

# Technical bulletin 2018/4

October to December 2018



 AUDIT SCOTLAND

Prepared for appointed auditors in all sectors

11 December 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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# Foreword

## Extracts from the code of audit practice

### Technical support

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. It is a condition of the audit appointment that auditors carry out their audits in accordance with guidance issued by Audit Scotland.

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* on [ishare](#) and the [Extranet](#).

Professional Support encourages feedback on this technical bulletin. Comments should be sent to [pobrien@audit-scotland.gov.uk](mailto:pobrien@audit-scotland.gov.uk).

Audit Scotland makes no representation that legal guidance is correct. Points of law can ultimately be decided only by the Courts. Audit Scotland accepts no responsibility for any loss or damage caused as a result of any person relying upon anything contained in this technical bulletin.

# 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.

Cross-sector chapter	Item paragraphs
<b>2018/19 audit year</b>	
<b><i>Technical developments</i></b>	
Professional Support has issued guidance on planning 2018/19 audits.	<a href="#">1 - 3</a>

Local government chapter	Item paragraphs
<b>2018/19 audit year</b>	
<b><i>Technical developments</i></b>	
Professional Support has published guidance on planning and performing the audit of the 2018/19 annual accounts.	<a href="#">5 - 9</a>
CIPFA has issued guidance notes on the 2018/19 accounting code.	<a href="#">10 - 11</a>
CIPFA has issued a disclosure checklist for the 2018/19 financial statements.	<a href="#">12 - 15</a>
The Scottish Government has issued revised statutory guidance on financial instruments.	<a href="#">22 - 24</a>
CIPFA has issued a statement on borrowing in advance and investing in commercial property.	<a href="#">25 - 27</a>
New regulations have been issued on the LGPS.	<a href="#">28 - 29</a>
The DWP has issued guidance on universal credit full service.	<a href="#">43 - 44</a>
The Accounts Commission has issued a financial overview report.	<a href="#">46 - 47</a>
CIPFA has issued guidance on the prudential code.	<a href="#">48 - 49</a>
<b><i>Emerging risks</i></b>	
Professional Support has provided guidance on the expiration of the statutory flexibility on equal pay and severance.	<a href="#">16 - 18</a>
Professional Support has provided guidance on loans fund repayments.	<a href="#">19 - 21</a>

Local government chapter	Item paragraphs
Professional Support has provided guidance on the treatment of equal pay sums as pensionable pay.	<a href="#">30 - 33</a>
Professional Support has provided guidance on the potential understatement of information on leases.	<a href="#">37 - 38</a>
Professional Support has issued an update on reducing the number of section 106 charities.	<a href="#">39 - 42</a>
<b>2020/21 audit year</b>	
<b>Technical developments</b>	
CIPFA/LASAAC has announced that the implementation of IFRS 16 has been deferred to 1 April 2020.	<a href="#">34 - 36</a>

Central government chapter	Item paragraphs
<b>2018/19 audit year</b>	
<b>Technical developments</b>	
Treasury has issued 2018/19 discount rates.	<a href="#">51 - 56</a>
The Scottish Government has issued amendments to the SPFM.	<a href="#">57</a>

College chapter	Item paragraphs
<b>2018/19 audit year</b>	
<b>Technical developments</b>	
Professional Support has issued guidance on considering whether a college exercises significant influence over an ALF.	<a href="#">59 - 60</a>

Professional developments chapter	Item paragraphs
<b>2018/19 audit year</b>	
<b>Technical developments</b>	
The FRC has issued a report on auditors' work on other information in the annual accounts.	<a href="#">62 - 65</a>
The FRC is reviewing the effectiveness of the ethical and auditing standards issued in 2016.	<a href="#">66 - 67</a>
The CMA is reviewing the operation of the statutory audit market in the commercial sector.	<a href="#">68 - 71</a>

<b>Professional developments chapter</b>	<b>Item paragraphs</b>
The FRC has issued a thematic review of IFRS 9.	<a href="#">72 - 73</a>
The FRC has issued a thematic review of IFRS 15.	<a href="#">74</a>
The FRC has issued a report on performance metrics.	<a href="#">75 - 76</a>

