contract.
Do you agree with the public sector interpretation for short-term leases?
IFRS 16 permits entities to not apply its requirements for short-term leases, i.e. those that, at the commencement date, have a lease term of 12 months or less. Treasury is proposing to mandate this exemption.

Do you agree with the proposal for low value assets?
IFRS 16 also permits entities to not apply its requirements for leases where the underlying value is of low value. IFRS 16 confirms that the assessment of the value of the asset is based on the asset when it is new, regardless of its age at the time of being leased. The application guidance provides examples of what might typically be low value assets including laptops, tablet computers and small items such as office furniture and telephones. Treasury does not propose to provide a central value for low value leases and proposes to leave the decision to apply the exemption to individual entities.
Do you agree Treasury should set an internal rate of borrowing centrally for entities to use when they cannot obtain the rate implicit in the lease?
The lease liability is discounted at the rate implicit in the lease. If that cannot be readily determined, the lessee is required to use its incremental borrowing rate. Indications from the private sector are that it will be difficult to identify the interest rate implicit in the lease, and therefore the incremental borrowing rate will need to be used. Treasury proposes to introduce a central internal rate of borrowing for entities to apply, when they cannot obtain the rate implicit in the lease contract. In developing the central rate, Treasury proposes the application of the internal rate of borrowing to all leases irrespective of the type of underlying asset.
What valuation methodology do you believe Treasury should mandate for the public sector?
IFRS 16 states that the cost model should be used to determine the subsequent measurement of the right of use asset. The cost model under IFRS 16 is different to the cost model under IAS 16. IFRS 16 requires the asset to be carried at cost (the value of the lease liability with certain adjustments) less any accumulated depreciation, impairment losses, and any adjustments for the re-measurement of the lease liability including changes in lease term and changes in lease payments resulting from a change in an index or a rate. Treasury proposes to adopt the IFRS 16 cost model for lessees as a proxy for the revaluation model adapted in the FReM under IAS 16. This is on the basis that leases provided by the private sector are generally constructed on market terms and contain regular rent reviews. As such, both the asset and liability would be subjected to regular re-measurement and may be considered a proxy to undertaking formal professional valuations.

Do you agree with the public sector adaptation for peppercorn leases?
Within the public sector there are a number of leases which are provided on a peppercorn basis (i.e. nominal consideration). At present, such assets are treated as finance leases under IAS 17 by both the lessee and the lessor. The application of the IFRS 16 cost model would not result in an appropriate valuation for the assets as the lease liability would be substantially low or nil value for peppercorn leases. Treasury proposes that peppercorn leases be treated as if they were owner occupied for the duration of the lease term and therefore be measured using the IAS 16 criteria rather than the IFRS 16 criteria.
Are there any disclosure requirements for lessee accounting which you believe are not applicable to the public sector?
The disclosure requirements for lessees in the IFRS 16 are significantly more extensive than under IAS 17. Treasury proposes to retain the disclosure requirements in full but to emphasise the materiality considerations that entities are expected to undertake in determining whether they are required to provide particular disclosures.
Do you agree with the proposals for lessor accounting?
Lessor accounting has not substantially changed from IAS 17. The dual accounting model of finance and operating leases remains under IFRS 16 as does the criteria for assessing the classification. The lack of symmetry between the lessee and lessor accounting models may cause practical issues.
Do you agree with the public sector interpretation on grandfathering existing lease classifications?
IFRS 16 offers entities the option of applying a practical expedient on the definition of a lease. An entity is not required to reassess whether a contract is, or contains, a lease at the date of initial application. Instead, the entity is permitted • to apply IFRS 16 to contracts that were previously identified as leases applying IAS 17 and *IFRIC 4 Arrangements containing a lease* • not to apply IFRS 16 to contracts that were not previously identified as containing a lease applying IAS 17 and IFRIC 4. Treasury is proposing to mandate the use of this practical expedient.

