

Technical Guidance Note 2023/1

Overview Module

Risks of misstatement that are pervasive to the
financial statements in 2022/23



Prepared for appointed auditors in the central government, health and college sectors

31 January 2023

Contents

Introduction	3
1. Presentation of financial statements	6
2. Accounting policies, estimates and prior year errors	10
3. Events after the reporting period	15
4. Significant judgements and estimation uncertainty	18
5. Principal or agent transactions	21

Introduction

Purpose and use of this Technical Guidance Note

1. The purpose of this Technical Guidance Note (TGN) from Audit Scotland's Professional Support is to assist external auditors appointed by the Auditor General in the consistent identification and assessment of risks of material misstatements in the 2022/23 Annual Report and Accounts of central government bodies, health boards and colleges.
2. Auditors should also use this TGN as a primary reference source when performing the audit. The TGN concisely explains the appropriate accounting treatment related to each risk of misstatement and sets out the action auditors should undertake to evaluate whether the body has followed the required treatment. This is intended to inform auditor's professional judgement and promote the exercise of professional scepticism.
3. In accordance with Appendix 6 of the Code of Audit Practice, auditors should pay due regard to the TGN and advise Professional Support of any intended departure.

Misstatements in the financial statements

4. A misstatement in the financial statements (and audited part of the Remuneration and Staff Report) is defined in ISA (UK) 450 as a difference between the amount, classification, presentation, or disclosure of a reported financial statement item and the amount, classification, presentation, or disclosure required for the item to be in accordance with the applicable financial reporting framework.
5. The applicable financial reporting framework for central government financial statements is set out in the [2022/23 Government Financial Reporting Manual \(FReM\)](#).
6. Auditors should use this TGN when identifying and assessing risks of misstatement as required by [ISA \(UK\) 315](#).
7. The risks of misstatement in this TGN reflect areas of complexity, subjectivity and uncertainty, and changes in requirements. Auditors should assess the likelihood and magnitude if the risks apply at audited bodies .
8. The determination of materiality is a matter of professional judgement, and is affected by the auditor's perception of the financial reporting needs of users of the financial statements. The primary users are the Scottish Government and Parliament. Other users include the body's management board and audit committee, and the taxpayer. Potential misstatements in individual statements and disclosures may be judged to be material due to size, nature or circumstances.

9. The definition of materiality in [IAS 1 Presentation of Financial Statements](#) states that information is material if omitting, misstating or obscuring it could reasonably be expected to influence decisions that users make on the basis of those financial statements. Paragraph 7 of IAS 1 gives examples of when information may be obscured, e.g. when the language used is vague or unclear, or a material item is hidden by immaterial information.

10. Auditors should request relevant officers in the audited body and, if necessary board members, to correct all misstatements identified during the audit, other than those that are clearly trivial.

Misstatements in Statutory Other Information

11. Auditors also have responsibilities relating to information included in the Annual Report and Accounts other than the financial statements (and audited part of the Remuneration and Staff Report). This includes additional responsibilities for information required by statute (which ISA (UK) 720 describes as Statutory Other Information). For public bodies, Statutory Other Information comprises items required by the FReM, including the Performance Report and Governance Statement.

12. A misstatement in Statutory Other Information exists when it is incorrectly stated or otherwise misleading, or has not been prepared in accordance with requirements. Guidance on materiality is provided at paragraphs 2.6.8 to 2.6.10. of the FReM. Auditors should request the audited body to correct all material misstatements in Statutory Other Information.

TGN modular structure

13. This TGN is split into modules. In addition to providing an overall introduction, this Overview Module covers risks of misstatement in the following areas that are pervasive to the financial statements as a whole:

- Presentation of the financial statements (section 1).
- Accounting policies, estimates and prior year errors (section 2).
- Events after the year end (section 3).
- Significant judgements and estimation uncertainty (section 4).
- Principal or agent transactions (section 5).

14. Modules 1 to 8 set out risks of misstatement for specific classes of transactions, balances and disclosures. Module 9 covers the regularity of expenditure and income, Module 10 the Remuneration and Staff Report and Module 11 Statutory Other Information.

15. Specific guidance on the application of the above modules to charitable NDPBs (Module 12), health boards (Module 13) and colleges (Module 14) is also provided.

Changes in risks of misstatement in 2022/23

16. A summary of the changes in this TGN compared with 2021/22 is provided in a [separate document](#).

17. There are additions to the guidance on the following risks of misstatement in this Overview Module:

- Opening balances are not properly stated.
- Going concern basis of accounting is not appropriate.
- Disclosed assumptions about estimation uncertainty are not complete.

Contact point

18. The main contact point for general questions on this TGN is Neil Cameron, Manager (Professional Support) – ncameron@audit-scotland.gov.uk.

Related guidance and support

19. Other related support and guidance from Professional Support is set out in the following table:

Guidance and support	To provide
Technical Guidance Note on Independent Auditor's Reports	Model Independent Auditor's Reports and guidance on their application
Technical Bulletins	Information on relevant technical developments each quarter and guidance on emerging risks
Latest Technical News	Information on relevant technical developments as they arise
Technical Reference Library	Each module of this TGN along with access to the main source reference material, e.g. the FReM, accounting standard and relevant guidance (there are also hyperlinks embedded in this TGN)
Consulting with Professional Support	Advice and support on specific issues Requests for consultations with Professional Support should be e-mailed to TechnicalQueries@audit-scotland.gov.uk

1. Presentation of financial statements

The set of financial statements is not complete or properly presented

20. The [FReM](#) (Chapter 7) requires the financial statements to be prepared in accordance with IAS 1 subject to adaptations and interpretations at section 8.2. The following table summarises what a complete set of financial statements for 2022/23 should comprise:

Element	Purpose
Statement of Comprehensive Net Expenditure (SoCNE)	The SoCNE presents the components that total to net expenditure.
Statement of Financial Position as at 31 March 2023	The Statement of Financial Position shows the value as at 31 March 2023 of the assets and liabilities recognised by the body. The net assets are matched by the reserves held by the body.
Statement of Changes in Taxpayers' Equity (SoCTE)	The SoCTE presents the movements from 1 April 2022 to 31 March 2023 on the various reserves held by the body. The movements are analysed over the gains and losses.
Statement of Cash Flow	A Statement of Cash Flow shows the changes in cash and cash equivalents of the body during 2022/23.
Notes to the financial statements	Information required to be disclosed in the notes includes significant accounting policies and other required disclosures.
Comparative information in respect of 2021/22	Except when otherwise permitted, comparative information for 2021/22 requires to be presented for all amounts reported in the 2022/23 financial statements.

21. Auditors should evaluate whether the body has in respect of the 2022/23 financial statements:

- presented a complete set of financial statements
- clearly identified the financial statements and distinguished them from the Remuneration and Staff Report and Statutory Other Information
- clearly identified each financial statement and the notes
- presented all of the financial statements with equal prominence

- used signage or brackets in a manner that is correct, clear and consistent
- offset assets and liabilities or income and expenses only where required or permitted by the FReM.

22. When checking that the disclosure requirements have been met, auditors should:

- request that the body completes the NAO's 2022/23 disclosure guide for the financial statements
- investigate the reasons for any non-compliance that the guide highlights
- evaluate whether the body's responses in the guide are consistent with knowledge obtained in the audit.

23. Where the body declines to do so, auditors should establish the alternative means by which the body satisfies itself regarding the completeness of disclosures, and evaluate the adequacy of the arrangements. Auditors should also consider completing the guide themselves.

SoCNE is not properly presented

24. The items that should generally be presented in the SoCNE are summarised in the following table:

Line item	Explanation
Total operating income	This will include lines for items such as income from goods and services (Module 7).
Total operating expenditure	This will include lines for items such as staff costs, goods and services, depreciation (Module 1), and movements in provisions (Module 2).
Net operating expenditure	This should equal to total operating expenditure less total operating income.
Net expenditure	This is net operating expenditure less finance income and plus any finance expenditure. [Note: This is the line that should be referred to in the first bullet of the opinion on the financial statements in the independent auditor's report.]
Other comprehensive net expenditure	This will include lines for items such as the net gain/loss on the revaluation of property, plant and equipment (Module 1).

25. Auditors should evaluate whether the 2022/23 SoCNE has been properly presented.

Statement of Financial Position is not properly presented

26. Paragraph 54 of IAS 1 specifies the minimum line items that should be presented in the Statement of Financial Position, where applicable and material. These include resources controlled by the body such as property, plant and equipment and financial assets, as well as obligations to transfer a resource, such as provisions, all of which are explained in the relevant module of this TGN.

27. Auditors should evaluate whether:

- all the applicable line items that are material have been presented in the Statement of Financial Position at 31 March 2023
- items have been disaggregated where that assists in understanding the financial position
- material items have not been aggregated where they have different natures.

Opening balances are not properly stated

28. As 2022/23 is the first year of the new audit appointments, auditors should apply ISA (UK) 510 when considering balances at 1 April 2022.

Presentation of financial statements is not consistent with previous years

29. Paragraph 45 of IAS 1 requires bodies to retain the presentation and classification of items in the financial statements used in the previous year unless another presentation or classification is required or is more appropriate.

30. Auditors should identify any cases where the body has changed presentation or classification in 2022/23 and evaluate whether:

- the new presentation or classification is more appropriate
- the body has accurately reclassified the 2021/22 comparative amounts for changes in the presentation, and any changes of classification, of items in 2022/23
- the nature of the reclassification, the reasons for it, and the amount of each item reclassified has been disclosed, and the disclosures are complete, concise, clear, relevant and free from misstatement.

31. Where 2021/22 comparative amounts have not been reclassified on the grounds that it is impracticable, auditors should evaluate whether the body has made every reasonable effort to reclassify the amounts. Where satisfied that is the case, auditors should evaluate whether:

- the body has disclosed the: reason for not reclassifying the amounts; and nature of the adjustments that would have been made if the amounts had been reclassified

- the disclosures are complete, clear, concise and free from misstatement.

32. Where it is not considered impracticable to reclassify the items, auditors should request the body to do so. Where the body declines, and the misstatement is material, auditors should consider the impact on their opinion on the financial statements.

Information in the notes is not properly disclosed

33. The information to be disclosed in notes to the financial statements (subject to materiality) is set out in the relevant standard as adapted or interpreted by FReM paragraphs 7.6.1 to 7.6.17. Specific guidance is provided in the relevant module of this TGN. As an overall responsibility, auditors should:

- evaluate whether the notes have been presented in a systematic manner as required by paragraph 113 of IAS 1
- confirm that each item in the financial statements has been cross-referenced to any related information in the notes.

2. Accounting policies, estimates and prior year errors

Under the going concern basis of accounting, the financial statements are prepared on the assumption that the body's services will continue for the foreseeable future.

Going concern basis of accounting is not appropriate

34. Under the going concern basis of accounting, the financial statements are prepared on the assumption that the services delivered by the body will continue for the foreseeable future. Assets and liabilities are recorded on the basis that the body will be able to realise its assets and discharge its liabilities in the normal course of business. This contrasts with a 'break up' basis which is required if a body's operations cease suddenly and consequently the recoverable values of its assets may be significantly less than the carrying amount in the balance sheet.

35. The concept of going concern applies in the public sector but in a different way to the private sector. A key difference is that when assessing whether the going concern basis of accounting is appropriate for a public body, the anticipated continued provision of the services is more relevant to the assessment than the continued existence of the particular body itself. [Practice Note 10](#) provides guidance on applying ISA (UK) 570 Going Concern to the audit of public bodies. Auditors should determine a proportionate approach based on the body's circumstances and the financial reporting framework.

36. Section 8.2 of the [FReM](#) interprets the requirements of IAS 1 in respect of going concern and states that the anticipated continuation of the provision of the service, as evidenced by inclusion of financial provision for that service in published documents, is normally sufficient evidence of going concern. It also clarifies that bodies with total net liabilities should prepare their financial statements on the going concern basis unless the sponsor department deems that inappropriate.

37. The assessment of whether the going concern basis of accounting is appropriate is therefore very straight-forward in the majority of cases. There is no need for any detailed cash-flow projections that are necessary for a business in the private sector.

38. The FReM also addresses cases where a body is to be discontinued. The body should consider whether its services will continue to be provided (by another public body using the same assets) in determining whether to prepare the final set of financial statements on a going concern basis. Where there are plans by the Scottish Government to discontinue a body during the 2023/24 financial year, auditors should establish whether the functions of the body will transfer to another public body. Where that is the case, a going concern basis is still likely to be appropriate.

39. If the body's functions are to be discontinued or privatised, it is likely that a 'break up' basis would be more appropriate. If the body wishes to continue to use a going concern basis, auditors may wish to seek confirmation from the Scottish Government that the body continues to have financial backing to utilise its assets and meet liabilities as they fall due. If adequate confirmations are received, it may be reasonable to conclude that the going concern basis is appropriate. If no such confirmation is provided, auditors may decide there is a material uncertainty to be disclosed.

40. Auditors should confirm that a going concern basis of accounting has been adopted in 2022/23 where there are no plans to discontinue the body. Where there are plans to discontinue or privatise the body's functions, auditors should evaluate whether the basis of accounting is appropriate.

Accounting policies are the principles and other practices applied in preparing and presenting financial statements.

Accounting policies are not appropriate

41. Accounting policies are the specific principles, bases, conventions, rules and practices applied in preparing and presenting financial statements. Section 8.1 of the FReM requires bodies to comply with [IAS 8 Accounting Policies, Changes in Accounting Estimates and Errors](#).

42. The accounting policy applied should normally be determined by the FReM. Where the FReM does not specifically apply to a particular transaction or event, the body should use judgement in developing and applying an accounting policy that results in information that is relevant and reliable. IAS 1 is clear that a body cannot rectify inappropriate accounting policies either by disclosure of the policies used or by explanatory material.

43. Auditors should evaluate whether the accounting policies applied by the body in 2022/23:

- have been determined by the FReM where applicable
- are appropriate to its circumstances
- have been consistently applied.

44. In accordance with ISA (UK) 240, auditors should evaluate whether the selection and application of accounting policies by the body, particularly those related to subjective measurements and complex transactions, is indicative of fraudulent financial reporting.

Accounting policies are not adequately disclosed

45. Auditors should evaluate whether a summary of the significant accounting policies adopted in 2022/23 has been adequately disclosed in the notes. FReM paragraph 7.6.8 states that the accounting policy for a particular item may be disclosed within the note for that item.

Changes in accounting policies are not properly accounted for

46. Auditors should evaluate whether the body has changed an accounting policy in 2022/23 only if:

- the change is required by the FReM; or
- it results in the financial statements providing reliable and more relevant information on an item.

47. Where a body changes an accounting policy, auditors should evaluate whether it has applied the changes retrospectively. Retrospective application involves adjusting the opening balance of each affected component for the earliest year presented and the other comparative amounts disclosed as if the new accounting policy had always been applied. Retrospective application is not required:

- where transitional provisions are specified
- to the extent that it is impracticable (i.e. the body cannot apply it retrospectively after making every reasonable effort to do so).

48. Auditors should evaluate whether a restated Statement of Financial Position as at 1 April 2021 has been prepared if the restatement is material.

Accounting estimates are judgements when measuring items in the financial statements based on the latest available, reliable information.

Accounting estimates are not reasonable

49. Many items in financial statements cannot be measured with precision but can only be estimated. Estimation involves judgements based on the latest available, reliable information. An estimate cannot be determined to be accurate or inaccurate, but it can be considered reasonable if:

- the method used in making the accounting estimate is appropriate
- the underlying assumptions are sound
- the body has considered and addressed the effect of estimation uncertainty
- the amount is described clearly as being an estimate
- the nature and limitations of the estimating process are explained
- no errors have been made in selecting and applying an appropriate process for developing the estimate.