<b>Fraud and irregularity chapter</b>	<b>Item paragraphs</b>
Professional Support has provided a summary of reported fraud cases and other irregularities.	<a href="#">78</a>

# Cross-sector chapter

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

## 2018/19 audit planning guidance

1. Audit Scotland's Professional Support has issued [guidance](#) to assist all appointed external auditors in planning their 2018/19 audits. The guidance covers the main activities that comprise core audit work and the products associated with each activity.
2. The following table provides a summary of the key changes in the guidance from last year:

Nature of change	Relevant section
The structure of the guidance has been refreshed and revised to focus on each core audit activity.	All
There have been changes to the submission requirements for audit outputs.	Various
The list of wider scope risk areas has been refreshed.	3
The local auditor input requirements for the performance audit work programme has been updated.	4
Enhanced guidance has been provided on the role of appointed auditors in highlighting potential statutory reports.	5E
There are new quarterly reporting arrangements for fraud returns.	5J
The policy on non-audit services has been revised.	Appendix 2
There is a new requirement to submit an annual quality report.	Appendix 5

3. Auditors should pay due regard to this guidance when planning their 2018/19 audits.

## Auditor action checklist

	Yes/No/N/A	Initials/date	W/P ref
1. Have you carried out the action recommended at paragraph 3?			

## Professional Support contact for cross-sector chapter

4. 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](mailto:pobrien@audit-scotland.gov.uk).

# Local government chapter

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

## Annual accounts overall

### Technical guidance notes

#### Audit of 2018/19 annual accounts

5. Audit Scotland's Professional Support has published [Audit of 2018/19 annual accounts \(local government\) - technical guidance note 2018/10\(LG\)](#) to provide guidance to all appointed external auditors on planning and performing the audit of the 2018/19 annual accounts of local government bodies.
6. The technical guidance note comprises a number of modules which, 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 accounts; information on <i>The Local Authority Accounts (Scotland) Regulations 2014</i> ; proper accounting practices; the application of ISAs (UK); presentation of the financial statements; accounting policies, estimates, and prior year errors; and events after the reporting period.
1 Property, plant and equipment	Each module highlights the risks of misstatement in each of the main financial statement areas, explains proper accounting practices applying to that area, and sets out actions for each risk that auditors should undertake to assess whether the body has followed those practices.
2 Provisions, creditors and accruals	
3 Financial instruments	
4 Retirement benefits	
5 Reserves	
6 Group financial statements	
7 Leases and similar arrangements	
8 Grants and other income	

Module	Content
9 Other financial statement areas	As for modules 1 to 8 but this module includes a number of financial statement areas including the expenditure and funding analysis, investment property, significant trading operations, and related parties.
10 Non-financial statements	This module covers the remuneration report, management commentary and annual governance statement. It explains auditors' responsibilities for these statements, sets out the different audit opinions required, highlights the main risks of misstatement, explains proper accounting practices applying to each statement, and prescribes the test procedures that auditors should undertake to assess whether the body has followed those practices.
11 Integration joint boards	These modules apply the other modules to specific accounts/bodies, and provide supplementary guidance.
12 Local government pension scheme fund accounts	
13 Section 106 charity accounts	

7. Following extensive consultation with all auditors, the technical guidance note represents an agreed position on a range of complex technical issues and is a key document as auditors plan and perform the audit of the 2018/19 annual accounts.
8. For the purposes of the Audit Scotland website, all the modules have been combined into [one document](#). The individual modules are also available to auditors from the relevant subject pages on the local government site of the *Technical reference library* on [ishare](#) and the [Extranet](#).
9. Auditors should use the technical guidance note when planning and performing the audit of the 2018/19 annual accounts of local government bodies.

## Financial statements

### 2018/19 accounting code guidance notes

10. The [Chartered Institute of Public Finance and Accountancy](#) (CIPFA) has issued [guidance notes](#) to assist in understanding the accounting requirements of the *2018/19 Code of practice on local authority accounting in the UK* (the accounting code). The guidance notes provide background to the 2018/19 accounting code's requirements, including detailed illustrations, but the guidance is not prescriptive.
11. The guidance notes have been amended to reflect the changes made to the 2018/19 accounting code (see [technical bulletin 2018/2](#) - paragraph 5), including the adoption of *IFRS 9 Financial instruments* and *IFRS 15 Revenue from contracts with customers*.