Do you agree with the transition approach for the proposed amendments?
IFRS 16 provides for two approaches to transition, i.e. full retrospective restatement or recognising the cumulative effect of initially applying the standard at the date of initial application as an adjustment to taxpayers equity (preceding year information is not restated). Treasury is proposing to mandate the second option.
Do you agree with the public-sector interpretation for asset measurement upon transition?
For leases previously classified as operating leases, IFRS 16 offers the lessee the choice of measuring the right-of-use asset at • its carrying amount as if IFRS 16 had been applied since the commencement date, or • an amount equal to the lease liability adjusted by the amount of any prepaid or accrued lease payments relating to that lease before the date of initial application. Treasury is proposing to use the second option.

Non-financial statements

Performance report/Remunerations and staff report

New guidelines

78. The European Commission has published Guidelines on non-financial reporting which are intended to help bodies disclose high-quality non-financial information in their annual report and accounts. The guidelines are relevant to the new 2017/18 FReM requirements (covered at paragraph 22 of technical bulletin 2018/1) for

- the performance report to disclose non-financial information pertaining to social matters, respect for human rights, anti-corruption and anti-bribery matters
- the staff report to disclose information relating to employee matters such as other diversity issues, health and safety at work and trade union relationships.

79. Pages 15 and 16 of the guidelines cover the requirement to disclose information on social and employee matters. These include

- diversity issues, such as gender diversity and equal treatment in employment and occupation
- employment issues, including employee consultation and/or participation, employment and working conditions
- trade union relationships, including respect of trade union rights
- human capital management including management of restructuring, career management and employability, remuneration system, training
- health and safety at work

- impacts on vulnerable consumers;
- community relations, including social and economic development of local communities.

80. Pages 16 and 17 cover the disclosure of information on the impact of a body's operations on human rights. It is considered best practice for a body to express its commitment to respecting human rights. This commitment may define what the organisation expects from its management, employees and business partners in relation to human rights.

81. Page 17 covers information on how the body manages anti-corruption and bribery matters. This may include disclosing

- anti-corruption policies, procedures and standards
- criteria used in corruption-related risk assessments
- internal control processes and resources allocated to preventing corruption and bribery
- employees having received appropriate training
- use of whistleblowing mechanisms.

Governance statement

Revised internal control checklist

82. The Scottish Government Finance directorate has published an amendment to the Scottish Public Finance Manual certificates of assurance section which updates the internal control checklist.

Auditor action checklist

	Yes/No/N/A	Initials/date	W/P ref
1 Have you carried out the action recommended at paragraph 76 in respect of the exposure draft on IFRS 16?			

Professional Support contacts for central government chapter

83. 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

This chapter contains information on the main technical developments in the quarter that are relevant to appointed auditors in the health sector, and guidance from Professional Support on risks emerging from the audit of 2017/18 health annual report and accounts.

Annual report and accounts overall

Re-issued 2017/18 accounts manual

84. The Scottish Government Health and Social Care Directorates (SGHSCD) has re-issued the *2017/18 NHS board manual for annual report and accounts* (2017/18 accounts manual) to include further changes to those in the version issued in December 2017 (covered at paragraph 31 of technical bulletin 2018/1).

85. The further changes are to reflect the amendments in the re-issued 2017/18 FReM (covered at paragraph 22 of technical bulletin 2018/1), and are summarised in the following paragraphs.

Performance report

86. Pages 6, 8 and 9 of the accounts manual have been amended to reflect the FReM requirements to disclose

- a statement of the purpose and activities of the board including in respect of a brief description of the business model and environment, organisational structure, objectives and strategies
- an explanation of the adoption of the going concern basis where this might be called into doubt
- additional explanatory narrative to link risk and uncertainty with key performance indicators
- an explanation of the relationships and linkages between information in the annual report and accounts
- non-financial information on social matters, respect for human rights, anti-corruption, and anti-bribery matters.

87. Page 6 has also been amended to require, as a new requirement, a short summary explaining the purpose of the overview section. In addition, the disclosure of a statement from the chief executive giving their perspective on performance (previously optional) is now required.

Remuneration and staff report

88. The staff report on pages 26 to 33 has been amended to

- include the apprenticeship levy under taxation and social security in the staff costs note, in accordance with the FReM

- define a senior employee for the purposes of the staff composition analysis as earning over £70,000 per annum (increased from £50,000)
- require information to be provided on other employee matters e.g. diversity issues.