50. Auditors should evaluate whether:

- the accounting estimates made by the body in 2022/23 are reasonable

- the related disclosures in the financial statements are adequate.

Changes in accounting estimates are not properly accounted for

51. Auditors should evaluate whether:

- accounting estimates have been revised in 2022/23:
 - where there are changes in the circumstances on which the estimate was based; or
 - as a result of new information or experience.
- the effect of a change in an accounting estimate has been recognised prospectively (i.e. from the date of change rather than retrospectively)
- a change in the measurement basis (i.e. historical cost, fair value or current value) applied to an accounting estimate has been treated as a change in an accounting policy rather than as a change in an accounting estimate.

Prior year errors arise from a failure to properly use reliable information in prior years.

Prior year errors are not properly corrected

52. Errors include the effects of mathematical mistakes, mistakes in applying accounting policies, oversights or misinterpretations of facts.

53. Prior year errors arise from a failure to use, or misuse of, reliable information in prior years that:

- was available when financial statements for those years were authorised for issue by the body's Accountable Officer; and
- could reasonably be expected to have been obtained and taken into account in the preparation and presentation of those financial statements.

54. Changes in accounting estimates are different from the correction of errors as the former results from new information or new developments.

55. Material prior year errors should be corrected by retrospective restatement in the first set of financial statements authorised for issue after their discovery. Auditors should evaluate whether the body has corrected material prior year errors identified in 2022/23 retrospectively by restating:

- the comparative amounts for the prior years presented in which the error occurred; or

- the opening balances of assets, liabilities and reserves for the earliest prior year presented (if the error occurred before the earliest prior year presented).

56. A retrospective restatement to correct a material prior year error is not required if the restatement is impracticable. This is the case where the body cannot restate after making every reasonable effort to do so because:

- the effects of the retrospective restatement are not determinable
- the retrospective restatement requires assumptions about what management's intent would have been in that year; or
- the retrospective restatement requires significant estimates of amounts and it is impossible to distinguish objectively information about those estimates that:
 - provides evidence of circumstances that existed on the date(s) at which those amounts are to be recognised, measured or disclosed; and
 - would have been available when the financial statements for that prior year were authorised for issue by the Accountable Officer.

57. When it is impracticable to determine the years affected by an error, auditors should evaluate whether the body has restated the opening balances of assets, liabilities and reserves for the earliest year for which retrospective restatement is practicable (which may be the current year).

Prior year errors are not properly disclosed

58. Where a prior year error has been corrected in 2022/23, auditors should evaluate whether the body has disclosed:

- the nature of the prior year error
- for each prior year presented, to the extent practicable, the amount of the correction for each financial statement line item affected
- the amount of the correction at 1 April 2021 (if years prior to 2022/23 are affected).

3. Events after the reporting period

Financial statements should reflect events after the year end up to the date they are authorised for issue.

Events after the year end are not complete

59. Section 8.2 of the [FReM](#) requires bodies to account for events after the year end in accordance with [IAS 10 Events after the Reporting Period](#). It requires the audited financial statements to reflect events after the year end up to the date on which the Accountable Officer signs the Statement of Financial Position to authorise the financial statements for issue. (i.e. the authorised for issue date).

60. The FReM interprets IAS 10 by stating that the authorised for issue date is normally the same date as the certificate of the Comptroller and Auditor General. In Scotland, the equivalent is the Independent Auditor's Report.

61. Auditors should evaluate whether the body has identified all events which might affect the Annual Report and Accounts occurring between 31 March 2023 and the authorised for issue date. In accordance with [ISA \(UK\) 560](#), this evaluation should involve auditors:

- obtaining an understanding of any procedures the body has established to ensure that events after 31 March 2023 are identified
- inquiring whether any events have occurred which might affect the Annual Report and Accounts. This should focus on establishing:
 - the up-to-date status of items that were accounted for on the basis of preliminary data, e.g. developments regarding contingencies
 - whether any events have occurred that are relevant to the measurement of estimates or provisions.

Relevant events after 31 March are not properly adjusted for

62. Events after 31 March should be classified as either adjusting or non-adjusting events. The difference is explained in the following table:

Adjusting	Non-adjusting
Definition	
Events after 31 March 2023 that provide evidence of conditions that existed at that date, e.g. information that allows a more accurate estimate.	Events that are indicative of conditions that arose after 31 March 2023.
Examples	
The settlement of a court case that confirms that the body had a present obligation at 31 March 2023.	The settlement of a court case arising solely out of events that occurred after 31 March 2023.
The determination after 31 March 2023 of the proceeds from assets sold before that date.	Major purchases or disposals of assets, or abnormally large changes in asset values, after 31 March 2023.
The receipt of information indicating that an asset was impaired at 31 March 2023.	The destruction of a significant property by fire after 31 March 2023.
Notification of changes to grant entitlements (other than those caused by a change in grant conditions after the year-end).	The announcement after 31 March 2023 of a major restructuring.

63. The financial statements should reflect material adjusting events. Any reliable information that was not used that was available and could reasonably have been taken into account represents a misstatement. Auditors should evaluate whether:

- the body has adjusted the amounts recognised in the financial statements to reflect new information concerning conditions that existed at 31 March 2023
- the adjustments are complete and free from misstatement.

Non-adjusting events are not properly disclosed

64. Where a non-adjusting event is material in 2022/23, **auditors should** evaluate whether:

- the body has disclosed the nature of the event and an estimate of its financial effect (or a statement that an estimate cannot be made)
- the estimate is reasonable (or whether an estimate cannot be made)
- the disclosures are complete, clear, concise, and free from misstatement.

Authorised for issue date is not properly disclosed

65. Bodies are required to disclose the authorised for issue date. The FReM does not allow the disclosure of the authorised for issue date to be on the title page.

66. Auditors should evaluate whether the authorised for issue date has been disclosed in accordance with IAS 10. The disclosure should read:

"The Accountable Officer authorised these financial statements for issue on [date of authorisation]".

Events after the authorised for issue date but before the Independent Auditor's Report is signed are not identified

67. ISA (UK) 560 requires auditors to identify any events occurring between 31 March 2023 and the date of the Independent Auditor's Report (which may be later than the date the financial statements are authorised for issue). ISA (UK) 700 explains that the date of the Independent Auditor's Report informs users that the auditor has considered the effect of events and transactions that occurred up to that date.

68. Auditors should therefore seek, where possible, to sign the Independent Auditor's Report on the same day the financial statements are authorised for issue. Where that is not possible, auditors should ensure they carry out a review to identify any adjusting or non-adjusting events in the period since that date.

Misstatements are identified after the independent auditor's report has been signed

69. Where auditors become aware of a material misstatement in the audited Annual Report and Accounts after the date of the Independent Auditor's Report, the appropriate action depends on whether the misstatement has been identified before or after the Annual Report and Accounts have been laid before Parliament. This is summarised in the following table:

Before laying in Parliament	After laying in Parliament
<p>Auditors should:</p> <ul style="list-style-type: none"> discuss the matter with the body and agree the required correcting amendment carry out necessary audit procedures in the circumstances of the amendment arrange for the Annual Report and Accounts to be re-signed and re-dated extend the subsequent review procedures to the date of the new Independent Auditor's Report provide a new, re-dated Independent Auditor's Report. 	<p>Once the Annual Report and Accounts have been laid before Parliament, they cannot be revised and the Independent Auditor's Report cannot be re-issued.</p> <p>In these circumstances, auditors should request that any material misstatement is corrected by the retrospective restatement of a prior year error (explained in section 2) in the 2023/24 accounts.</p>

4. Significant judgements and estimation uncertainty

Disclosure is required of the judgements in applying accounting policies that have the most significant effect on the amounts recognised in the financial statements.

Disclosed significant judgements are not complete

70. Paragraph 122 of [IAS 1](#) requires disclosure of the judgements made by bodies in applying the accounting policies that have the most significant effect on the amounts recognised in the financial statements. These exclude judgements in respect of estimates which are disclosed separately. Examples of judgements to be disclosed under paragraph 122 are whether:

- a lease agreement is a finance or operating lease
- the body controls or significantly influences another entity
- the body is acting as principal or agent in a particular transaction
- an item should be recognised as a provision or disclosed as a contingent liability.

71. Auditors should evaluate whether the judgements made in applying accounting policies with the most significant effect on the amounts recognised in the 2022/23 financial statements have been considered by the body for disclosure.

Information on significant judgements is not properly disclosed

72. The relevant judgements should be disclosed along with the significant accounting policies or other notes. The aim of the disclosure is to provide sufficient details to help users understand how the policy has been applied, the areas of subjectivity and the basis for the body's judgement.

73. Auditors should evaluate whether a clear and concise explanation has been disclosed in 2022/23 which:

- explains the basis of the judgement
- sets out the factors taken into account
- refers to relevant technical sources
- justifies the view taken ahead of any potential alternatives..

Information should be disclosed on sources of estimation uncertainty that have a significant risk of resulting in a material adjustment to the carrying amounts within the next financial year.

Disclosed assumptions about estimation uncertainty are not complete

74. Paragraph 125 of IAS 1 requires disclosure of information about the assumptions the body makes about the future, and other major sources of estimation uncertainty, that have a significant risk of resulting in a material adjustment to the carrying amounts within the next financial year. All three factors apply (i.e. risk, materiality and timescale), which limits the number of items that require to be reported.

75. The disclosure requirement focusses on assets and liabilities whose carrying amount relies on estimates which are dependent on complex judgements for which there is a risk that correction or re-estimation with material effect during 2023/24 may be required.

76. Estimation uncertainty disclosures deal with situations where a body has incomplete or imperfect information which will only be enhanced as a result of future events. Paragraph 127 of IAS 1 states that the requirements relate only to the most difficult, subjective and complex judgements. Examples of estimates that the body should be considering for inclusion in the note include:

- selection of discount rate for pensions
- provisions subject to the future outcome of litigation in progress at the year end
- determination of asset useful lives for depreciation
- collection rates for debtors.

77. Bodies should be considering the impact of climate change issues, such as potential changes in the regulatory environment or any estimation uncertainty created by environmental issues.

78. Auditors should evaluate whether the body has considered the assumptions at 31 March 2023 that have a significant risk of resulting in a material adjustment to carrying amounts of assets and liabilities by 31 March 2024.

Information on estimation uncertainty is not properly disclosed

79. Auditors should evaluate whether the body, after considering the assumptions and other major sources of estimation uncertainty, has disclosed for the assets and liabilities affected:

- their nature
- their carrying amount as at 31 March 2023.

80. IAS 1 explains that the nature and extent of the information provided vary according to the nature of the assumption and other circumstances. Examples of the types of disclosures a body makes are as follows:

- the nature of the assumption or other estimation uncertainty
- the sensitivity of carrying amounts to the methods, assumptions and estimates underlying their calculation, including the reasons for the sensitivity;
- the expected resolution of an uncertainty and the range of reasonably possible outcomes within the next financial year in respect of the carrying amounts of the assets and liabilities affected; and
- an explanation of changes made to past assumptions concerning those assets and liabilities, if the uncertainty remains unresolved.

5. Principal or agent transactions

A body is acting as an agent in a transaction when it is an intermediary for a third party.

Agency transactions are not complete

81. A body is acting as an agent in a transaction when it is an intermediary for a third party (as opposed to being the principal when it is operating on its own behalf). Guidance on whether a body is acting as a principal or agent is provided at paragraphs B34 to B38 of paragraph B34 of [IFRS 15 Revenue from Contracts with Customers](#) requires a body to determine whether it is a principal or an agent for each specified good or service. IFRS 15 states that a body may be acting as an agent where it does not control the goods or services before transfer to the service recipient.

82. Indications that the body is acting as a principal are summarised in the following table:

Area	Indications body acting as principal
Primary responsibility for provision or fulfilment	Body has the primary responsibility for providing the goods or services to the service recipient or for fulfilling the order, e.g. by being responsible for the acceptability of the products
Inventory risk	Body has inventory risk before or after the customer order, during shipping or on return
Price setting	Body has discretion in establishing prices of the goods or service
Credit risk	Body bears the service recipient's credit risk for the amount receivable

83. Where the above indications do not apply, this indicates the body is acting as an agent. This may be where the body is acting as a distribution point for grant monies but has no control over the amount of grant allocated.

84. Auditors should evaluate whether the body has identified the transactions when it acted as an agent during 2022/23.

The accounting treatment of agency transactions is not appropriate

85. Paragraph B36 of IFRS 15 sets out the accounting treatment for transactions when the body is acting as an agent. Where that is the case during 2022/23, auditors should evaluate whether:

- the transactions have been excluded from the body's net expenditure
- the Statement of Financial Position reflects the debtor or creditor position at 31 March 2023 in respect of cash collected or expenditure incurred on behalf of the principal
- the net cash position at 31 March 2023 is included in the financing activities in the Statement of Cash Flow
- any commission received for acting as an agent during 2022/23 has been recognised as income.

Information on agency arrangements is not properly disclosed

86. Paragraph 119(c) of IFRS 15 requires the disclosure of the nature of the goods or services that the body has promised to transfer, highlighting any performance obligations to arrange for another party to transfer goods or services (i.e. when it is an agent).

87. Although there is no requirement for the amount of agency transactions to be disclosed in the financial statements, where the amounts involved are significant, bodies may wish to make a voluntary disclosure in the interests of public accountability and transparency.

88. Auditors should evaluate whether the:

- required disclosures have been made for 2022/23
- disclosures are complete, clear, concise, and free from misstatement.

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Technical Guidance Note 2023/1 - Overview Module

Risks of misstatement that are pervasive to the financial statements in 2022/23

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Audit Scotland, 4th Floor, 102 West Port, Edinburgh EH3 9DN
Phone: 0131 625 1500 Email: **info@audit-scotland.gov.uk**
www.audit-scotland.gov.uk

Technical Guidance Note 2023/1

Module 1

Risks of misstatement in property, plant and
equipment in 2022/23



 AUDIT SCOTLAND

Prepared for appointed auditors in the central government, health and college sector

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Contents

Module 1 introduction	3
1.1: Capital expenditure	4
1.2: Valuations	8
1.3: Depreciation and Impairment	17
1.4: Disposals	22

Module 1 introduction

Purpose and use of this module

1. This module of TGN 2023/1 provides guidance on the risks of misstatements in the following aspects of property, plant and equipment (PPE):

- Capital expenditure (section 1).
- Valuations (section 2).
- Depreciation and impairment (section 3).
- Disposals (section 4).

2. Section 8.2 of the [FReM](#) requires bodies to account for PPE in accordance with [IAS 16 Property, Plant and Equipment](#), subject to adaptations in respect of the measurement basis.

Changes in risks of misstatement in 2022/23

3. There are some additions, clarifications and changes in the guidance on the following risks of misstatement:

- Revaluation frequency for land and buildings is not adequate.
- Prior year errors are not properly accounted for (new risk).
- Carrying amount of land and buildings not revalued at the year-end differs materially from current value.
- Depreciation charge is not properly measured.
- Significant parts are not complete.
- Impairment assessment did not occur.
- Replaced parts of an asset are not derecognised (new risk).