## 2018/19 disclosure checklist

12. CIPFA has issued a [disclosure checklist](#) for the 2018/19 financial statements. The checklist is intended for use as an aide-memoire to ensure that the requirements of the 2018/19 accounting code are met. It is in the form of a series of questions:
  - If the answer to a question is 'yes', the accounting code is being complied with.
  - If the answer is 'no', a justification for departing from the code should be given.
13. The accounting code's provisions enable required disclosures to be excluded if the information resulting from that disclosure is not material. This is the case even if the code or a standard contains a list of specific requirements or describes them as minimum requirements.
14. Auditors should:
  - request that the body completes the disclosure checklist
  - investigate the reasons for any non-compliance that the checklist highlights
  - assess whether the body's responses in the checklist are consistent with auditor's knowledge.
15. Where the body declines to complete the checklist, auditors should establish the alternative means by which the body satisfies itself regarding the completeness of disclosures, and assess whether the arrangements are adequate.

## Provisions

### Expiration of statutory adjustments on equal pay and severance

16. Auditors are reminded that the statutory adjustments allowed by [finance circular 4/2015](#) to assist with meeting the costs associated with equal pay and severance ceased to apply on 1 April 2018.
17. Where the body had opted to take advantage of the flexibility, auditors should confirm that:
  - the statutory adjustments debited to the statutory adjustment accounts have been matched by credits by 31 March 2019
  - any capital receipts credited to the statutory adjustment accounts in previous years that were not applied by 31 March 2019 have been transferred to the capital fund.
18. Further guidance on this matter is provided at module 2 (paragraphs 21 to 23 and 28) of [TGN 2018/10\(LG\)](#).

## Financial instruments

### Loans fund repayments

19. Professional Support has been made aware that some local government bodies are carrying out exercises to reschedule their loans fund repayments using the prudent repayment options

set out in the statutory guidance issued with [finance circular 7/2016](#). In some cases, the exercises include loans fund advances made before 1 April 2016.

20. Auditors are reminded that the statutory guidance (paragraph 33 in part 2) is clear that all loans fund advances made prior to 1 April 2016 should continue to be repaid as if paragraph 15 of Schedule 3 of the *Local Government (Scotland) Act 1975* had not been repealed. It follows that the prudent repayment options apply only to advances made from 1 April 2016.
21. Auditors should confirm that loans fund advances made before 1 April 2016 continue to be repaid in accordance with the 1975 Act. Further guidance on this matter is provided at module 3 (paragraphs 38 to 42) of [TGN 2018/10\(LG\)](#).

### Revised statutory guidance

22. The Scottish Government has issued revised statutory guidance on financial instruments in [finance circular 7/2018](#). The guidance has been revised to include points when a body uses capital receipts to fund the cost of premiums. These are summarised in the following table:

Use	Guidance
Funding the cost of premiums	Capital receipts may fund the cost of premiums either as they are incurred or as they are recharged annually back to the general fund.
Funding the annual charge of premiums	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, credit general fund).
Funding additional charges	Capital receipts may be used to fund additional charges to the general fund over and above the annual charge.
Funding the whole premium when incurred	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.
Funding part of the premium when incurred	Where only part of the premium cost is funded from capital receipts, a body may choose to defer the remaining amount by transferring it to the financial instrument adjustment account as a statutory adjustment.

23. 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.
24. For the avoidance of doubt, there are no changes to the statutory adjustments permitted by the guidance originally provided in finance circular 4/2007 (i.e. premiums and discounts associated with the refinancing of loans, soft loans at 31 March 2007, and stepped interest

rate loans as 31 March 2007). However, the guidance has been amended to clarify that all statutory adjustments require to be reported in the adjustments between accounting basis and funding basis of the movement in reserve statement or note. The analysis should clearly identify each statutory adjustment. The guidance provides suggested descriptors for each statutory adjustment at paragraphs 41 to 46.