Name of health board

89. An auditor has raised with Professional Support the issue of which name health boards should use in their annual report and accounts. The National Health Service (Determinations of Areas of Health Boards)(Scotland) Order 1974 defines the geographical areas covered by health boards, and indicates the names by which the areas should be known. The accounts direction for each board refers to it as the geographical area followed by 'health board' (e.g. Fife Health Board). However, many boards drop the 'health board' from their name in common usage, such as in correspondence, signage etc, and add 'NHS' (e.g. NHS Fife).

90. There is no prescription as to which form of the name should be used in the annual report and accounts. However, where a board uses their common name, Professional Support recommends that the statutory name be referred to with an explanation that the board has chosen to use the name it is more commonly known by.

91. Whichever form of name a board uses in the annual report and accounts, auditors should use the same name in the independent auditor's report.

Financial statements

Income

Recognition of funding allocations

92. Auditors have raised the issue of when it may be appropriate for health boards to defer the recognition of funding allocations. NHS allocations letters provide boards with the authority to spend under the budget approved in Parliament. However, Professional Support has confirmed with the SGHSCD that these allocations are equivalent to grant-in-aid. They should therefore be accounted for in accordance with the FReM, which requires grant-in-aid to be accounted for on a cash basis. The allocations should therefore be recognised as income on receipt.

93. Notwithstanding the requirement to account for the allocations on a cash basis, any objectives or policy outcomes stipulated in such letters are not considered conditions that require repayment if they are not satisfied. The existence of such stipulations would not therefore justify deferring recognition of the income. Whether a board spends this specific amount on these programmes or fund the programmes from their general allocation is a matter for the board to decide based on financial management and budgetary control considerations.

Authorised for issue date

94. The auditor of a health board has sought advice from Professional Support regarding the wording that boards should give when disclosing the date the financial statements were authorised for issue by the Accountable Officer.

95. The FReM requires the authorised for issue date to be disclosed in the annual report and accounts. It does not specify a location other than to exclude the title page. The accounts manual requires the date the financial statements were approved by the board to be disclosed. It notes that the authorised for issue date is usually taken as the date the accounts are adopted by the board.

96. Professional Support's advice is for boards to consider combining these disclosures to read 'The annual report and accounts were approved by the board and authorised for issue by the Accountable Officer on X June 2018'.

Provisions

Estimating pension provision

97. An auditor has queried a health board's use of life expectancy tables for the UK when calculating its pension provision at 31 March 2018.

98. The board should use the latest available, reliable information to arrive at the best estimate of the expenditure required to settle the obligation. The Office of National Statistics also prepare Scottish life expectancy tables. In Professional Support’s view, it is reasonable to assume that the use of Scottish tables would result in a better estimate than the UK tables.

99. In the absence of an acceptable justification from the board for using the UK tables, it should change to using the Scottish tables for 2017/18. As Scottish tables were available in previous years but not used, this could be treated as the correction of a prior year error which would require a retrospective restatement.

Clinical negligence claims

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

101. Professional Support has also evaluated the appropriateness of the methodology adopted by the Scottish Government to establish the total national liability for CNORIS. The review focused on the estimation of the liability as at 31 March 2018.

102. Professional Support has provided auditors with the outcome of the above reviews.

Large hospital services

Guidance on calculating 2017/18 set aside

103. Following the letter referred to in technical bulletin 2018/1 (paragraph 132), the SGHSCD has issued a second letter on the arrangements for calculating the set aside for large hospital services in 2017/18.

104. This guidance clarifies that, similar to 2016/17, where the arrangements required for calculating the amount of set aside are still not yet in place, boards and IJBs are permitted to use the agreed budget as the basis for the entries in the financial statements.

Non-financial statements

Remuneration and staff report

Fair pay disclosure

105. An auditor has queried what figure should be used for 'remuneration' in the fair pay disclosure in the remuneration and staff report. This relates to the requirement in the FReM and the accounts manual for boards to disclose information comparing the remuneration of the highest paid director with the median remuneration of the board's staff. The main issue is whether the pension benefit component of remuneration should be included in the comparison.