4. The risk of material uncertainty declaration on valuations not being properly disclosed has been removed.

Consulting with Professional Support

5. Auditors should consult with Professional Support by sending an email to TechnicalQueries@audit-scotland.gov.uk

1.1: Capital expenditure

Expenditure on purchasing PPE is not complete or did not occur

6. PPE are tangible assets held to deliver services, for rental to others, or for administrative purposes, and are expected to be used over more than one year. Expenditure incurred on purchasing an item of PPE should be recognised as an asset in the Statement of Financial Position (i.e. capitalised) if it is probable that the body will obtain future:

- economic benefits - this is the potential for the asset to contribute to the flow of cash to the body (in the private sector, this would be the sole determinant); or
- service potential - this concept is added by the FReM for assets which do not contribute to cash flows, but instead provide benefits by allowing the body to deliver services.

7. However, it is acceptable for bodies to set a de minimis below which items will not be capitalised. A body may group similar items, such as laptops, and capitalise them even if individually they are below the threshold.

8. Auditors should evaluate whether:

- any de minimis level applied in 2022/23 is appropriate
- expenditure in 2022/23 that meets the recognition criteria above any de minimis has been recognised in the Statement of Financial Position.

Acquisition costs are not properly measured

9. An item of PPE that meets the recognition criteria should be initially measured at its cost, which paragraph 16 of IAS 16 requires to comprise:

- the purchase price
- any costs directly attributable to bringing the asset to the location and condition necessary for it to be capable of operating in the manner intended by the body. Paragraph 17 of IAS 16 gives examples of attributable costs that may be included in the measurement of an asset, e.g.
 - the costs of site preparation, initial delivery and handling costs, and installation costs
 - professional fees that relate directly to the acquisition of the assets.

- the initial estimate of the costs of dismantling and removing the item and restoring the site on which it is located discounted to present value.

10. Auditors should evaluate whether:

- items of PPE purchased in 2022/23 are recognised in the Statement of Financial Position at cost
- cost has been properly calculated.

Construction costs are not properly recognised or measured

11. The cost of an asset constructed by the body is determined using the same principles as for a purchased asset (described above). However, some additional issues are summarised in the following table:

Issue	Explanation
Employee costs	Employee costs should be capitalised only where the employees' activities are directly attributable to an asset. However, the entire price of the services rendered by the staff of external contractors can be capitalised (including items not capitalised for internal staff).
Recharges	Recharges should be capitalised only if they can be traced back to activity on the asset (and so general overhead costs should not be capitalised).
Cut-off	The recognition of costs in the carrying amount of an asset under construction should cease when the item is capable of operating in the manner intended. This may be before it has actually been brought into use.
Abortive costs and abnormal costs	Any abortive costs relating to projects that are discontinued or abnormal costs that arise from inefficiencies (e.g. design faults, theft of materials) should not have been capitalised.

12. Auditors should evaluate whether in 2022/23:

- employee costs, recharges and other costs have been capitalised where they are directly attributable to the asset being capable of operating as intended
- no further costs have been included in assets under construction after the asset was capable of operating in the manner intended by management
- abortive costs relating to projects that are discontinued and abnormal costs that arise from inefficiencies have not been capitalised.

Assets under construction are inappropriately classified

13. The cumulative balance of expenditure for assets under construction should be reclassified to the appropriate class of operational PPE at the point when the asset is capable of operating in the manner intended by the body (regardless of whether it is actually being used).

14. Auditors should evaluate whether assets under construction:

- recognised in the Statement of Financial Position at 31 March 2022 were transferred to the appropriate class of operational PPE when the asset is capable of operating in the intended manner
- recognised in the Statement of Financial Position at 31 March 2023 represents projects where the asset is not yet capable of operating in the intended manner by that date.

Subsequent expenditure is not complete or did not occur

15. Expenditure incurred during 2022/23 can be added to the carrying amount of an existing asset (i.e. an asset that was recognised at 31 March 2022) if the expenditure has added to the future economic benefits or service potential of the asset e.g. it has increased the useful life, current value or future performance of the asset. Auditors should evaluate whether:

- any expenditure incurred during 2022/23 on an asset that was recognised in the Statement of Financial Position at 31 March 2022 has been included in its carrying amount at 31 March 2023 where the expenditure adds to its future economic benefits or service potential
- all other expenditure during 2022/23 that maintains (rather than adds to) the future economic benefits or service potential of the asset (that the asset was expected to provide when it was originally acquired) have been recognised as an expense. This includes, for example, the costs of repairs and maintenance.

Donated assets are not complete or are inappropriately classified

16. Bodies may also acquire assets through donation. These are any assets acquired where no consideration is given, including assets transferred from one public sector body to another. Auditors should evaluate whether any assets acquired for no consideration during 2022/23 have been identified and classified as donated assets.

Donated assets are not properly measured on receipt

17. Paragraph 10.1.24 of the FReM requires a donated asset that will be used to deliver services to be measured at current value in existing use (explained in section 2) as at the date of acquisition.

18. Auditors should evaluate whether donated assets at 31 March 2023 have been appropriately measured on receipt.

Accounting entries for donated assets are inappropriate

19. The requirement to measure a donated asset at current value requires a debit to PPE for that amount. The related credit entry reflects the funding element and depends on whether any conditions that could require the return of the asset have been met by 31 March. The entries are summarised in the following table:

Treatment if conditions met	Treatment if conditions not met
Recognise immediately in the Statement of Comprehensive Net Expenditure (SOCNE) as income	Defer recognition as income until the conditions are subsequently met

20. Auditors should evaluate whether donated assets received during 2022/23 have been properly accounted for.

1.2: Valuations

Operational land and buildings are not complete

21. Operational land and buildings are those that were used to provide services during the year and continue to be used at the year-end. It is important that the body's asset register is a complete and accurate record of the land and buildings it holds.

22. Auditors should evaluate whether all operational land and buildings held at 31 March 2023 have been identified.

Measurement basis for operational land and buildings is inappropriate

23. Section 8.2 of the FReM adapts IAS 16 and requires the measurement basis for operational land and buildings which are non-specialised (i.e. where an active market exists) to be current value in existing use. This is described in [RICS Valuation - Global Standards 2017: UK national supplement](#) (RICS standards) as Existing Use Value. In summary, it is the amount that would be exchanged for the asset in its existing use. CIPFA's [Property Asset Valuation Handbook](#) is intended to help local government bodies comply with the requirements of the RICS standards but could also assist bodies in other sectors.

24. In some cases, there will be no active market on which to base the value of a building. In such cases, a depreciated replacement cost (DRC) approach may be needed to estimate current value.

25. Auditors should evaluate whether the body has adopted an appropriate measurement policy for operational land and buildings in 2022/23.

Specialised assets are not complete or are inappropriately classified

26. Auditors should evaluate whether the body has identified its properties at 31 March 2023 that are considered specialised. These are properties which:

- have a specialised nature arising from:
 - the construction, arrangement, size or location of the property
 - the nature of the plant and machinery which the properties are designed to house
 - the function or the purpose for which the buildings are provided.

- are rarely sold on the open market for single occupation in their existing use.

27. Examples of specialised properties that a body may hold include:

- properties of such construction, arrangement, size or specification that there would be no market for a sale to a single owner occupier for the continuation of existing use
- standard properties that are located in particular geographical areas (remote from main business centres) for operational reasons, which are of an abnormal size for that area
- properties where there is no competing market demand from other organisations using these types of property in the area
- museums, libraries, and other similar premises.

Specialised assets are not properly measured

28. Section 8.2 of the FReM adapts IAS 16 and requires ‘current value in existing use’ for specialised assets to be interpreted as the present value of the asset’s remaining service potential. Paragraph 10.1.9 of the FReM and [guidance](#) from Treasury explain that valuers may determine that a DRC basis may be the most appropriate. This would be where there is no market-based evidence of current value. Paragraph 10.1.10 goes on to explain that this is a method of valuation which provides the current cost of replacing an asset with its modern equivalent asset. It is the aggregate amount of the:

- value of the land for the existing use or a notional replacement site in the same locality
- the gross replacement cost of the buildings and other site works, from which appropriate deductions may then be made to allow for age, condition, economic or functional obsolescence, and environmental and other relevant factors.

29. Valuers may decide to use indices in the years between their quinquennial valuations. Interim valuations are not required where bodies choose to use annual indexation. However, the Treasury guidance warns that the use of indices for assets at Existing Use Value can result in overstatement. Indexation generally works better for specialised assets measured at DRC.

30. Where a body has used a DRC basis in 2022/23, auditors should evaluate whether there is any market-based evidence that could have been used.

Valuations of land and buildings are not undertaken appropriately

31. Auditors should expect the current value of land and buildings to be determined by the body engaging (external) or employing (internal) a professionally qualified valuer to undertake a valuation.

32. A professionally qualified valuer is a person who:

- holds a recognised and relevant professional qualification
- has sufficient current local and national knowledge of the particular market
- possesses the skills and understanding to undertake the valuation competently.

33. Under [ISA \(UK\) 500](#), auditors should:

- evaluate the competence, capabilities and objectivity of the valuer
- obtain an understanding of the valuer's work
- evaluate the appropriateness of the valuer's work as audit evidence. This may include considering the relevance and reasonableness of significant assumptions and methodologies, as well as the relevance, completeness and accuracy of the source data.

34. There is no requirement for the qualified valuer to be external to the body. However, auditors should request bodies to consider whether it is appropriate for a valuation undertaken by an internal valuer to be reviewed by an external valuer on a sample basis.

Revaluation frequency for land and buildings is not appropriate

35. The carrying amount of land and buildings in the Statement of Financial Position at the year-end is required to reflect its current value. Paragraph 31 of IAS 16 requires revaluations to be made with sufficient regularity to ensure that the carrying amount does not differ materially from the current value. Paragraph 34 of IAS 16 explains that the frequency of revaluations depends on the anticipated significance and volatility of changes in current value. The following table sets out the expectations of IAS 16:

Nature of changes in value	Appropriate frequency
Significant and volatile changes	Annual revaluation
Insignificant changes	Revaluation every three or five years

36. Paragraph 10.1.2 of the FReM provides guidance that, for those assets where an annual revaluation is not required, it might be appropriate for a quinquennial valuation supplemented by:

- annual indexation; or
- regular desktop valuation updates; or
- an interim valuation in year three.

37. The appropriate valuation frequency should be informed by the results of previous valuation exercises (e.g. if a significant increase is identified at a quinquennial revaluation, the body should consider increasing the frequency).

38. Paragraph 38 of IAS 16 and the FReM allow bodies the option to revalue:

- all land and buildings in each class simultaneously; or
- a proportion of land and buildings in each class each year on a rolling basis provided it is completed over a short period. For example, if it is appropriate to revalue a class of assets every five years, 20% of each class would be revalued each year in a five-year cycle.

39. Auditors should evaluate whether land and buildings are revalued with sufficient regularity to ensure that the carrying amount in the Statement of Financial Position at 31 March 2023 does not differ materially from the current value at that date.

Prior year errors are not properly accounted for

40. An adjustment to the carrying amount of land and buildings as a result of a valuation is normally treated as a change in accounting estimate and accounted for prospectively (as explained in section 3 of the Overview Module). However, there may be a prior period error if carrying amounts should have been adjusted in a prior year but were not. Retrospective restatement is required unless it is impracticable to determine the period-specific or cumulative effects of the error. Bodies should consider how any adjustments to the carrying amount at 31 March 2023 should be allocated between 2022/23 (and accounted for as a change in accounting estimate) and prior periods.

41. An example is set out in the following table:

Example: A quinquennial valuation at 31 March 2023 identified a significant increase in current value. There was no evidence of the increase arising solely during 2022/23.

As there was no evidence of the increase in value arising solely during 2022/23, the body concluded that the increase in value had been accumulating over the period since the previous quinquennial valuation at 31 March 2018. The increase in the current value was not significant at 31 March 2019, but the cumulative effect meant there was a material difference between current value and the carrying amount at 31 March 2021.

There should have been arrangements to identify the increase in value at the point the difference to the carrying amount became material, and a valuation exercise should have been carried out by a valuer so the carrying amount could be adjusted accordingly.

The consequences of that adjustment not happening are that the carrying amounts at 31 March in 2021 and 2022 were understated and an element of the increase should be treated as correcting a prior year error.

42. Auditors should evaluate whether a proportion of the movement in value identified as a result of a valuation exercise at 31 March 2023 should be treated as a prior year error and subject to retrospective restatement.

Carrying amount of land and buildings not revalued at the year-end differs materially from current value

43. For land and buildings where the quinquennial revaluation exercise is not scheduled for 31 March 2023, auditors should evaluate whether bodies can provide robust supporting evidence to demonstrate that any supplementary measures (e.g. indexation, desktop valuation or interim valuation) are adequate to ensure that the carrying amount does not differ materially from the current value. It may be helpful if bodies developed a working definition for material in this context. Auditors should evaluate whether any working definition of materiality is reasonable bearing in mind their own materiality levels.

44. It is expected that the supporting evidence would include, for land and buildings valued on a DRC basis, a consideration of relevant building indices by the valuer. However, there have been significant increases in build costs recently due to inflationary pressures which are likely to result in material increases in asset values.

45. Where a body uses a rolling basis of valuations, the supporting evidence may be an immaterial movement in the proportion of assets revalued at 31 March 2023 and a statement from the valuer that a similar movement is expected in the other assets in that class that were not revalued.

46. Auditors should critically examine the evidence that the carrying amount does not differ materially from the current value and, if it is judged to be inadequate, or if indexation indicated a material change in value, they should request that the body arranges for a full valuation exercise to be carried out as at 31 March 2023.

47. It may not be necessary to carry out a full valuation exercise for all assets at 31 March 2023. It may be possible that carrying out a revaluation of a proportion of assets would provide sufficient evidence that there is not a material misstatement. For example, the proportion may be a:

- stratified sample whereby the highest value assets are revalued
- representative sample of assets in each class with the outcomes extrapolated across the whole class.

48. Where the body declines to arrange a full valuation exercise of a sufficient number of assets by a professionally qualified valuer, auditors should consider whether this constitutes a limitation of the scope of the audit.

Valuations do not reflect current value at the year-end

49. Auditors should encourage bodies to carry out valuations as at the year-end, i.e. 31 March. However, there is no requirement for this, and bodies may use 1 April (or other date) subject to the standard condition that the carrying amount at the end of the year does not differ materially from the current value at that date.

50. Where a valuation has been carried out at 1 April 2022, auditors should evaluate whether:

- the body has considered whether there have been any movements in value during 2022/23 that should be reflected in the 31 March 2023 carrying amount
- the evidence that supports the body's consideration of the above is adequate
- the body has made necessary adjustments to the 31 March 2023 carrying amount to reflect any movements that require to be reflected.

51. Where a valuation has been carried out at 1 April 2023, auditors should ensure they obtain the results and consider whether this should be treated as an adjusting event in 2022/23 (as explained at section 3 of the Overview Module) on the basis that it provides evidence of conditions that existed at 31 March 2023. There have been examples of material movements in value not being reflected in the relevant year resulting in a prior year error corrected by a retrospective restatement in the following year.

Changes in valuation method are not appropriate

52. Where a body has changed its valuation method in 2022/23, auditors should evaluate whether the body can demonstrate that the change in method is more appropriate and results in a more accurate estimate of property values.

53. When a body changes its valuer, it is often the case that the new valuer will wish to adopt a new valuation method. However, a change in valuer should not necessarily lead to a change in the method adopted. It is for each body to determine the required approach and to instruct the valuer accordingly. It is important that bodies take responsibility for providing valuers with clear instructions. Auditors should obtain the instructions and evaluate their clarity and appropriateness.