## Statement on borrowing in advance and investments in commercial property

25. CIPFA has issued a [statement](#) on borrowing in advance of need and investments in commercial property. The statement reminds local government bodies that:
  - the policy objective of treasury management investment activities is the security of funds, and that a body should avoid exposing public funds to unnecessary risk
  - bodies must not borrow more than or in advance of their needs purely in order to profit from the investment of the extra sums borrowed.
26. The statement also notes that bodies have continued to invest in commercial properties, and in some cases these investments have been financed by borrowing. CIPFA is concerned about this practice, and will therefore be issuing guidance that will:
  - make it clear that these investment approaches are not consistent with the requirements of fiscal sustainability, prudence and affordability
  - set out the substantial risks which are being incurred by such practices.
27. Auditors should confirm that the body's approach to borrowing in advance and any investments in commercial property is in accordance with the statutory guidance in [finance circular 5/2010](#).

## Retirement benefit/pension funds

### New LGPS regulations

28. Modules 4 and 12 of [TGN 2018/10\(LG\)](#) (on retirement benefits and pension fund accounts respectively) refer to *The Local Government Pension Scheme (Scotland) Regulations 2014* and subsequent amending regulations. However, the modules should also have referred to [The Local Government Pension Scheme \(Scotland\) Regulations 2018](#) which were issued in May 2018 and consolidate the 2014 regulations and all subsequent amendments with effect from 1 June 2018. Professional Support apologises for this oversight.
29. The main substantive impact is the table at paragraph 88 in module 12 which relates to voluntary early retirement. Under the 2018 regulations, members are allowed to retire from the age of 55 without needing permission from their employer.

### Pensionable pay - equal pay

30. [TGN 2018/10\(LG\)](#) advises auditors to assess whether pensionable pay has been calculated correctly. Pensionable pay is defined at [regulation 20](#) of *The Local Government Pension Scheme (Scotland) Regulations 2014* (and the 2018 regulations from June 2018) as an

employee's salary, wages, and other pensionable emoluments. This includes any sum representing arrears of pay paid to achieve equal pay, but excludes any award of compensation.

31. Professional Support understands there may be some uncertainty regarding the distinction between arrears of pay and compensation. The terms are not defined in the regulations but sums representing arrears of pay include cases where:
  - an employment tribunal makes an award in respect of arrears of pay
  - a settlement agreement expressly states that the amount represents arrears of pay.
32. Compensation in contrast is any ex gratia sum which is not referable to pay and which is in effect is an 'injury to feelings' type award for the distress caused. However, this may include cases where the sum was calculated using pay data as a reference point if there was no acknowledgement that back pay was due and no assertions made that the sum represented arrears of pay.
33. Professional Support will provide further guidance early next year on the work auditors should carry out in this area.

## Leases

### Deferral of IFRS 16 implementation

34. CIPFA/LASAAC has issued a [statement](#) announcing that the implementation of *IFRS 16 Leases* has been deferred one year to 1 April 2020. The statement encourages local government bodies to continue to progress their plans for implementation and ensure they have the information, processes and systems in place.
35. The statement also highlights that the main decision regarding the implementation of IFRS 16 that remains outstanding is the approach to the subsequent measurement of the right-of-use asset (see [technical bulletin 2018/2](#) - paragraph 43 for the options being discussed). More information is expected to be provided early in 2019.
36. Auditors should confirm that local government bodies are making adequate preparations for the implementation of IFRS 16.

### Potential understatement of leases information in 2018/19

37. A number of local government bodies have carried out impact assessments and preparatory work for the implementation of IFRS 16. These exercises have surfaced issues around the completeness of information held on leases, particularly licences or agreements that are not described as leases but nevertheless meet the definition for accounting purposes. In many cases the agreements have been found to be held in service departments.
38. Auditors should consider whether this indicates a risk of understatements when reporting under existing leasing standards (IAS 17 and IFRIC 4) in 2018/19.