106. In Professional Support's view, there is a lack of consistency in the requirements. The 2017/18 FReM refers to the Hutton review of fair pay - implementation guidance, but this was last updated in 2012/13 which was before the introduction of the pension benefit component of remuneration.

107. The FReM also requires bodies to follow guidance contained in the annual employer pension notice (EPN) issued by the Cabinet Office. The approach used in the worked examples in the EPNs excludes the pension benefit component. This is consistent with an illustration in the accounts manual, which all health boards followed in 2016/17.

108. Professional Support recommends that boards follow a consistent approach in 2017/18 and exclude pension benefit from the disclosure. Professional Support will seek to clarify the requirements for 2018/19, but consider that maintaining consistency with both previous practice and the EPN for 2017/18 is a reasonable position.

Guidance on trade union facility time disclosures

109. The SGHSCD has issued guidance clarifying the arrangements for the disclosure of trade union facility time information (explained in the cross-sector chapter of this technical bulletin) in health boards' 2017/18 annual report and accounts.

110. The email advises that, if reliable information is available, it should be included within the remuneration and staff report in the 2017/18 annual report and accounts. However, if boards are not able to produce reliable information in time, the email provides explanatory wording to be used.

Performance report

Information on brokerage

111. An auditor has sought clarification as to whether the requirement to repay brokerage should be recognised as a liability in the financial statements. Brokerage relates to an advance on future funding to assist a board achieve its financial target for a year. When boards are provided with brokerage, they are required to commit to a schedule of future resource allocation reductions to facilitate repayment of the brokerage amount.

112. This commitment should not be recognised as a liability in the financial statements of the board as settlement will be based on future funding reductions.

113. However, the accounts manual requires 'additional funding' arrangements to be disclosed under the financial performance section of the performance report. This includes the disclosure of brokerage arrangements.

NHS endowment funds

Letters on use of charitable funds

114. The SGHSCD has issued two letters to the chairs of health boards asking for information on the use of NHS endowment funds established under the *National Health Service (Scotland) Act 1978*. The letters were prompted as a result of issues raised in respect of the endowment fund at NHS Tayside.

115. The letters requested that the chairs provide assurances that

- all funds have been awarded and used in furtherance of the charitable purposes. The required response was required to advise what the board has received or applied for in terms of endowments
- retrospective awards are not permitted. This relates to any decision to charge expenditure to exchequer funds that was later reversed by retrospectively applying for endowment funding.

116. The Office of the Scottish Charity Regulator (OSCR) has subsequently written to the SGHSCD explaining that, having considered the chairs' responses as well as reviewing the endowment funds' statement of accounts, there are no issues in other NHS endowment funds that merit the opening of an inquiry by OSCR.

Professional Support contact for health chapter

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

Professional developments chapter

This chapter contains information on the main professional developments in the quarter that are relevant to appointed auditors in the public sector.

Auditing developments

Thematic review on audit culture

118. The Financial Reporting Council (FRC) has issued the results of a thematic review of audit culture. The report sets out the actions being taken by audit firms to establish, promote and embed a culture that is committed to delivering consistently high quality audits.

119. The report identifies a number of areas where more actions by firms are required. For example, the report recommends that firms should

- give additional prominence to audit specific behaviours and values within the firms' cultural design, including the fundamental principles of integrity, objectivity, independence and professional scepticism that underpin high quality audit
- ensure that all audit partners and staff appreciate that a good audit is of significant societal value and helps to underpin transparency and integrity in business
- balance robust processes to sanction poor quality work or behaviour with better recognition of positive contributions to high audit quality
- further develop root cause analysis techniques to identify the behavioural or cultural factors that contributed to good and poor quality outcomes
- improve their monitoring of how successful they are at embedding their desired culture.

Accounting developments

Proposed amendment to IAS 8

120. The International Accounting Standards Board has issued an exposure draft of proposing amendments to *IAS 8 Accounting policies, changes in accounting estimates and errors*. The proposed amendments are intended to facilitate the application of particular voluntary changes in accounting policy.