54. Auditors should consider whether the change in method is arbitrary. ISA (UK) 540 states that arbitrary changes result in inconsistent financial statements over time and may give rise to a misstatement or be an indicator of possible management bias. If the body cannot demonstrate that the change results in a more accurate estimate, the method should not be changed.

Surplus assets are not complete or are inappropriately classified

55. Assets which are not used in the delivery of services, and there is no clear plan to bring them back into use, but which do not meet the criteria to be classified as either held for sale or as investment properties (explained in Module 8) should be classified as surplus assets.

56. Auditors should evaluate whether the body has identified all its surplus assets at 31 March 2023.

Surplus assets are not properly measured

57. The FReM adapts IAS 16 in respect of the measurement basis for surplus assets. The basis depends on whether there are restrictions which prevent the body from accessing the market. This is explained in the following table:

Accessing the market	Measurement basis
Restrictions	Current value in existing use
No restrictions	Fair value in accordance with IFRS 13. This is explained at section 2 of Module 8 but in summary fair value is the price that would be received to sell the asset in an orderly transaction between market participants at the measurement date.

58. Auditors should evaluate whether:

- the measurement basis for surplus assets in 2022/23, including any transfers during the year, is fair value (no restrictions) or current value in existing use (where restrictions exist)
- the valuations at 31 March 2023 are free from misstatement.

The accounting entries for revaluation movements during the year are inappropriate

59. The entries where the carrying amount of PPE has increased or decreased as a result of a revaluation affect the Statement of Financial Position, and Net Operating Expenditure (NOE) and Other Comprehensive Income and Expenditure (OCIE) in the SOCNE. The appropriate entries are summarised in the following table:

Movement	SoFP	SOCNE	Comment
Increase	Dr PPE CR Revaluation Reserve	OCIE	This is the most likely position.
Increase (reversing previous decrease charged to SOCNE)	Dr PPE CR General Fund	NOE	This may arise where the increase is reversing a previous decrease on the same asset charged to SOCNE. The amount credited should be less any depreciation that would have been charged had the decrease not been recognised.
Decrease (up to asset's credit balance on Revaluation Reserve)	Dr Revaluation Reserve CR PPE	OCIE	If the asset had previously been revalued upwards, it will have a credit balance on the Revaluation Reserve. Any decrease is first charged against that balance.

Movement	SoFP	SOCNE	Comment
Decrease (in excess of asset's credit balance on Revaluation Reserve)	Dr General Fund CR PPE	NOE	Any decrease in excess of the credit balance is charged to NOE.

60. Auditors should evaluate whether an increase in value at 31 March 2023 has been recognised in:

- the Revaluation Reserve; or
- the NOE if reversing a previous decrease on the same asset that was originally charged there.

61. Auditors should evaluate whether a decrease in value at 31 March 2023 has been recognised in:

- the Revaluation Reserve up to the credit balance in respect of the asset
- the NOE to the extent it exceeds the credit balance on the Revaluation Reserve.

Plant and equipment are not properly measured

62. Paragraph 10.1.14 of the FReM allows bodies to adopt a depreciated historical cost basis as a proxy for the current value of plant and equipment. Auditors should evaluate whether:

- this has only been used for non-property assets that have short useful economic lives and/or low values, e.g., ICT, furniture and fittings, motor vehicles
- the carrying amount at 31 March 2023 is free from misstatement.

The carrying amount of PPE is not properly presented

63. The carrying amount of an item of PPE in the Statement of Financial Position should be:

- the current value at the date of revaluation: less
- subsequent accumulated depreciation and any impairment (explained in the following section).

64. When the item is revalued, the carrying amount should be adjusted to the revalued amount. At the date of the revaluation, paragraph 35 of IAS 16 requires the asset to be treated in one of the two ways summarised in the following table:

Option	Treatment
Adjustment of gross carrying amount	<p>The gross carrying amount is adjusted in a manner that is consistent with the revaluation of the carrying amount of the asset. For example, the gross carrying amount may be restated proportionately to the change in the carrying amount.</p> <p>The accumulated depreciation at the date of the revaluation should be adjusted to equal the difference between the gross carrying amount and the carrying amount of the asset after taking into account accumulated impairment losses.</p>
Elimination of accumulated depreciation	The accumulated depreciation is eliminated against the gross carrying amount of the asset.

65. Auditors should evaluate whether the carrying amount for PPE at 31 March 2023 is current value at the date of the last revaluation less any subsequent accumulated depreciation and impairment.

1.3: Depreciation and Impairment

Depreciation charge is not complete

66. A charge for depreciation applies to all PPE regardless of measurement basis. For assets brought into use during 2022/23, auditors should evaluate whether the depreciation charge commenced at the point the asset was available for use in accordance with paragraph 55 of IAS 16 (i.e. when it is in a location and condition for it to be capable of operating in the manner intended by the body's management), even if that is before it was actually brought into use.

67. If depreciation has not been charged on a particular item of PPE during 2022/23, auditors should establish the reason and evaluate whether it is valid. Reasons often given by bodies for not charging depreciation, and Professional Support's view on their validity, are summarised in the following table:

Valid	Invalid (i.e. depreciation still required)
Land which has an unlimited useful life.	The asset's current value has increased over the year.
The residual value of an asset is equal to (or greater than) its carrying value.	Annual revaluations are undertaken.
Community assets that have an indefinite life.	Regular repairs and maintenance are carried out on the asset.
Assets in the course of construction.	
The asset has been reclassified as being held for sale (explained at section 5 of Module 8).	
The asset has been disposed of.	

Depreciation charge is not properly measured

68. Depreciation should be calculated by allocating the depreciable amount (i.e. the carrying value of the asset less any residual value) over the useful life of the asset:

- The residual value is the estimated amount that the body would currently obtain from disposal of the asset, after deducting the estimated costs of disposal, if the asset was already of the age and in the condition expected at the end of its useful life.

- The useful life should reasonably reflect the period which the assets are expected to be available for use by the body (and therefore may be shorter than the economic life).

69. IAS 16 requires bodies to review the residual value and useful life at least at each year-end and account for any necessary amendments prospectively as a change in an accounting estimate. This includes any assets with a nil net book value. Bodies should be including the potential impact of climate change considerations in their review.

70. Land should be accounted for separately from buildings, even when acquired together. An increase in the value of land (which is not depreciated) on which a building stands should not therefore affect the depreciable amount of the building.

71. Auditors should evaluate whether:

- the body has reviewed the useful lives and residual value at 31 March 2023 and they are reasonable
- the depreciation methods are appropriate and reflect the pattern in which the asset's future economic benefits or service potential are expected to be consumed, including the impact of climate change
- any change in useful lives, residual values or depreciation method has been accounted for prospectively as a change in accounting estimate
- land and buildings have been accounted for separately.

Significant parts are not complete

72. Paragraph 43 of IAS 16 requires depreciation to be provided for separately on each part of an item of PPE:

- with a cost that is significant in relation to the total cost of the item; and
- has a different useful life or depreciation method.

73. Bodies should have established a policy for determining whether the cost of a part is significant. It is expected that the policy will refer to cost as a proportion of the overall cost of the asset (including the new part's cost) rather than an absolute amount. The comparison of the cost of the new component with the overall cost of the asset should be as at the same date. This means the body should have either:

- estimated the current build cost of the asset and compared it with the cost of the new part; or
- discounted the cost of the new part back to the date when the asset was initially recognised and compared it with the original cost of the asset.

74. The remainder consists of the parts of the PPE item that are individually not significant. Approximation techniques may be necessary to depreciate the remainder in a manner that faithfully represents the consumption pattern and useful life of its parts.

75. Auditors should evaluate whether the body has:

- established a reasonable policy for determining whether the cost of a part is significant
- determined significance by comparing a part's cost against the overall asset cost and considering the result against the criteria in the policy
- compared the cost of a new part during 2022/23 against the overall cost of the asset as at the same date.

Accounting entries for depreciation are not appropriate

76. When considering whether depreciation has been properly accounted for in 2022/23, auditors should evaluate whether:

- depreciation has been charged to NOE in the SOCNE
- a transfer has been made from the Revaluation Reserve to the General Fund for assets measured at current value for the difference between the depreciation charge and the depreciation that would have been charged if the asset was carried at historical cost.

Impairment assessment did not occur

77. Paragraph 9 of [IAS 36 Impairment of Assets](#) requires bodies to assess at 31 March whether there is any indication that an asset may be impaired. Paragraphs 12 to 14 give examples of indications that an impairment may have occurred which include:

- an unexpectedly significant decline in an asset's carrying amount that is specific to the asset
- evidence of obsolescence
- physical damage to an asset.

78. IAS 36 also includes, as an indication, significant changes with an adverse effect on the body during the year in the extent to which an asset is used. These changes include the asset becoming idle, plans to discontinue or restructure the operation to which an asset belongs, plans to dispose of an asset before the previously expected date, and reassessing the useful life of an asset. Bodies should be considering the potential impact of climate change on assets as part of their impairment assessments (e.g. changes in environmental requirements).

79. Auditors should evaluate whether the body has considered at 31 March 2023 whether there are any indications that assets are impaired.

Impairment losses are not properly measured

80. If there are indications that an asset is impaired, paragraph 8 of [IAS 36 Impairment of Assets](#) requires bodies to make a formal estimate of the recoverable amount of the asset. The recoverable amount of an asset is the higher of its current value less disposal costs and its value in use (i.e., the cost of providing the service potential provided by the asset).

81. Paragraph 5 of IAS 36 confirms that revaluation requirements take precedence. Before an impairment loss is calculated, the asset should be revalued so the carrying amount is up to date. If the disposal costs are negligible, it is unlikely that asset will then be impaired in which case the recoverable amount does not require to be estimated.

82. If there are any indications that an asset is impaired in 2022/23, auditors should evaluate whether:

- the carrying amount of the asset at 31 March 2023 has been brought up to date before the impairment loss is calculated
- the body has made a formal estimate of the recoverable amount of the asset (unless disposal costs are negligible)
- the estimate of the recoverable amount is reasonable
- any impairment loss is the amount by which the updated carrying amount exceeds the value in use (or current value less disposal costs if higher than value in use).

The accounting entries for impairment losses are not appropriate

83. An asset is described as impaired if its carrying amount is greater than its recoverable amount. Where this is the case, paragraph 59 of IAS 36 requires the recognition of an impairment loss.

84. Paragraph 60 of IAS 36 requires all impairment losses to be recognised in the Revaluation Reserve to the extent that there is a credit balance relating to the impaired asset. However, the FReM adapts IAS 36 so that losses arising from the consumption of economic benefits or reduction in service potential should be recognised in the SOCNE. The appropriate accounting treatment is therefore summarised in the following table:

Arising from clear consumption?	Appropriate treatment
Yes	Recognise in net operating expenditure
No	Recognise in the Revaluation Reserve to extent there is credit balance relating to impaired asset
	Recognise excess in net operating expenditure

85. Auditors should evaluate whether the accounting treatment for any impairment loss in 2022/23 is appropriate.

Impairment reversals are not complete or did not occur

86. At each year end, bodies are required by paragraph 110 of IAS 36 to assess whether there is any indication that an impairment loss recognised in earlier periods may no longer exist or has decreased. Where an indication exists, bodies are required to estimate the recoverable amount.

87. An impairment loss in a prior year should only be reversed in 2022/23 where there is evidence of genuine reversal of the event or change in circumstances, i.e. where there has been a change in the estimates of the asset's recoverable amount. For impairments relating to physical damage or loss to the asset, this is unlikely to be the case (if an asset is reconstructed, the reconstruction should be accounted for as subsequent expenditure on the existing asset or a new asset in its own right explained in section 1).

88. Auditors should evaluate whether any reversal of impairment losses in 2022/23 is genuinely a reversal of the event that caused the loss.

1.4: Disposals

Disposals are not complete

89. Auditors should evaluate whether the body has identified all disposals of PPE during 2022/23. PPE can be disposed of through:

- sale
- entering into a finance lease as lessor
- demolition.

90. A disposal should be recognised on the date when control of the asset is transferred in accordance with IFRS 15, rather than the point when the body becomes committed to the disposal. For a property transfer, this is likely to be the completion date rather than when contracts are exchanged.

Disposals are not properly derecognised

91. Auditors should evaluate whether:

- the carrying amount of an item of PPE has been derecognised (i.e. removed from the Statement of Financial Position) during 2022/23 on disposal (or when no future economic benefits or service potential are expected from its use or disposal)
- the credit balance on the Revaluation Reserve in respect of that asset has been transferred to the General Fund.

Gain or loss on disposal is not properly measured

92. Bodies are required to calculate the gain or loss arising from the disposal of an asset. The gain or loss is the difference between:

- the disposal proceeds; and
- the carrying amount of the asset at the date of disposal (i.e. the amount at which the asset is recognised after deducting accumulated depreciation and impairment losses).

93. Auditors should:

- evaluate whether the gain or loss in 2022/23 has been recognised in other operating expenditure in the SOCNE (unless the asset is leased back which is covered at Module 6)

- evaluate whether the gain or loss has been properly calculated.

94. If payment is deferred beyond normal credit terms, the disposal proceeds should be discounted using a reasonable discount rate. The discounting should be unwound over the credit period by recognising the difference between the discounted amount and the total payments received as interest income.

95. Auditors should evaluate whether:

- deferred disposal proceeds in 2022/23 have been discounted
- the discount rate is reasonable
- the difference between the discounted amount and the total payments received has been recognised as interest income.

Replaced parts of an asset are not derecognised

96. Paragraph 70 of IAS 16 requires that, where a part is replaced:

- the cost of the new part should be reflected in the carrying amount of the asset
- the carrying amount of the replaced part should be derecognised to avoid double counting. If it is not practicable to determine the carrying amount of the replaced part, IAS 16 allows the cost of the new part to indicate the cost of the replaced part at the time it was acquired or constructed (adjusted for depreciation and impairment, if required).

97. The recognition and derecognition should take place regardless of whether the replaced part had been depreciated separately.

98. Auditors should evaluate whether replaced parts of assets have been derecognised at 31 March 2023.

Technical Guidance Note 2023/1– Module 1

Risks of misstatement in property, plant and equipment in 2022/23

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Technical Guidance Note 2023/1

Module 2

**Risks of misstatement in provisions, creditors and
accruals in 2022/23**



Prepared for appointed auditors in the central government, health and college sectors

31 January 2023

Contents

Module 2 introduction	3
2.1. Provisions and contingencies	4
2.2: Creditors and accruals	11

Module 2 introduction

Purpose and use of this module

1. This module of TGN 2023/1 provides guidance on the risks of misstatements in the following aspects of provisions, creditors and accruals:

- Provisions and contingencies (section 1).
- Creditors and accruals (section 2).

Changes in risks of misstatement in 2022/23

2. There are some clarifications and changes in the guidance on the following risks of misstatement:

- Provisions are not complete.
- Disclosures on provisions are not complete.
- Contingent liabilities disclosures are not complete.

Consulting with Professional Support

3. Auditors should consult Professional Support by sending an email to TechnicalQueries@audit-scotland.gov.uk.

2.1. Provisions and contingencies

A provision is a liability of uncertain timing or amount. Provisions should be accounted for in accordance with IAS 37 subject to a FReM interpretation in respect of discount rates.