## Section 106 charities

### Number of statements of accounts

39. Audit Scotland continues to strongly encourage councils to reduce the number of section 106 charities that they administer. While there has been some progress, there remains considerable scope for further reductions. The following table provides a summary of the total number of section 106 charities in 2017/18, and the progress in reducing the total numbers since the audit requirement first applied in 2013/14:

Year	Number of section 106 charities	Rationalisation progress
2013/14	384	-
2014/15	389	(5)
2015/16	307	82
2016/17	270	37
2017/18	218	52

40. While the ultimate aim is to rationalise the number of section 106 charities, the overall number of separate sets of statements of accounts that are required can be reduced by the effective application of the connected charities provisions under [The Charities Accounts \(Scotland\) Regulations 2006](#). Regulation 7 (as amended in 2010) permits a single set of accounts for charities if they have common or related purposes, or shared management (i.e. connected charities). This would be the case where charities have common trustees. The overall number of separate sets of statements of accounts that are required for section 106 charities can therefore be reduced by the effective application of the connected charities provisions.
41. There were 77 sets of accounts in 2017/18 (down 14 from 91 in 2016/17). [Module 13](#) (Appendix 1) of TGN 2018/10(LG) shows an analysis by council and indicates the extent to which the connected charities provisions were applied in 2017/18. Seven councils made no use of the connected charities provisions and a further two only partially applied them.
42. Auditors should:
- assess whether the council is making reasonable progress in rationalising the number of section 106 charities that it administers
  - encourage the council to make full use of the connected charities provisions in 2018/19, where there is scope to do so, so that the total number of sets of accounts that requires to be audited is minimised.

## Grant claims and returns

### Housing benefit subsidy claim

#### Guidance on UCFS

43. [The Department for Work and Pensions \(DWP\)](#) has issued [HB circular A7/2018](#) to provide guidance on the award of housing benefit (HB) in areas where *Universal credit full service* (UCFS) has been introduced.
44. The circular confirms the circumstances when: a new universal credit claim is required; a HB claim can remain in payment; and a new HB claim may be accepted.

#### Funding

45. The DWP has issued [HB circular S11/2018](#) to announce the 2018/19 funding arrangements for supporting the costs of reviewing the self-employed HB caseload.

## Wider scope

### Financial management

#### Financial overview

46. The Accounts Commission has issued a [report](#) to provide an analysis of the financial performance of councils during 2017/18 and their financial position at the year end. It also looks ahead and comments on the financial outlook for councils. The primary sources of information for the financial overview are councils' 2017/18 audited accounts and the 2017/18 annual audit reports for each council.
47. Key messages in the report include the following:
  - Scottish Government revenue funding to councils reduced in 2017/18 (in real terms) by 2.3%. Council tax increases and increased fees and charges were used by councils to increase overall budgets by £0.3 billion (cash terms).
  - In 2017/18, councils managed funding gaps of 4% in their net expenditure budgets of £12 billion, mainly through savings and planned use of reserves.
  - Eighteen councils ended 2017/18 with lower levels of usable reserves than they had at the start of the year. Total usable reserves fell by £18 million.
  - The financial outlook is for reductions in Scottish Government revenue funding to councils. This will mean continued and increasing financial pressures on council services.
  - The impact of EU withdrawal is not yet clear, but councils need to identify the risks and develop contingency plans to manage these risks.

#### Revised prudential code guidance notes

48. CIPFA has issued [guidance notes](#) to give local government bodies a practical interpretation of the prudential code to enable them to meet its key principles of ensuring that capital

programmes are affordable, prudent and sustainable and to explain this effectively to those charged with governance.

49. This revised guidance updates the 2013 version and includes changes made to the prudential code in 2017 (see [technical bulletin 2018/1](#) - paragraph 51).

### Auditor action checklist

	Yes/No/N/A	Initials/date	W/P ref
1. Have you carried out the action required at paragraph 9 in respect of TGN 2018/10(LG)?			
2. Have you carried out the action recommended at paragraphs 14 and 15 in respect of the disclosure checklist?			
3. Have you carried out the action recommended at paragraph 17 in respect of the expiration of the statutory adjustments for equal pay and severance costs?			
4. Have you carried out the action recommended at paragraph?			
5. Have you carried out the action recommended at paragraph 21 in respect of loans fund repayments?			
6. Have you carried out the action recommended at paragraph 27 in respect of borrowing in advance and investing in commercial properties?			
6. Have you carried out the action recommended at paragraph 36 in respect of implementing IFRS 16?			
7. Have you carried out the action recommended at paragraph 38 in respect of potential understatement of information on leases?			
8. Have you carried out the action recommended at paragraph 42 in respect of section 106 charities?			