121. The relevant changes in accounting policy are those arising from explanatory material included in 'agenda decisions' published by the IFRS Interpretations Committee. The published agenda decisions explain the committee's rationale for not adding a particular matter to its standard-setting agenda.

122. The proposal is that retrospective application of a change in accounting policy resulting from an agenda decision will not be required to the extent that the cost of determining the effects exceeds the expected benefit to users.

123. Comments should be sent to commentletters@ifrs.org by 27 July 2018.

Professional Support contact for professional developments chapter

124. 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.

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.

Expenditure

Invoices paid to employee

125. A council IT employee embezzled over £1 million between August 2009 and May 2016 as a result of 57 payments made into two bank accounts set up by the employee.

Key features

Routine financial year end procedures highlighted an invoice where supporting information could not be found. It was discovered that the payment for this invoice was made into an employee's bank account. This resulted in both internal and Police Scotland investigations which highlighted fundamental weaknesses in the council's internal financial control systems.

The fraud was possible as the employee worked in the council IT section and had unrestrictive access to several systems which allowed him to insert false invoices into the system and alter the bank payment details of suppliers without detection.

An external accountancy firm identified additional control weaknesses within budgetary control, reconciliation procedures and IT system access. Internal audit plan to follow up recommendations to ensure that they have been implemented effectively and to review the *Bank automated clearance system* (BACS) including user access levels.

The employee was immediately suspended and resigned from his position. The Police Scotland investigation resulted in the ex-employee pleading guilty and being sentenced to more than five years imprisonment.

Recovery of most of the loss has been achieved through a range of methods including recovery from the pension of the convicted individual, an ex gratia payment from a third party, and proceeds from the council's fidelity insurance policy.

Invalid funding claims (1)

126. An external service provider inappropriately claimed over £47,000 of funding from a central government body in respect of unemployed individuals who were receiving support to move towards employment. The service provider claimed payments for individuals who did not meet the eligibility criteria.

Key features

The agreement with the service provider was based on payments for successful recruitment and outcomes for unemployed individuals. An inappropriate financial claim was submitted without the necessary funding criteria having been met.

The irregularity was discovered after a whistle-blower contacted the central government body. It was facilitated by poor management of the scheme.

The central government body suspended payments to the provider and carried out an investigation. The service provider has dismissed staff as a result of the investigation.

The funding has been recovered from the service provider.

Invalid funding claims (2)

127. An advisor within a body in receipt of council funding submitted claims for £11,000 of funding using false evidence.

Key features

Internal audit carried out an investigation following receipt of information from a third party which suggested that an adviser who was an employee of a consortium delivering a project falsified claim evidence.

The falsified evidence consisted of forwarded emails regarding client activities, which the adviser could edit. Documents which were intended to evidence eligibility of benefits and identification were also tampered with.

The internal audit investigation prevented the council paying out on the ineligible claims.

The adviser resigned during the subsequent disciplinary process.

Controls have been tightened and emails alone are not allowed as evidence. Training has also been given to consortium supervisors on detecting tampered documents.

Change of bank details

128. Two separate third parties defrauded two councils of £175,000 and £25,000 by re-directing payments intended for a legitimate supplier. In each case, the fraudster sent an email from an email account purporting to be from one of the council's contractors requesting a change in bank details. Payments were then made to the new bank account.

Key features (1)

The council was notified of a change of bank details by email from a supplier. The council followed its procedures in this regard and requested confirmation details by email. The relevant information was duly received from an individual known to the council. The change was actioned and a payment made.

The supplier subsequently contacted the council looking for the payment which the council thought it had already made. It was identified that the supplier's email account had been hacked.

While the council followed its agreed procedures in this regard, it was not its practice to telephone the supplier to confirm details. The council has reviewed its procedures in respect of requests to change bank details and they now include a requirement to make a telephone call to the customer.

Around £55,000 is expected to be recovered from the bank.

Key features (2)

Emails from a perpetrator purporting to be a legitimate contractor were sent to the council's technical services department requesting a change to bank account details. The revised bank details were then communicated onwards to the accounts payable section.