Provisions are not complete

4. Bodies should recognise a provision when the conditions specified at paragraph 14 of [IAS 37 Provisions, Contingent Liabilities and Contingent Assets](#) are met. The specified conditions are summarised in the following table:

Condition	Explanation
The body has a present obligation as a result of a past event	<p>A past event leads to a present obligation where the settlement:</p> <ul style="list-style-type: none"> • can be enforced by law; or • where there is a constructive obligation, i.e. the body has indicated to other parties that it will accept certain responsibilities and has created valid expectations that it will discharge those responsibilities.
It is probable that an outflow of resources will be required to settle the obligation	An outflow of resources is regarded as probable if the event is more likely than not to occur.
A reliable estimate can be made of the amount of the obligation	Except in extremely rare cases, a body should be able to determine a range of possible outcomes and can therefore make a 'best estimate' of the obligation that is sufficiently reliable.

5. Auditors should evaluate whether the body has identified all of its obligations at 31 March 2023 that can either be enforced by law or represent constructive obligations. These may include:

- a regulatory change in building standards or policy commitments to meet climate change needs if that creates an obligating event
- a public announcement regarding future grant funding. Treasury [guidance](#) advises that whether it is an obligating event is dependent on the nature of the announcement, the details provided, and whether the body has undertaken any further actions or administrative processes that create a valid expectation by those affected.

6. Where a body has identified a present obligation but has not recognised a provision because it believes a reliable estimate cannot be made, auditors should presume that a reasonable estimate is possible. When evaluating reasonableness, auditors should:

- consider the reliability of the latest available information
- evaluate whether there is an appropriate method that can be used in making the estimate
- consider the underlying assumptions.

7. If a reasonable estimate is possible, auditors should confirm that a provision has been recognised and evaluate whether the nature and limitations of the estimating process have been disclosed.

8. In some cases, it may not be clear whether there is present obligation (e.g. in respect of legal claims). Auditors should deem that a past event has given rise to a present obligation at 31 March 2023 if, taking account of all available evidence including the opinion of experts, it is more likely than not that a present obligation exists. The evidence considered should include any additional information provided by events after 31 March 2023.

9. Auditors identified in previous years some bodies setting aside resources in their budgets to fund uncertain future expenditure. For financial reporting purposes, auditors should not accept this as a substitute for recognising a provision.

Recognised provisions do not exist

10. A provision should be recognised only when the three specified conditions have been met. Auditors should consider the provisions recognised by the body at 31 March 2023 and evaluate whether all three of the recognition conditions have been met.

11. Where there is a present obligation but one or both of the other conditions are not met, a provision should not be recognised, but a contingent liability should instead be disclosed.

Provisions are not properly measured

12. The amount recognised for a provision should be the body's best estimate of the expenditure required to settle the obligation at 31 March 2023. This should be the case even where settling the obligation is prohibitively expensive. For example, auditors have identified in previous years that bodies have incorrectly limited the estimate to what is affordable.

13. The management of the body should make reasonable estimates of outcome and financial effect determined by their judgement and supplemented by experience of similar transactions and, where appropriate, reports from independent experts.

14. When considering the amount recognised for a provision at 31 March 2023, auditors should evaluate whether:

- the amount is the body's best estimate of the expenditure required to settle the obligation at that date, and has not been restricted on the grounds of affordability
- the estimates of outcome and financial effect are reasonable
- the estimate reflects additional evidence provided by any events after 31 March 2023
- provisions recognised in previous years have been reviewed and adjusted, where appropriate, to reflect the best estimate at 31 March 2023 or to reflect material changes in the assumptions underlying the calculations of the cash flows.

15. Where the effect of the time value of money is material, paragraph 45 of IAS 37 requires the amount of the provision to be discounted to the present value of the expected payments. Section 8.2 of the [FReM](#) interprets IAS 37 by requiring bodies to use the discount rates set by Treasury in public expenditure system (PES) papers. [PES\(2022\)80](#) sets out the rates to be applied to provisions recognised in accordance with IAS 37 as at 31 March 2023. The rates vary depending on the number of years the expected cash flows are from that date. The nominal discount rates to be applied as at 31 March 2023 are set out in the following table:

Category	Period	Percentage
Short term	Within 5 years	3.27%
Medium term	Between 5 and 10 years	3.2%
Long term	Between 10 and 40 years	3.51%
Very long term	More than 40 years	3.0%

16. 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:

- 7.4% for up to one year from the year end
- 0.6% between one and two years
- 2.0% for after two years.

Accounting entries for provisions are not appropriate

17. Auditors should evaluate whether:

- new or increased provisions during 2022/23 have been recognised by a charge to net operating expenditure in the Statement of Comprehensive Net Expenditure (SoCNE) (unless in respect of restoring an asset explained later)
- the unwinding of any discounting has been recognised as an interest charge
- decreased provisions at 31 March 2023 have been recognised by a credit to the SoCNE
- the provision balance at 31 March 2022 has been debited for any liabilities settled during 2022/23 to arrive at the balance at 31 March 2023.

Constructive obligations for restructurings are not complete or do not exist

18. A restructuring is a programme that is planned and controlled by the body, and materially changes either the scope of its activities, or the manner in which those activities are carried out. Paragraph 72 of [IAS 37](#) explains that a constructive obligation to restructure arises when a body has by 31 March 2023:

- a detailed formal plan for the restructuring identifying: the activities concerned; the principal locations; the number of employees who will be compensated for terminating their services; the cost; date; and
- started to implement that plan or announced its main features to those affected by it.

19. Auditors should evaluate whether:

- the body has recognised a provision at 31 March 2023 for the expected costs of restructuring its operations when the recognition conditions are met
- the provision includes only the direct expenditure necessarily entailed by the restructuring (and hence excludes cost associated with the ongoing activities of the body).

Provisions for restoring assets are not complete

20. As explained in Module 1.1, the initial estimate of the costs of dismantling and removing an item and restoring the site on which it is located should be included in the measurement of the cost of the asset. However, any costs recognised have to be able to be balanced by a provision meeting the requirements of IAS 37.

21. Examples of potential qualifying costs include decommissioning plant whose installation is damaging to the environment, clean-up and restoration costs, and the cost of dismantling additions to property occupied under leases.

22. Auditors should evaluate whether the body has recognised a provision for restoring assets at 31 March 2023, where appropriate.

Provision for financial guarantees is not complete

23. Bodies should recognise a provision in respect of financial guarantees in accordance with [IFRS 9 Financial Instruments](#) rather than IAS 37. These contracts require bodies to make specified payments to reimburse the holder of a debt if the debtor (e.g. a voluntary organisation or a subsidiary) fails to make a payment under a contract. For example, they include letters of comfort provided in respect of a subsidiary.

24. Auditors should evaluate whether the body has recognised a provision for financial guarantees at 31 March 2023, where appropriate.

Accounting entries for financial guarantee provision are not appropriate

25. Auditors should evaluate whether:

- financial guarantee contracts entered into since 1 April 2006 are recognised as a liability on the Statement of Financial Position at 31 March 2023
- the provision was initially recognised at fair value in accordance with IFRS 13 (as explained at Module 8.2), estimated by considering the probability of the guarantee being called and the likely amount payable
- the entries on initial recognition of any new provisions recognised in 2022/23 were a credit to the financial guarantee liability and a charge to Net Operating Expenditure
- the provisions have been amortised over their useful lives to match any reductions in the underlying risk exposure, e.g. a repayment of some of the principal by the debtor
- the carrying amount of the financial guarantee at 31 March 2023 has remained at the initially recognised amount (less cumulative amortisation) unless payment under the guarantee has become probable in which case the amount of the provision should have been determined in accordance with IAS 37
- any movements in the carrying amount in 2022/23 have been debited or credited to Net Operating Expenditure.

Recognised reimbursements do not exist

26. Where some or all of the expenditure required to settle a provision is expected to be reimbursed by another party, auditors should evaluate whether the reimbursement:

- is a reasonable estimate (where there is uncertainty over the amount)

- has been recognised at 31 March 2023 only when receipt is virtually certain
- does not exceed the amount of the provision.

Reimbursements are not properly presented

27. Auditors should evaluate whether a reimbursement has been treated as a separate asset (and not netted off the provision) at 31 March 2023.

Disclosures on provisions are not complete

28. Auditors should evaluate whether:

- the body has complied in 2022/23 with the disclosure requirements for provisions set out at paragraphs 84 and 85 of IAS 37
- the disclosures are complete, clear, concise, and free from misstatement.

29. In extremely rare cases, where disclosure of some or all of the required information can be expected to prejudice seriously the position of the body in a dispute with other parties on the subject matter of a provision, paragraph 92 of IAS 37 allows the body to not disclose the information that would otherwise be disclosed under IAS 37. The FRC clarify in their [thematic review](#) of IAS 37 that this exemption does not disapply all disclosure requirements relating to the matter; the exemption applies only to the specific prejudicial information. Where the body believes this exception may apply in 2022/23, auditors should evaluate whether:

- the disclosure is likely to seriously prejudice the body
- if the above applies, the body has disclosed: the general nature of the dispute; the fact that the specific prejudicial information has not been disclosed; and the reason for non-disclosure
- the disclosures are otherwise complete, clear, concise, and free from misstatement.

Contingent liability disclosures are not complete

30. A contingent liability requires to be disclosed where:

- there is a present obligation but it is not probable that an outflow of resources will be required or the amount cannot be reliably measured
- there is a possible obligation arising from past events whose existence will be confirmed by uncertain future events not wholly within the body's control.

31. Auditors should evaluate whether:

- the body has identified all its contingent liabilities at 31 March 2023

- the body has disclosed for each contingent liability: a brief description of its nature; an estimate of its financial effect; an indication of the uncertainties; and the possibility of any reimbursement
- the disclosures are complete, clear, concise, and free from misstatement.

32. The disclosure of a contingent liability is not required where:

- the possibility of any outflow in settlement is remote
- it is not practicable to do so
- disclosure of specific information can be expected to prejudice seriously the position of the body in a dispute.

33. Where the body believes any of the above circumstances apply in 2022/23, auditors should evaluate whether non-disclosure is justified and, if so whether:

- the body has disclosed (as appropriate):
 - the fact it is not practicable
 - the general nature of the dispute; the fact that the specific prejudicial information has not been disclosed; and the reason for non-disclosure.
- the above disclosures are complete, clear, concise, and free from misstatement.

2.2: Creditors and accruals

Creditors should be accounted for in accordance with IFRS 15 Revenue from Contracts with Customers, IPSAS 23 Revenue from Non-Exchange Transactions and IFRS 9 Financial Instruments.

Creditors are not complete or do not exist

34. Creditors are financial liabilities arising from the contractual obligation to pay cash in the future for goods or services or other benefits that have been received or supplied and have been invoiced or formally agreed with the supplier. Auditors should evaluate whether the body has identified all cases where:

- it has been invoiced for ordered goods that have been delivered or services rendered during 2022/23; and
- payment has not been made by 31 March 2023.

Creditors are not properly measured

35. Auditors should evaluate whether creditors have been measured at the fair value of the consideration payable in accordance with IFRS 13. Fair value is defined as the price that would be paid to transfer a liability in an orderly transaction between market participants at the measurement date (explained further at Module 8.2).

Transactions are not recorded in the correct year

36. Auditors should evaluate whether the transactions around 31 March 2023 involving goods or services are recorded in the correct year.

Accruals are not complete or do not exist

37. Accruals are liabilities to pay for goods and services that have been received or supplied, including amounts due to employees. They technically differ from creditors in that they have not been invoiced or formally agreed with the supplier. Although it is usually necessary to estimate the amount of accruals, the uncertainty is generally much less than for provisions.

38. Auditors should be alert to circumstances which motivate the body to manipulate the amount accrued (either by over or understating) to achieve a particular presentation or result.

39. Auditors should evaluate whether the body has identified all cases where:

- ordered goods have been delivered or services rendered during 2021/22; and
- it has not been invoiced, and payment has not been made, by 31 March 2023.

Technical Guidance Note 2023/1 - Module 2

Risks of misstatement in provisions, creditors and accruals in 2022/23

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Technical Guidance Note 2023/1

Module 3

Risks of Misstatement in Financial Assets in 2022/23



Prepared for appointed auditors in the central government, health and college sectors

31 January 2023

Contents

Module 3 introduction	3
3.1: Financial assets	4

Module 3 introduction

Purpose and use of this module

1. This module of TGN 2023/1 provides guidance on the risks of misstatements in financial assets.
2. Section 8.2 of the [FReM](#) requires bodies to account for financial instruments in accordance with
 - [IFRS 9 Financial Instruments](#) (subject to adaptations and interpretations)
 - [IAS 32 Financial Instruments: Presentation](#)
 - [IFRS 7 Financial Instruments: Disclosures](#).
3. The transitional provisions when the FReM first adopted the equivalent UK financial instrument standards in 2007/08 remain in effect where they continue to be relevant. In particular, recognition and derecognition decisions prior to 1 April 2006 need not be reconsidered.
4. Trade payables (i.e. creditors) and financial guarantees are also financial instruments but are covered in Module 2, and receivables are covered in Module 7.

Consulting with Professional Support

5. Auditors should consult Professional Support by sending an email to TechnicalQueries@audit-scotland.gov.uk.

3.1: Financial assets

Financial assets are not properly classified

6. Financial assets held by central government bodies are generally, a lending arrangement to third parties, and investments in equity shares and bonds.

7. The classification of financial assets should be based on the business objective for holding the asset and the characteristics of its contractual cash flows. Guidance on classification is provided in chapter 3 of [application guidance](#) from HM Treasury. The classifications are summarised in the following table:

Contractual cashflows	Objective	Classification
Solely payments of principal and interest on the principal amount outstanding (i.e. basic lending arrangement)	To collect contractual cash flows	Amortised cost
	To both collect contractual cash flows and for selling investment	Fair value through other comprehensive income (FVOCI)
Volatility unrelated to a basic lending arrangement (e.g. changes in share prices)		Fair value through profit or loss (FVPL)

8. Auditors should evaluate whether the body has properly classified its financial assets at 31 March 2023.

Financial assets are not properly measured at initial recognition

9. Auditors should evaluate whether new financial assets during 2022/23 have been measured initially at:

- fair value in accordance with IFRS 13 (explained at section 2 of Module 8). This is usually the transaction price, i.e. the amount of the originating transaction (e.g. payment of loan advance, purchase of bond) unless the transaction was not based on market terms, e.g. soft loans; plus
- transaction costs (other than for those classified as FVPL). Bodies have the option to charge transaction costs immediately to net expenditure where they are not material.

Accounting entries for soft loans advanced at initial recognition are not appropriate

10. 'Soft loans' are made by a body at below prevailing market rates. The fair value of a soft loan does not equal the consideration given as it needs to reflect that the contractual interest rate is lower than the market rate.

11. The fair value of soft loans at the year end should have been estimated as the present value of all future cash receipts discounted using the prevailing market rate of interest for a similar instrument and for an organisation with a similar credit rating.

12. Section 8.2 of the FReM interprets IFRS 9 by stating that bodies should use the higher of the rate intrinsic to the financial instrument and the real financial instrument discount rate set by HM Treasury as applied to the flows expressed in current prices. The rate set for 2022/23 by Treasury in [PES\(2022\)8](#) is 1.9%.

13. The difference between the fair value of the soft loan and the amount of the cash lent (unless the recipient is a subsidiary) should have been charged to net expenditure. Where the loan was to a subsidiary, the difference should be recorded as an investment.

14. Auditors should evaluate whether:

- the fair value of soft loans at 31 March 2023 has been estimated as the discounted present value of all future cash receipts
- the difference between the fair value of the soft loan and the amount of the cash lent has been charged to the net expenditure (unless the loan is to a subsidiary in which case it has been recorded as an investment).