### Professional Support contact for local government chapter

50. 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](mailto:pobrien@audit-scotland.gov.uk).

# Central government chapter

This chapter contains information on the main technical developments in the quarter that are relevant to appointed auditors in the central government sector.

## Financial statements

### Provisions

#### 2018/19 discount rates

51. HM Treasury has issued PES(2018)12 to announce the discount rate for general provisions, post-employment benefit liabilities, and financial instruments as at 31 March 2019.
52. In previous years, Treasury issued real rates for discounting general provisions recognised under IAS 37. From 2018/19, Treasury is issuing nominal rates. This should be treated as a change in estimate rather than a change in accounting policy. The nominal discount rates to be applied as at 31 March 2019 are set out in the following table:

Category	Period	Percentage
Short term	Within 5 years	0.76%
Medium term	Between 5 and 10 years	1.14%
Long term	Between 10 years and 40 years	1.99%
Very long term	More than 40 years	1.99%

53. As nominal rates do not take inflation into account, cash flows require to be inflated separately. There is a rebuttable assumption that the inflation rates specified in the paper will be used (unless other rates are clearly more applicable). The specified rates are:
- 2% for up to two years from the year end
  - 2.1% for after two years.
54. The discount rates for post employment benefits are set out in the following table:

Use	Rate from 31 March 2019
Real rate used for valuing unfunded pension scheme liabilities and early departure provisions	0.29%
Nominal rate for unwinding discount on liabilities (interest costs)	2.90%

Use	Rate from 31 March 2019
Rate used for funded pension schemes	Based on returns from AA corporate bonds at 31 March

55. The financial instrument discount rates to be applied at 31 March 2019 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%

56. Auditors should refer to this paper when reviewing the discount rates applied to provisions in 2018/19 financial statements.

## Wider scope

### Financial management

57. The [Scottish Government Finance directorate](#) has published two amendments to the [Scottish Public Finance Manual](#).
- [Finance guidance note 2018/08](#) amends the property, acquisition, disposal and management section to:
    - reflect the introduction of the *Community Empowerment (Scotland) Act 2015* which sets out the rights of communities to acquire rights in publicly owned assets. The guidance clarifies that decisions on sale at less than market value still need to be consistent with the principles of Best Value.
    - set out the minimum requirements necessary for inclusion in asset registers.
  - [Finance guidance note 2018/09](#) amends the definition of major investment projects to include criteria around complexity, innovation, impact and risk.

## Professional Support contacts for central government chapter

58. The contacts in Professional Support for this chapter are:
- Neil Cameron, Manager (Professional Support) - 0131 625 1797 or [ncameron@audit-scotland.gov.uk](mailto:ncameron@audit-scotland.gov.uk).
  - Helen Cobb, Senior Adviser (Professional Support) - 0131 625 1901 or [hcobb@audit-scotland.gov.uk](mailto:hcobb@audit-scotland.gov.uk).

# College chapter

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

## Group financial statements

### Significant influence over ALFs

59. Auditors have raised with Professional Support the issue of whether colleges exercise significant influence over their arm's-length foundations (ALFs). Significant influence is defined in FRS 102 as follows:
- If a college holds 20% or more of the voting power of an entity, it is presumed that it has significant influence, unless it can be clearly demonstrated that this is not the case.
  - Conversely, if the college holds less than 20%, it is presumed that there is not significant influence, unless such influence can be clearly demonstrated.
60. In order to gain an overall picture, Professional Support requested information from all college auditors in relation to the operation of ALFs. A number of colleges identified that they hold a voting share in excess of 20% in the ALF. In order to conclude on whether there is significant influence, auditors at these colleges should consider other issues around the operation of the ALF including whether there is evidence that:
- the ALF has approved applications from third parties
  - the ALF has rejected applications from the college
  - there is a clear applications process which has been applied consistently
  - the college can exercise influence included within the ALF governing documents.