The fraud was identified after a further communication was received from the same email address. This e-mail was reviewed by a senior officer who was concerned about the wording and poor use of English. The senior officer telephoned the contractor from the contact details held on the council system and informed them that their e-mail account may have been hacked or compromised.

Internal audit carried out an investigation. Telephone records for the accounts payable section identified that a call had been made to a clerical assistant in technical services and it was concluded that the accounts payable member of staff had most likely called technical services to confirm the bank details rather than directly with the contractor.

The fraud was possible as the accounts payable clerk did not have a full knowledge of the procedures to follow. In addition, there was a lack of follow up and review which should have happened at the authorisation stage of the process.

Payments totalling £21,000 were subsequently recovered through the BACS process.

Purchase of goods for personal gain

129. A street lighting technician ordered goods and materials worth £15,500 which he subsequently sold for personal gain.

Key features

> The officer either placed orders for cabling material by creating a requisition on the purchasing system or placed the order first by phone, then requisitioned these through the purchasing system retrospectively. In either case, he would collect the material from the supplier without a requisition having been approved. In addition, some purchases were made 'in store' using a purchasing card. The officer subsequently sold the materials for personal gain.
>
> The fraud was possible as control checks on these purchases were ineffective and did not identify, initially, that they were of a specific type of material that the officer would not have required as part of his normal post. The officer was circumventing the ordering processes and controls and applying them retrospectively. Issues with the purchasing IT system also meant that orders could be placed without approval.
>
> The fraud was identified when a supervisor identified that a delivery note was missing at the point of 'signing off' procurement system orders. Copies of delivery notes were subsequently obtained from the supplier, identifying the officer who had placed the orders.
>
> Controls are now in place within the purchasing system to ensure the any orders for goods follow the correct route for purchase authorisation. Internal Audit is reviewing the service area concerned and is also assisting with periodic reviews of compliance with purchasing card controls.
>
> The matter has been reported to Police Scotland, and the individual has been charged. The individual also went through an internal disciplinary process and was dismissed.

Income

Council tax evasion (1)

130. A principal teacher evaded a council tax liability of £6,300.

Key features

> A council tax exemption of 100% was in place at a property in relation to the previous occupier who died in May 2012. The teacher failed to notify the council that they occupied the property from that date.
>
> The council tax evasion went undetected as limited visits were carried out on exempt properties.
>
> The evasion was eventually identified after a visit by internal audit to properties with council tax exemptions in place identified that the council employee was resident in the property. Further investigations identified his date of entry.
>
> Debt recovery procedures are now being carried out and a recommendation for a sanction has been passed to the employee’s head of service.

Council tax evasion (2)

131. A local resident evaded a council tax liability of £16,400 by claiming an exemption he was not entitled to.

Key features

A landlord applied for a false exemption by claiming that the tenant, who was exempt because he was a member of a visiting armed force, resided at the address until 2017.

The fraud was identified when a Team Leader became suspicious. Enquiries indicated the exemption should have ended in 2005, and that the landlord had occupied the property over that period. The landlord provided paperwork which was believed to be falsified to support the fraud. When interviewed the landlord was unable to produce any evidence to support his position.

The fraud was possible due to a lack of review of exemption status once granted.

Council tax exemptions are now being reviewed.

A repayment agreement has been reached with the resident.

Theft

Theft of mobile phones

132. Mobile telephones valued at £5,400 were stolen from a council store.

Key features

The council ordered mobile phones which were placed into a council secure store on receipt. The project that the phones were ordered for did not go ahead and therefore the phones remained in storage. Fourteen months later it was discovered that these items were no longer in storage and they were presumed stolen.

The theft was possible due to the code for the door entry system to the store being widely known by employees. There were also issues with fire exits being left open and the building not being secure. In addition, the phones were not recorded on the council asset tagging system upon receipt.

Following an internal audit review, an action plan has been put in place to improve controls including periodic changes to door entry codes, ensuring fire doors remain closed, regular physical checks of stock and recording and tagging assets when received.

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 and irregularity chapter

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