Financial assets at amortised cost are not properly measured subsequently

15. After initial recognition, investments classified as amortised cost should be carried on the Statement of Financial Position using a discount rate which should be the higher of

- the calculated single effective interest rate that exactly discounts estimated future cash receipts over the expected life of the instrument to the initial net carrying amount and
- the real discount rate set by Treasury. The rate set for 2022/23 by Treasury in [PES\(2022\)8](#) is (1.3%) up to February 2030 and (0.2%) in excess of RPI.

16. The interest so calculated should be added to the carrying amount of the financial asset each year.

17. In the case of soft loans, the effective interest rate will be higher than the contractual interest rate as the initial carrying amount of the loan is less than the principal sum required to be repaid. The appropriate accounting is as follows:

- interest income for the year should be credited to net expenditure based on the market rate at inception
- the carrying amount of the loan at 31 March 2023 should be written up by the difference between the interest credited to net expenditure and the actual interest received.

18. Auditors should evaluate whether the carrying amount of investments at amortised cost at 31 March 2023 is free from misstatement.

Financial assets at fair value are not properly measured

19. Financial assets held at FVOCI or FVPL should continue to be measured at fair value, after initial recognition, but without any deduction for transaction costs that would be incurred on sale or other disposal. Bodies should use the quoted price in an active market for an identical instrument, where available, or the valuation techniques set out in IFRS 13 (explained at Module 8.2) to measure investments at fair value. Auditors should evaluate whether:

- fair value at 31 March 2023 reflects published price quotations or, in the absence of that information, a suitable valuation technique in accordance with IFRS 13
- there has not been any deduction for transaction costs that would be incurred on disposal
- the calculation of fair value is free from misstatement.

20. The cost of an equity instrument may be an appropriate estimate of fair value in limited circumstances, i.e. where:

- insufficient information is available since the acquisition to measure fair value
- there is a wide range of possible fair value measurements but cost is the best estimate within the possible range.

21. If a body wishes to use cost as an estimate of fair value at 31 March 2023, auditors should evaluate whether:

- the body has made a reasonable effort to identify a reliable basis of valuation
- cost represents the best estimate of fair value.

Accounting entries for valuation gains and losses are not appropriate

22. Financial assets measured at fair value require to be regularly re-measured. Movements in fair value should be recognised as follows:

- For FVPL, in net expenditure.

- For FVOCI, in other comprehensive income and expenditure (OCIE) until derecognition.

23. Auditors should evaluate whether any gain or loss arising from a change in the fair value during 2022/23:

- has been recognised in net expenditure for assets classified at FVPL
- has been recognised in OCIE for assets classified at FVOCI
- is free from misstatement.

Interest income is not properly measured

24. The interest credited to net expenditure should be determined by applying the effective interest rate to the gross carrying amount.

25. Auditors should evaluate whether interest income in 2022/23:

- has been credited to net expenditure
- is free from misstatement.

Dividends are not properly accounted for

26. Auditors should evaluate whether dividends on equity investments have been credited to net expenditure when:

- the body's right to receive payment of the dividend is established
- it is probable that the economic benefits associated with the dividend will flow to the body
- the amount of the dividend can be measured reliably.

Impairments are not properly measured

27. At each year end, bodies are required by IFRS 9 to recognise expected credit losses on investments classified at amortised cost and FVOCI. The FReM adapts IFRS 9 to provide an exemption where the counterparty is a central government department or agency. The FReM clarifies that the exemption does not apply to a body's own sponsor department.

28. Guidance on credit losses is provided in chapter 4 of the Treasury's [application guidance](#). A credit loss is the cash shortfall between cash flows that are due to a body in accordance with the contract and the cash flows that the body expects to receive, discounted at the original effective interest rate. Expected credit losses should be measured in a way that reflects reasonable and supportable information that is available without undue cost or effort at the year end about past events, current conditions and forecasts of future economic conditions. For example, the impact of COVID-19 may increase the risk of credit losses.

29. The approach to measuring the expected credit losses depends on whether there has been a significant increase in credit risk since initial recognition as summarised in the following table:

Significant increase?	Measurement	Meaning
Yes	Lifetime expected credit losses.	The expected credit losses that result from all possible default events over the expected life of a financial instrument.
No	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 year end.

30. When evaluating whether the increase in credit risk is significant, bodies should apply the following guidelines:

- A body should use the change in the risk of a default occurring over the investment's expected life.
- The credit risk has not increased significantly if the investment has a low credit risk.
- There is a rebuttable presumption that the credit risk has increased significantly when contractual payments are more than 30 days past due.
- It may be necessary to perform the assessment on a collective basis by considering information that is indicative of significant increases in credit risk on a group of investments.
- The maximum period to consider when measuring expected credit losses is the maximum contractual period (including extension options) over which the body is exposed to credit risk.

31. Auditors should evaluate whether the body has at 31 March 2023:

- assessed at 31 March 2023 whether the increase in credit risk since initial recognition is significant (unless credit risk is low)
- measured the loss allowance at either (as appropriate):
 - the lifetime expected credit losses (when increase is significant); or
 - 12 month expected credit losses.

Loss allowances are not properly presented

32. A body is required to recognise the movement in the amount of expected credit losses in net expenditure as an impairment loss (or gain if a reversal).

33. For financial assets classified at amortised cost, the credit loss should be netted off the carrying amount of the investment in the Statement of Financial Position. However, paragraph 16A of IFRS 7 prohibits that treatment for financial assets classified at FVOCI; instead the credit loss should be disclosed in the notes to the accounts.

34. Auditors should evaluate whether the body has properly presented loss allowances in 2022/23.

Derecognition is not properly accounted for

35. A financial asset should be derecognised (i.e. removed from the Statement of Financial Position) when the contractual rights to cashflows have expired. The difference between the asset's carrying amount at derecognition and any consideration received should be recognised in net expenditure.

36. For financial assets at FVOCI, the cumulative gain or loss previously recognised in OCI should be recognised in net expenditure.

37. When there is no reasonable expectation of recovering a financial asset (in whole or part), a body should directly reduce the gross carrying amount. This write off constitutes a derecognition event rather than an impairment.

38. Auditors should evaluate whether:

- financial assets have been derecognised when cashflows have expired during 2022/23
- the difference between the carrying amount and consideration received has been recognised in the net expenditure
- financial assets have been written off when there is no reasonable expectation of recovery.

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Risks of Misstatement in Financial Assets in 2022/23

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Technical Guidance Note 2023/1

Module 4

Risks of misstatement in employee benefits in
2022/23



 **AUDIT SCOTLAND**

Prepared for appointed auditors in the central government, health and college sectors

31 January 2023

Contents

Module 4 introduction	3
4.1: Untaken holiday liability	4
4.2: Retirement benefits	6
4.3: Termination benefits	18

Module 4 introduction

Purpose and use of this module

1. This module of TGN 2023/1 provides guidance on the risks of misstatements in the following aspects of employee benefits:

- Untaken holiday liability (Section 1).
- Retirement benefits (Section 2).
- Termination benefits (Section 3).

Changes in risks of misstatement in 2022/23

2. There are some changes in the guidance on the risk of misstatement that significant events are not reflected.

Consulting with Professional Support

3. Auditors should consult with Professional Support by sending an email to TechnicalQueries@audit-scotland.gov.uk

4.1: Untaken holiday liability

Untaken holiday liability is not complete

4. The [FReM](#) (section 8.2) requires bodies to recognise the liability for any untaken holiday at the year-end that can be carried forward, in accordance with paragraph 13 of [IAS 19 Employee Benefits](#).

5. Auditors should evaluate whether the body has identified any untaken holiday (i.e. annual leave, flexitime and time off in lieu balances) at 31 March 2023 that can be carried forward and used during 2023/24.

Untaken holiday liability is not properly measured

6. The issues in respect of measuring the untaken holiday liability at the year-end are summarised and discussed in the following table:

Issue	Comment
Identification of relevant costs	The liability should be measured as the additional amount that the body expects to pay as a result of the unused leave entitlement that has accumulated at 31 March 2023. This should include salary as well as associated employer's national insurance and pension contributions. The reference to 'expectation to pay' does not relate to an additional payment; it refers to where an employee receives their salary for the current year but takes a day off that is part of their entitlement from an earlier year. The liability at 31 March 2023 should reflect rates applicable from 1 April 2023 as that is the year the leave will be taken
Calculating the liability	The liability should be based on the proportion of the annual salary and associated costs which relates to the number of untaken days of leave at the year end.
Identifying number of untaken days	For most staff, it is expected that contracts of employment specify the rate at which leave is paid, e.g. 1/261 of the annual salary per day. The following two scenarios need to be considered: <ul style="list-style-type: none"> Where the employee's leave year is aligned with the financial year (i.e. ends on 31 March 2023), the accrual will be based on any leave carried forward at the end of the leave year. Where the employee's leave year is not aligned with the financial year, the leave earned by the employee to 31 March 2023 will need to be calculated. This is then compared with the leave taken by that date to establish whether leave is owed to or by the employee.

7. Auditors should evaluate whether:

- the holiday liability includes salary as well as associated employer's national insurance and pension contributions
- the body has gathered reliable information on the number of days of untaken leave as at 31 March 2023
- the calculation, where based on a sample of staff, reflects all groups of staff.

Accounting entries for the untaken holiday liability are not appropriate

8. Auditors should evaluate whether:

- the liability in respect of untaken holiday at 31 March 2022 has been reversed in 2022/23 and replaced with the accrual at 31 March 2023
- the net increase or decrease in the accrual has been charged/credited to net expenditure.

4.2: Retirement benefits

Retirement benefits are pensions and lump sum payments payable to former employees after the completion of their employment. Retirement benefit schemes are classified by IAS 19 as either defined contribution or defined benefit.

Most employees are members of the Principal Civil Service Pension Scheme (PCSPS) which section 8.2 of the FReM requires to be accounted for on a defined contribution basis.

Accounting policy for the PCSPS is not appropriate

9. Auditors should evaluate whether the PCSPS has been accounted for on a defined contribution basis in 2022/23.

Accounting entries for the PCSPS are not appropriate

10. The accounting treatment on a defined contribution basis involves employer contributions being charged to the Statement of Comprehensive Net Expenditure (SoCNE) as they become payable. Auditors should evaluate whether:

- balances are recognised in the Statement of Financial Position only to the extent that there are prepaid or outstanding contributions at 31 March 2023
- contributions are free from misstatements.

Some employees are members of the Local Government Pension Scheme (LGPS) which operates under The Local Government Pension Scheme (Scotland) Regulations 2018 (the 2018 LGPS regulations). The scheme managers responsible for the local administration of each LGPS pension fund (referred to as administering authorities) are set out at Schedule 3 to those regulations. The LGPS may have to be accounted for on a defined benefit basis. Some bodies (e.g. Police Scotland) also have employees in their own separate defined benefit pension schemes.

Accounting policy for the LGPS is not appropriate

11. The differences in the accounting between a defined contribution and defined benefit basis, and the applicability to the LGPS, are set out in the following table:

Classification	Characteristics	Applicability to LGPS
Defined benefit	<p>Benefits are determined independently of the investments of the scheme. Employers have obligations to make contributions.</p> <p>Liabilities are recognised as benefits are earned or awarded and are matched with the body's attributable share of the scheme's assets.</p>	Bodies where employer contributions are set on the basis of their specific circumstances.
Defined contribution	The employer's obligation is limited to the amount it has agreed to contribute to the pension scheme.	Any body where it is not possible to identify its share of the underlying financial position and performance of the scheme with sufficient reliability for accounting purposes.

12. Auditors should evaluate whether the body's accounting policy is to account for retirement benefits arising from the LGPS on a defined benefit basis in 2022/23, unless they are satisfied that it is not able to reliably identify its share of the underlying financial position and performance of the scheme.

Valuations of defined benefit obligation are not undertaken by an appropriate person

13. In practice, the determination of the defined benefit obligation is carried out by a firm of actuaries engaged by each administering authority. The work of actuaries is set out in the [Pensions technical actuarial standard](#).

14. Regulation 60 of the 2018 LGPS regulations requires administering authorities to obtain a formal actuarial valuation every three years. Although a valuation will take place at 31 March 2023, the valuation undertaken at 31 March 2020 will continue to apply in 2022/23, and auditors are advised to obtain a copy of the actuary's report.

15. The FReM interprets IAS 19 to require an approximate assessment of the obligation at 31 March 2023. An assessment is not carried out to the same level of detail as the full valuations and will involve actuaries 'rolling forward' the 31 March 2020 valuation using latest available data to arrive at an estimate as at 31 March 2023.

16. Auditors' evaluation of the actuaries and assessment of the assumptions and approach adopted in the IAS 19 reports may be informed by a report prepared by PWC which is procured each year on auditors' behalf by Audit Scotland's Professional Support. Professional Support will advise auditors on the [Latest Technical News](#) page when the 2022/23 report is available, which is expected to be in May 2023. Where intending to make use of the PWC report, auditors should:

- evaluate PWC as an auditor's expert under ISA (UK) 620
- satisfy themselves that the report includes sufficient information to fully understand PWC's work, the judgements made and the basis for the conclusions and opinions expressed. Where that is not the case, auditors should advise Professional Support.

17. Auditors' responsibilities under ISA (UK) 500 are summarised in the following table:

ISA (UK) 500 requirement	Comment
Evaluate the competence, capabilities and objectivity of the actuary	Covered in PWC report.
Understand the work of the actuary	Auditors should consider the instructions issued by employers and evaluate whether local issues have been adequately covered.
Consider the relevance and reasonableness of significant assumptions	The PWC report assists auditors understand the sensitivity of each assumption. Further investigation will be required, particularly where the employer has requested different assumptions than those proposed by the actuary.
Consider the relevance, completeness and accuracy of the source data	The PWC report will comment on the approach taken by the actuaries to verify the validity and completeness of the data. Auditors should subject the data to further audit procedures (see below).
Consider the reasonableness of the roll-forward approach to estimating the liability	<p>The PWC report will comment on the roll-forward approach.</p> <p>Auditors should consider whether material significant events have been communicated to the actuary.</p>

Source data is not complete or accurate

18. Actuaries rely on the accuracy of the source data provided by employer bodies and the administering authority. Bodies should have communicated accurate cash flows and details of significant events to the pension fund actuary (usually via the relevant administering authority). However, actuaries generally produce their IAS 19 reports by April each year before final cash flow information is available. This means that a significant portion of the figures are estimates.

19. Auditors should:

- discuss with the auditor of the relevant pension fund any assurances required regarding the completeness and accuracy of the information

for 2022/23. Auditors may find it helpful to follow a [protocol for assurances](#) that will be provided by Professional Support in due course

- evaluate whether the body has a satisfactory procedure in place to check for significant movements or employer decisions, particularly those occurring in the final months of 2022/23 and early 2023/24, and has passed details to the actuary.

Significant events are not reflected

20. Events external to the bodies (e.g. court cases, changes in legislation) can impact on the actuaries' estimates of retirement benefit liabilities, including events after the year end. This may be where the courts have found in favour of members who have argued that they have been unfairly treated in some way. In recent years, there have been a number of legal cases that have implications for the benefits paid in public service pension schemes. Examples include the following:

- The McCloud and Sargeant Judgements found that transitional protections on moving from the 2009 to 2015 schemes for members who were within 10 years of normal retirement age in 2012 discriminated against younger members on the grounds of age.
- The Goodwin Tribunal found that male survivors in opposite sex marriages were discriminated against on the grounds of gender (see SPPA Circular 2020/04 for more information). This resulted in Regulation 17 of The Local Government Pension Scheme (Transitional Provisions and Savings) (Scotland) Regulations 2014 being amended by Regulation 4 of The Local Government Pension Scheme (Scotland) (Miscellaneous Amendments) Regulations 2022.
- The O'Brien case concerned discrimination against part-time judges in the calculation of pensions.