### Auditor action checklist

	Yes/No/N/A	Initials/date	W/P ref
1 Have you carried out the action recommended at paragraph 60 in respect of determining whether colleges have significant influence over ALFs?			

### Professional Support contact for further education chapter

61. The contact in Professional Support for this chapter is Helen Cobb, Senior Adviser (Professional Support) - 0131 625 1901 or [hcobb@audit-scotland.gov.uk](mailto:hcobb@audit-scotland.gov.uk).

# Professional developments chapter

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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 other information

62. The [Financial Reporting Council](#) (FRC) has issued a [report](#) following a thematic review of auditors' work on other information in the annual accounts. The 'other information' is all financial and non-financial information included in a body's annual accounts other than the financial statements and the audited parts of the remuneration report.
63. The FRC observed a number of instances where insufficient work was performed to support the statements auditors make in respect of the other information in the independent auditor's report. This increases the risk that material inconsistencies or misstatements may go undetected.
64. Revisions made to ISA (UK) 720 in 2016 raised the bar in terms of the work auditors were expected to perform on the other information. However, it is clear that auditors have not responded consistently to these additional expectations and that the revised standard has not been fully effective in achieving the objectives set for them. The FRC therefore proposes to look again at these as part of the FRC's post implementation review of the 2016 standards (referred to in the following item). In addition, auditors are expected to drive improvement in the following areas:
  - More prescriptive and targeted procedures, including templates and workbooks, to guide audit teams in the work they perform.
  - Specific consideration of the other information at the planning stage of the audit.
  - Greater emphasis on the review of key non-financial information, in addition to the financial information.
  - Increased scepticism and more attention on the completeness of the information, particularly the principal risk disclosures.
  - Ensuring staff with appropriate experience and knowledge of the audit are assigned to review the other information to identify potential material misstatements and inconsistencies.
65. Audit Scotland prescribes in technical guidance notes the procedures that appointed auditors are required to carry out (e.g. module 10 of [TGN 2018/10\(LG\)](#)).

## Review of audit standards

66. The FRC is [consulting with stakeholders](#) to determine how effective the changes to ethical and auditing standards in 2016 have been in delivering high quality audit. The aims of the review of the standards are to:
- gather feedback on whether the changes made to standards have had the desired impact on auditor independence, prevention of conflicts and on audit quality
  - consider whether further measures are needed to address weaknesses, and ensure that audit better meets the expectations of those who rely on it
  - consider whether auditor reporting and communication with those charged with governance could be further strengthened to better meet the needs and expectations of users.
67. Feedback and responses to the review questions should be sent to [AAT@frc.org.uk](mailto:AAT@frc.org.uk) by 15 February 2019.

## Review of statutory audit market in the commercial sector

68. The [Competition and Markets Authority](#) are carrying out a [review](#) to consider whether the market for the provision of statutory audit in the UK commercial sector is working as well as it should. The review comes amid growing concerns about statutory audits, in particular following the collapse of construction firm Carillion and the criticism of those charged with governance, as well as recent poor results from reviews of audit quality.
69. The review is examining three main areas in the market as summarised in the following table:

Area	Issues
Choice and switching	97% of the audits of FTSE 350 companies are undertaken by the four biggest accountancy firms.
Resilience	The risk that each of the four firms is 'too big to fail', potentially threatening long-term competition.
Incentives	Companies pick their own auditor. The review is examining concerns that this might result in a lack of challenging performance reviews.

70. Potential outcomes being considered include:
- Restricting or prohibiting the provision of non-audit-services.
  - Reducing the barriers for firms outside the biggest four (e.g. market share cap, joint audits, breaking up the Big 4 into smaller firms).
  - Moving responsibility for appointing auditors away from companies to an independent body.
71. Audit Scotland responded to the invitation to comment by explaining the benefits of the Scottish public sector audit model.