21. Where a legal ruling has found that certain provisions in the LGPS regulations are illegal, those provisions no longer have legal effect. It is not necessary to wait until the regulations have been amended before recognising any change in liability. This may require estimates based on the latest proposals to amend the regulations.

22. Auditors should evaluate whether bodies are identifying significant events that impact on retirement benefit liabilities at 31 March 2023 (including events after that date) and whether:

- actuaries are making appropriate allowances for the events
- bodies are properly recognising the liabilities in 2022/23.

Assumptions are not reasonable

23. The defined benefit obligation is an estimate of expected future payments required to settle the obligation resulting from employee service in the current

and prior periods. It is based on assumptions that are subjective and involve significant judgement. These are:

- actuarial assumptions about demographic variables (e.g. employee turnover, mortality, and expected early retirement rates)
- financial variables (e.g. future increases in salaries) based on market expectations for the period over which the obligations are to be settled. This is usually as at the end of the year but an amendment to IAS 19 requires it to be as at the date of any plan amendment, curtailment or settlement that occurs during year.

24. The estimate is discounted to present value using a discount rate determined by reference to market yields on high quality corporate bonds.

25. Auditors should evaluate, using the PWC report where appropriate, whether:

- the assumptions are within an acceptable range (auditors should be able to demonstrate how their acceptable range has been reached)
- the assumptions are at the optimistic or pessimistic end of the range
- each assumption is appropriate to the body's circumstances
- there is a particular impact on the financial statements of changes in any of the assumptions
- the actuarial assumptions are unbiased (i.e. neither imprudent nor excessively conservative) and mutually compatible
- financial assumptions are based on market expectations, at 31 March 2023 (or the date of any plan amendment, curtailment or settlement), for the period over which the obligations are to be settled
- the rate used to discount the obligation was determined by reference to market yields at 31 March 2023 on high quality corporate bonds
- any change in the discount rate from the previous year has been treated as a change in accounting estimate rather than a change in accounting policy.

Scheme assets are not properly measured

26. Each body's attributable share of the investments held in the pension scheme to cover the defined benefit obligation should be measured at fair value in accordance with IFRS 13 (explained at Module 8.2) at the 31 March 2023. Scheme assets exclude any unpaid employer contributions.

27. Under the LGPS, a detailed exercise to allocate assets between employers was also carried out at 31 March 2020. These employer asset allocations are then 'rolled forward' to subsequent year ends for IAS 19 purposes and amended

for subsequent cash flows from dealing with members and from investment returns.

28. Actuaries typically produce IAS 19 reports before full cashflow data is available. Investment returns for the last few months of the year are estimated using market indices. Actual investment returns to 31 March 2023 are expected to be available in May. Bodies should discuss with their actuaries whether the estimates need be updated to reflect the actual returns.

29. Auditors should evaluate whether the fair value of attributable scheme assets at 31 March 2023 is free from misstatement.

Net defined benefit liability is not properly presented

30. The employer's deficit of obligations over attributable scheme assets is referred to as the net defined benefit liability. This amount should be recognised on the employing body's Statement of Financial Position.

31. Auditors should evaluate whether:

- the net defined benefit liability at 31 March 2023 has been presented in the Statement of Financial Position (in a separate line if it is material)
- the amount is free from misstatement.

Service costs are not properly measured or presented

32. The measurement and presentation of each service cost element are summarised in the following table:

Element	Measurement	Presentation in SoCNE
Current service cost	Increase in the present value of a defined benefit obligation resulting from service in the current period	Included in the net expenditure
Past service cost	<p>Change in the present value of the defined benefit obligation for service in prior periods, resulting from:</p> <ul style="list-style-type: none"> • scheme amendment, i.e. the introduction or withdrawal of, or changes to, a defined benefit plan • curtailment, i.e. a significant reduction in the number of employees covered by a plan <p>[Note: past service cost may be either positive (benefits are introduced) or negative (benefits are withdrawn).]</p>	<p>Included in net expenditure</p> <p>Recognised at the earlier of when:</p> <ul style="list-style-type: none"> • the scheme amendment or curtailment occurs • the body recognises related restructuring costs or termination benefits (explained in section 3)

Element	Measurement	Presentation in SoCNE
Gain or loss on settlements	Difference between: <ul style="list-style-type: none"> the present value of the defined benefit obligation being settled, as determined on the date of settlement and the settlement price, including any scheme assets transferred and any payments made directly by the body related to the settlement 	Included in net expenditure Recognised when the settlement occurs

*[Note: A settlement occurs when a body eliminates all further obligation for the benefits (other than a payment of benefits in accordance with the terms of the scheme and included in the actuarial assumptions).]

33. Bodies need not distinguish between past service cost resulting from a plan amendment, past service cost resulting from a curtailment and a gain or loss on settlement if these transactions occur together.

34. Before determining past service cost or a gain or loss on settlement, the body should have re-measured the net defined benefit liability using the current fair value of scheme assets and current actuarial assumptions reflecting the benefits offered under the plan before the amendment, curtailment or settlement.

35. In respect of 2022/23 service costs, auditors should evaluate whether:

- current service cost has been included in net expenditure
- past service cost has been:
 - included in net expenditure
 - recognised at the earlier of when the scheme amendment/curtailment occurs or the body recognises related restructuring costs or termination benefits
- any gain or loss on settlement has been:
 - included in net expenditure
 - recognised when the settlement occurs.
- the amounts are free from misstatement.

Net interest on the net defined benefit liability is not properly measured or presented

36. Net interest on the net defined benefit liability is the change during the period in the liability that arises from the passage of time. It comprises the:

- interest income on scheme assets
- interest cost on the defined benefit obligation (representing the unwinding of the discount applied in calculating the present value of the obligation).

37. Paragraph 123 of IAS 19 requires the interest to be determined by multiplying the fair value of the scheme assets and defined benefit liability by the rate used to discount the obligation to present value. The assets and liability, and discount rate, should have been determined at the start of the year, and take into account changes due to contributions and benefit payments throughout the year.

38. Auditors should evaluate whether:

- net interest has been calculated based on the net defined benefit liability brought forward and the discount rate at 1 April 2022
- changes during 2022/23 have been taken into account
- net interest has been included in net expenditure
- the amount is free from misstatement.

Remeasurements of the net defined benefit liability are not properly measured or presented

39. The elements that comprise the remeasurements of the net defined benefit liability item are summarised in the following table:

Element	Characteristics
Actuarial gains and losses	<p>This element comprises:</p> <ul style="list-style-type: none"> • changes in actuarial assumptions • experience adjustments, i.e. the effects of differences between the previous actuarial assumptions and what has actually occurred due to, for example, unexpectedly high or low rates of employee turnover.
Return on scheme assets	<p>This element comprises:</p> <ul style="list-style-type: none"> • interest, dividends and other income derived from scheme assets (except for amounts included in net interest) • realised and unrealised gains or losses on the scheme assets. <p>The costs of managing the scheme assets (but not other administration costs) should be deducted from the above.</p>

40. Auditors should evaluate whether:

- remeasurement of the net defined benefit liability in 2022/23 is presented in other comprehensive income and expenditure
- remeasurement of the net defined benefit liability comprises:
 - actuarial gains and losses
 - interest, dividends and other income derived from scheme assets except for amounts included in net interest) net of costs of managing the assets
 - realised and unrealised gains or losses on the scheme assets.
- the amount is free from misstatement.

Employee contributions are not properly measured

41. Employee contributions are payments made into the scheme by employees which increase assets and liabilities equally. Some key features are summarised in the following table:

Feature	Measurement
Normal contribution rates	<p>Employee contributions are paid on a tiered basis over five earnings bands set out at regulation 9(2)(b) of the LGPS regulations, with the contribution rate being determined by the amount of earnings falling into each band.</p> <p>The earnings for each band in the regulations are expressed as at 1 April 2014 and are increased each year by any increase to benefits under the relevant pensions increase order. For pensions which began before 8 April 2019, the increase is 1.7%. For pensions which began on or after that date, the increases are set out in The Pensions Increase (Review) Order 2022.</p> <p>The contribution rates range from 5.5% to 12%.</p>
Other contribution rates	<p>Regulation 10 allows members to elect to pay a reduced rate of 50% of that which would otherwise be payable.</p> <p>Regulation 16 allows an active member to pay additional pension contributions up to £6,500 (this limit is expressed as at 1 April 2015 and is increased by subsequent pension increase orders).</p>
Pensionable pay	<p>Pensionable pay is defined at regulation 20 as all an employee's salary, wages, and other pensionable emoluments (which excludes equal pay compensation).</p> <p>In some circumstances (e.g. reduced pay on sick leave), an assumed pensionable pay requires to be calculated in accordance with regulation 21.</p> <p>Under Regulation 90, a member may be protected from a permanent reduction in pay for 10 years.</p>

42. Auditors should evaluate whether:

- contributions for 2022/23 are at the correct rate
- the rate is applied to the correct pensionable pay
- the contributions are in respect of all members, and only members.

43. Auditors should discuss with the auditor of the relevant pension fund the assurances that the pension fund auditor requires. This is expected to include assurance as to whether, based on their testing, there are:

- matters arising that could impact on the employing body's ability to properly account to the pension fund for contributions
- audit findings expected to be material to the employer
- issues to be reported to those charged with governance.

44. Auditors may find it helpful to follow a [protocol for assurances](#) that will be provided by Professional Support in due course.**45.** Actuaries generally use actual contribution figures to 31 December and generally estimate contribution amounts for the period up to 31 March. Auditors should confirm that the body has discussed with its actuary whether the figure for the 12 months needs to be revised to reflect actual contributions.**Employee contributions are not properly presented****46.** Paragraphs 92 and 93 of IAS 19, with application guidance at paragraph A1, set out the requirements for presenting employee contributions.**47.** Auditors should evaluate whether employee contributions have been appropriately presented in 2022/23.**Employer contributions are not properly measured****48.** Contributions from employers are paid into the scheme and increase scheme assets. The rates for employer contributions are calculated by actuaries to ensure that the existing assets and future contributions will be sufficient to meet future benefit payments from the funds. Some key features of employer contributions are summarised in the following table (all references to regulations are to the 2018 LGPS regulations):

Feature	Measurement
Normal contributions	The actuaries provide a report to the administering authority in respect of the valuation and a rates and adjustments certificate specifying the primary rate of employers' contribution, and any adjustments for a particular body (i.e. secondary rate), for each of the three years beginning on 1 April in the year following that in which the valuation date falls.

Feature	Measurement
	<p>The administering authority is then required to send a copy of the report and certificate to each employing body.</p> <p>The applicable actuarial valuation for 2022/23 was as at 31 March 2020 which set contribution rates for the three years from 1 April 2021.</p>
Other contributions	<p>Further payments are made by scheme employers to the fund under regulation 63 where benefits are paid out to a member early. The payments are to compensate for what is referred to as 'strain on the fund costs' caused by benefits being paid earlier.</p> <p>Payments require to be made to the fund for the early payment of retirement benefits on ill-health grounds under regulation 34.</p> <p>An administering authority may require further payments for benefits becoming immediately payable for:</p> <ul style="list-style-type: none"> – early retirement under regulation 29(6), including the cost of waiving any reduction under regulation 29(9) – flexible retirement under regulation 29(7), including the cost of waiving any reduction under regulation 29(9) – redundancy under regulation 29(8).
Pensionable pay	Same as for employee contributions.

49. Auditors should evaluate whether the 2022/23 employer contributions have been:

- calculated using the correct primary percentage. This is the primary rate of the employer's contribution specified in the rates and adjustments certificate expressed as a percentage of the pay of its employees who are active members
- calculated using the correct pensionable pay
- increased or reduced by any secondary rate adjustments specified for the body for 2022/23 in the rates and adjustments certificate.

50. As with employee contributions, auditors should provide assurances to the pension fund auditor.

51. Actuaries generally use actual contribution figures to 31 December and estimate contribution amounts for the period up to 31 March. Auditors should confirm that the body has discussed with its actuary whether the figure for the 12 months needs to be revised to reflect actual contributions.

Disclosed information on retirement benefits is not complete

52. The disclosure requirements for retirement benefits are set out at paragraphs 135 to 150 of IAS 19. This includes explicit disclosure objectives which require bodies to disclose information that: explains the characteristics of their defined benefit schemes; identifies and explains the amounts in the

financial statements arising from the defined benefit schemes; and describes how defined benefit schemes may affect the amount, timing and uncertainty of future cash flows.

53. Auditors should evaluate whether:

- the body has met the disclosure objectives for 2022/23
- the disclosures are complete, clear, concise and free from misstatement.

4.3: Termination benefits

Termination benefits are compensation in exchange for the termination of an employee's employment

Provision for termination benefits is not complete

54. Termination benefits may be made as:

- payments under a voluntary severance scheme. This is typically because posts have been removed following a restructuring of the body's operations. Payments are those due in the normal course of employment including in lieu of notice (i.e contractual) but are also likely to include a discretionary, ex-gratia element (i.e. non-contractual)
- enhanced retirement benefits in the case of early retirement. The enhanced pension is then usually paid by the pension fund on an agency basis but may be paid directly by the body.
- payments under agreements to settle an employment dispute (settlement agreements)
- redundancy payments where the body decides to terminate an employee's employment before normal retirement age. This is rare in practice due to the policy of no compulsory redundancies.

55. Termination benefits do not include employment being terminated at the request of the employee without an offer from the body, such as early retirement under scheme rules available to all members.

56. A body is required by paragraph 165 of [IAS 19](#) to recognise the liability for termination benefits when it can no longer withdraw the offer of those benefits. This is summarised in the following table:

Reason for termination	Point where offer cannot be withdrawn
Body's decision to terminate an employee's employment before normal retirement age	<p>When the body has communicated to the affected employees a plan of termination meeting all of the following criteria:</p> <ul style="list-style-type: none"> • It is unlikely that significant changes to the plan will be made. • The plan identifies the number of employees whose employment is to be terminated, their job classifications or functions and their locations, and the expected completion date. • The plan establishes the termination benefits in sufficient detail that employees can determine the type and amount of benefits they will receive.
Employee's decision to accept an offer of voluntary severance, early retirement or settlement	<p>The earlier of when:</p> <ul style="list-style-type: none"> • the employee accepts the offer; and • a legal or other restriction on the body's ability to withdraw the offer takes effect. This would be when the offer is made, if the restriction existed at that time.

57. In the absence of the above events, a body is required to recognise a liability for the termination benefits no later than when it recognises a provision for the costs of a related restructuring under IAS 37 (explained in Module 2).

58. Auditors should evaluate whether termination benefits have been recognised at 31 March 2023 if the body cannot withdraw the offer at that date (or it has recognised a provision for the costs of a related restructuring).

Technical Guidance Note 2023/1 Module 4

Risks of misstatement in employee benefits in 2022/23

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Audit Scotland, 4th Floor, 102 West Port, Edinburgh EH3 9DN
Phone: 0131 625 1500 Email: **info@audit-scotland.gov.uk**
www.audit-scotland.gov.uk

Technical Guidance Note 2023/1

Module 5

Risks of misstatement in group financial statements
in 2022/23



 **AUDIT SCOTLAND**

Prepared for appointed auditors in the central government, health and college sectors

31 January 2023

Contents

Module 5 introduction	3
5.1: Subsidiaries	4
5.2: Associates and joint ventures	7
5.3: Application to arm's-length external organisations	9
5.4: Disclosure	11
Appendix 1 Assessing power over an ALEO	13

Module 5 introduction

Purpose and use of this module

1. This module of TGN 2023/1 provides guidance on the risks of misstatements in the following aspects of group financial statements:

- Subsidiaries (section 1).
- Associates and joint ventures (Section 2)
- Application to arm's-length external organisations (Section 3).
- Disclosure (Section 4).