## Accounting developments

### Thematic review of IFRS 9

72. The [Financial Reporting Council](#) (FRC) has issued a [report](#) summarising the key findings of a thematic review of disclosures in 2018 interim accounts relating to the implementation of *IFRS 9 Financial instruments*.
73. The review aims to provide guidance for entities when considering the completeness of their year-end disclosures. Although the report focuses on banking entities, non-banking bodies are also considered. Key findings were that the following disclosures could be improved:
- Transitional disclosures analysing the principal differences between IAS 39 and IFRS 9.
  - Qualitative and quantitative disclosures regarding determination of significant increases in credit risk, including linkage to internal credit ratings.
  - Disclosure of estimation uncertainty, in particular quantification of sensitivities of expected credit losses to changes in assumptions.
  - Discussion of the business model in assessing the classification of financial assets.

### Thematic review of IFRS 15

74. The FRC has also issued a [report](#) summarising the key findings of a thematic review of interim disclosures relating to the implementation of *IFRS 15 Revenue from contracts with customers*. The review found that the following disclosures could be improved:
- Information about transitional adjustments, and linking these to changes in accounting policies.
  - Clearer explanation of the changes made to accounting policies, including the reasons for the changes and the judgements made by management in arriving at the new policies.
  - Information about performance obligations, including judgements made in determining these and the timing of their satisfaction (i.e. when control transfers to the customer).
  - The impact on the balance sheet, including disclosure of accounting policies for new items such as contract assets and contract liabilities.

### Narrative reporting developments

75. The FRC has issued [Performance metrics - principles and practice](#) as a result of a project on how entities report performance. The term 'performance metrics' means all forms of metric an entity might disclose. These may include financial metrics or wider metrics compiled under internationally recognised standards or frameworks, or according to decisions and policies at the entity level. Performance metrics presented in a fair, balanced and understandable way are key to the communication between companies and investors.
76. The report identifies five principles for reporting performance metrics which are summarised in the following table:

Principle	Explanation	Achieved by:
Aligned to strategy	Metrics that give users insight into the entity's performance and strategy and provide indicators of the sources of long-term value.	<ul style="list-style-type: none"> <li>disclosing metrics that management uses internally, including where and how they link to remuneration</li> <li>providing a combination of metrics linked to their strategic objectives, competitive advantage and business model, which may involve incorporating operational metrics alongside higher-level KPIs</li> <li>explaining why the metrics are important.</li> </ul>
Transparent	The ability for users to understand what the metric attempts to measure and how it does so.	<ul style="list-style-type: none"> <li>providing an explanation for the use of metrics and a full break down of non-GAAP metrics</li> <li>being consistent and using the same, transparent format over a number of years</li> <li>demonstrating that metrics which investors would expect to be attributable to specific numbers in the financial statements or reconciliations are directly drawn from them.</li> </ul>
In context	Explaining what a company was trying to achieve and what it has achieved, with explanations for where this is good or poor	<ul style="list-style-type: none"> <li>disclosing targets for metrics, showing whether performance has achieved its target or not</li> <li>referencing an industry benchmark when disclosing performance where this is relevant; and</li> <li>providing a market context that is linked to how that context affects the company.</li> </ul>
Reliable	Sufficient governance and oversight the use and reporting of the metrics	<ul style="list-style-type: none"> <li>making the governance and oversight over metrics clear</li> <li>explaining the levels of scrutiny to which metrics have been subjected</li> <li>highlighting third party information in conjunction with internal information where relevant to strategic objectives.</li> </ul>
Consistent	Consistent reporting across time and reporting formats, helps build credibility	<ul style="list-style-type: none"> <li>consistent information across reporting formats, even if it is presented differently for different audiences</li> <li>performance with reference to industry benchmarks or standards</li> <li>a five-year track record.</li> </ul>

## Professional Support contact for chapter

77. 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](mailto:pobrien@audit-scotland.gov.uk).

# Fraud and irregularities chapter

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

### Change of bank details

78. A third party defrauded £29,000 from a public body by re-directing payments intended for a legitimate supplier.

### Key features

The purchase team received several emails purporting to be from a supplier. Further emails from the fraudulent email requested that bank details were amended. Subsequently a payment was made to the amended bank account.

The fraud was possible as:

- no phone call was made to the supplier to confirm the change of bank account
- subtle differences from the usual email address were not spotted.

## 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

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