2. Group financial statements are those in which the assets, liabilities, reserves, income, expenses and cash flows of a parent public body and its subsidiaries, plus its investments in associates and interests in joint ventures, are presented as those of a single economic entity.

3. Auditors of the parent body should ensure they clearly communicate their requirements to the auditor of the subsidiary, associate or joint venture on a timely basis. Appendix 5 of [ISA \(UK\) 600](#) contains guidance on required and additional matters that may be included in a letter of instruction.

Consulting with Professional Support

4. Auditors should consult with Professional Support by sending an email to TechnicalQueries@audit-scotland.gov.uk

5.1: Subsidiaries

A subsidiary is an entity that is controlled by a parent entity. Subsidiaries are consolidated into the group financial statements on a line-by-line basis. Section 8.2 of the [FReM](#) requires bodies to adopt [IFRS 10 Consolidated Financial Statements](#) when accounting for subsidiaries, subject to adaptations regarding scope for departments and agencies.

Subsidiaries are not complete or do not exist

5. The adaptations to IFRS 10 mean that, for the Scottish Government and agencies, it applies only to entities within the consolidation boundary set by the [Office of National Statistics](#) (ONS). Auditors of the Scottish Government and agencies should confirm that the body has treated as a subsidiary only those public bodies designated for consolidation in accordance with criteria set by ONS.

6. IFRS 10 applies without adaptation to NDPBs. Entities that an NDPB controls should be treated as subsidiaries. Paragraph 7 of IFRS 10 sets out the three aspects of control summarised in the following table:

Aspect of control	Explanation
Power over an entity	<p>Power is existing rights to direct the relevant activities of the entity. The main indicator of 'power' is the right to direct the financial and operating policies of that entity. This may be through:</p> <ul style="list-style-type: none"> • more than half of voting rights granted by shares; or • contractual or other binding arrangements.
Exposure, or rights, to variable returns from involvement with the entity	This is the case when the financial and non-financial returns have the potential to vary as a result of the entity's performance.
Ability to use power over the entity to affect the amount of the returns	This is the case where the body is able to direct the entity to further the body's objectives.

7. Further information on assessing control is provided at paragraphs B2 to B72 of IFRS 10, sections 1 and 2 of [application guidance](#) from Treasury, and there are examples on page 80 of [IPSAS 35](#).

8. Where the body has voting rights, the assessment of power is straightforward. This may be the case where the body has invested in a third-party company.

9. However, the assessment of whether contractual or other binding arrangements give rise to power is more complex. [IFRS 12](#) introduced the term 'structured entity' to describe an entity that has been designed so that the relevant activities are directed by means of contractual arrangements (as distinct from simply investing in a third party). Voting rights are not the dominant factor in deciding who has power over a structured entity. Consequently, it is necessary to consider the contractual arrangements. Auditors should refer to section 3 of this module for guidance on contractual or other binding arrangements.

10. Auditors should evaluate whether all entities which the NDPB controls in 2022/23 have been treated as a subsidiary. Auditors may find it helpful to use the checklist at Appendix 1 of this module to help evaluate whether a body has identified the entities over which it has control through contractual arrangements at 31 March 2023.

Accounting entries for subsidiaries is not appropriate

11. Subsidiaries should be consolidated into the group financial statements on a line-by-line basis in accordance with paragraph B86 of IFRS 10. Auditors should evaluate whether the body has accounted for its subsidiaries by:

- combining like items of assets, liabilities and reserves at 31 March 2023, and income, expenses and cash flows during 2022/23
- offsetting (i.e. eliminating) the carrying amount of the body's investment in each subsidiary and its portion of reserves of each subsidiary
- eliminating in full intragroup assets and liabilities, reserves, income, expenses and cash flows relating to transactions between entities of the group
- treating changes in the body's ownership interest in a subsidiary that do not result in a loss of control as reserve transactions.

Accounting dates are not aligned

12. The group financial statements should be prepared as at 31 March 2023. This may require the other entities in the group financial statements to prepare financial information at that date if they have a different year end. Where that is not practicable, paragraph B93 of IFRS 10 allows the entities' financial statements to be used, with suitable adjustments, provided the year end is within three months of the 31 March 2023 (i.e. 31 December 2022 to 30 June 2023)

13. Auditors should evaluate whether financial information for the other entities has been prepared as at 31 March 2023. Where this is not practicable (and instead the entities' most recent financial statements have been used), auditors should evaluate whether:

- the year end is within three months of the 31 March 2023
- the financial statements have been adjusted for significant transactions between the entity's year end and 31 March 2023.

Accounting policies are not aligned

14. In accordance with paragraph 19 of IFRS 10, the accounting policies of the subsidiaries may have to be aligned with the policies of the parent body, for the purposes of the group financial statements, if they are materially different.

15. Auditors should evaluate whether the group financial statements for 2021/22 have been prepared using uniform accounting policies.

5.2: Associates and joint ventures

An associate is an entity over which an investor has significant influence, but not control. A joint venture is where two or more parties have joint control of an arrangement and have rights to the net assets. Investments in an associate or a joint venture are accounted for using the equity method. Section 8.2 of the [FReM](#) requires bodies to adopt [IFRS 11 Joint Arrangements](#) and [IAS 28 Investments in Associates and Joint Ventures](#), subject to an adaptation that limits application for departments and agencies to investments in private sector bodies.

Associates are not complete or do not exist

16. Entities over which a body has significant influence, but not control, should be treated as associates. Auditors should evaluate whether the body has identified all its associates at 31 March 2023.

17. Significant influence is defined at paragraph 3 of IAS 28 as the power to participate in the financial and operating policy decisions of the entity. The existence of significant influence is usually demonstrated by at least one of the following:

- 20% or more of the voting power
- representation on the board of directors or equivalent governing body of the other entity
- participation in policy-making processes, including decisions about dividends
- material transactions between the body and the entity, interchange of managerial personnel, or provision of essential technical information.

Joint ventures are not complete or do not exist

18. Auditors should evaluate whether the body has identified all its joint ventures at 31 March 2023. A joint venture is defined in IFRS 11 as an arrangement where:

- parties are bound by a contractual arrangement which gives two or more of those parties joint control of the arrangement. Joint control exists only when decisions about the relevant activities require the unanimous consent of the parties sharing control
- the joint venturers have rights to the net assets of the arrangement.

Joint operations are not accounted for appropriately

19. Joint arrangements also include joint operations.

20. In contrast with a joint venture, joint operations do not involve a separate vehicle or, if they do, the joint operators have rights to the assets, and obligations for the liabilities, relating to the arrangement (rather than the net assets).

21. Auditors should evaluate whether any joint operation at 31 March 2023 is recognised in the body-only financial statements.

Accounting entries for associates and joint ventures are not appropriate

22. IAS 28 requires bodies to account for investments in an associate or a joint venture using the equity method (in contrast with the line-by-line method applied for subsidiaries). Only the body's share of the associate or joint venture's net assets should be recognised within the group financial statements.

23. The body should initially recognise the investment at cost. The value should be adjusted thereafter for the post-acquisition change in the body's share of net assets of the associate/joint venture. Gains and losses should be disclosed in the group Statement of Comprehensive Net Expenditure.

24. Where surpluses or deficits resulting from transactions between the body and the associate or joint venture are included in the carrying value of assets of either entity, the body's share of those surpluses or deficits should be eliminated. This may be needed, for example, in relation to sales of assets between the body and the associate or joint venture.

25. Auditors should evaluate whether the body has:

- used the equity method to account for investments in an associate or joint venture at 31 March 2023
- eliminated its share of surpluses or deficits resulting from transactions with an associate or joint venture, where necessary
- included its share of the investee's profit or loss in the group net expenditure
- included its share of the investee's other comprehensive income and expenditure in the group other comprehensive income and expenditure.

5.3: Application to arm's-length external organisations

Bodies may set up arm's-length external organisations to deliver services which they may in practice control or at least significantly influence.

Arm's-length external organisations are not properly classified in group financial statements

26. Bodies may have established and fund arm's-length external organisations (ALEOs) to deliver services. ALEOs meet the definition of structured entities (as explained in section 1) and usually take the form of companies limited by guarantee or charitable trusts.

27. Voting rights may not be the dominant factor in deciding who controls the ALEO. The activities of the ALEO are likely to be directed by means of binding arrangements or provisions in founding documents such as articles of association or a constitution.

28. Paragraph AG 17 of [IPSAS 35](#) give examples of rights that would give a body power over an ALEO (NB The Charities SORP acknowledges that, although a charity is controlled and managed by its trustees, it can be a subsidiary for accounting purposes). These include rights to:

- give policy directions to the governing body of the ALEO that give the body the ability to direct its relevant activities
- appoint, reassign or remove members of the ALEO's key management personnel who have the ability to direct the relevant activities
- approve or veto the ALEO's budgets
- direct the ALEO to enter into, or veto any changes to, transactions for the benefit of the body
- veto key changes to the ALEO, such as the sale of a major asset or of the ALEO as a whole.

29. The above apply even if the rights have not yet been exercised, but the rights should be 'substantive', i.e. the body must have the practical ability to exercise that right. Protective rights relate to fundamental changes to the activities of the ALEO or apply in exceptional circumstances; protective rights are not indicators of power.

30. Where it is difficult to determine whether a body's rights are sufficient to give it power over an ALEO, it is necessary to consider whether the body has the practical ability to direct the relevant activities unilaterally. Examples of

considerations are provided at paragraph A20 of IPSAS 35, and include the body being able (without having the contractual right) to:

- appoint or approve the ALEO's key management personnel who have the ability to direct the relevant activities
- direct the ALEO to enter into, or veto any changes to, significant transactions.

31. Paragraph AG 21 of IPSAS 35 lists other indications that, in combination with other rights, may indicate power. These include the following:

- The body funds a significant portion of the ALEO's operations which the ALEO depends on.
- The body guarantees a significant portion of the ALEO's obligations, which the ALEO depends on.
- A significant portion of the ALEO's activities either involve or are conducted on behalf of the body.

32. Auditors may find it helpful to use the checklist at Appendix 1 of this module to help evaluate whether a body has power over an ALEO through binding arrangements or provisions in founding documents.

33. While IFRS 10 refers to financial returns (e.g. dividends), IPSAS 35 refers also to non-financial benefits. Non-financial benefits can occur when the activities of the ALEO are congruent with the body's objectives and support it in achieving those objectives, e.g. service potential generated by the ALEO on behalf of a body. Congruent activities may be undertaken voluntarily or the body may have the power to direct the other entity to undertake those activities.

34. Paragraph 33 of IPSAS 35 provides the following examples of non-financial benefits:

- The ability to benefit from the specialised knowledge of another entity.
- The value to the body of the other entity undertaking activities that assist the body in achieving its objectives.
- Improved outcomes, or more efficient delivery of outcomes.
- More efficient or effective production and delivery of goods and services, or having a higher level of service quality than would otherwise be the case.

35. Auditors should evaluate whether the body has properly classified each ALEO as at 31 March 2023.

5.4: Disclosure

Section 8.2 of the FReM requires bodies to adopt IFRS 12 Disclosures of Interests in Other Entities, subject to the adaptations to the other standards in respect of departments and agencies.

Information on structured entities is not properly disclosed

36. Paragraphs 14 to 17 of IFRS 12 require the disclosure of information that enables users to evaluate the nature of, and changes in, the risks associated with the body's interests in structured entities. For example, the body should have disclosed:

- the terms of any contractual arrangements that could require them to provide financial support to a consolidated structured entity
- the type and amount of financial or other support provided where there was no contractual obligation, and the reasons for providing the support
- any current intentions to provide financial or other support.

37. There are also specific requirements at paragraphs 24 to 31 in respect of unconsolidated structured entities (e.g. ALEOs that are not subsidiaries), including disclosing a summary of the following:

- The carrying amounts of the assets and liabilities relating to unconsolidated structured entities, and the line items in the Statement of Financial Position in which they are recognised.
- The amount that best represents the body's maximum exposure to loss from its interests in unconsolidated structured entities, including how that amount is determined.
- A comparison of the carrying amounts of the assets and liabilities that relate to unconsolidated structured entities and the maximum exposure to loss.

38. Auditors should evaluate whether:

- the body has properly disclosed the required information on structured entities in 2022/23
- the disclosures are complete, clear, concise, and free from misstatement.

39. The disclosure requirements for unconsolidated structured entities are required even where group financial statements are not prepared. Where that is

the case in 2022/23, auditors should evaluate whether the disclosures have been made in the body-only financial statements.

Significant judgements and assumptions are not disclosed

40. Paragraph 7 of IFRS 12 requires bodies to disclose information on the significant judgements and assumptions made in determining whether it has control, joint control or significant influence..

41. Auditors should evaluate whether:

- the body has properly disclosed the required information on judgements and assumptions in 2022/23
- the disclosures are complete, clear, concise, and free from misstatement.

Appendix 1 Assessing power over an ALEO

Question	Auditor assessment
1 Does the audited body have the right to give policy directions to the governing body of the ALEO that give the audited body the ability to direct its relevant activities?	
2 Does the audited body have the right to appoint, reassign or remove members of the ALEO's key management personnel who have the ability to direct the relevant activities?	
3. Does the body have the right to approve or veto the ALEO's budgets?	
4. Does the body have the right to direct the ALEO to enter into, or veto any changes to, transactions for the benefit of the body?	
5. Does the body have the right to veto key changes to the ALEO, such as the sale of a major asset or of the ALEO as a whole?	
6. Does the body have the practical ability to direct the relevant activities of the ALEO unilaterally?	
<p>7. Are there other indications that may indicate power including:</p> <ul style="list-style-type: none"> – the body funding a significant portion of the ALEO's operations – the body guaranteeing a significant portion of the ALEO's obligations – a significant portion of the ALEO's activities involve or are conducted on behalf of the body? 	

Technical Guidance Note 2023/1 - Module 5

Risks of misstatement in group financial statements in 2022/23

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Audit Scotland, 4th Floor, 102 West Port, Edinburgh EH3 9DN
Phone: 0131 625 1500 Email: info@audit-scotland.gov.uk
www.audit-scotland.gov.uk

Technical Guidance Note 2023/1

Module 6

**Risks of misstatement in leases and service
concession arrangements in 2022/23**



 **AUDIT SCOTLAND**

Prepared by appointed auditors in the central government, health and college sectors

31 January 2023

Contents

Introduction	3
6.1: Lease identification	4
7.2: Body as lessor	5
7.3: Body as lessee	10
6.3: Service concession arrangements	16
Appendix 1 Indicators of finance lease	20

Introduction

Purpose and use of this module

1. This module of TGN 2023/1 provides guidance on the risks of misstatement in:

- Leases (Sections 1 to 3)
- Service concession arrangements (Section 4).

Changes in risks of misstatement in 2022/23

2. Section 8.1 of the [2022/23 FReM](#) has been amended to require bodies to account for leases in accordance with [IFRS 16 Leases](#) subject to adaptations and interpretations for the public sector context are set out in chapter 6 of the FReM and explained in [application guidance](#) from Treasury.

Consulting with Professional Support

3. Auditors should consult with Professional Support by sending an email to TechnicalQueries@audit-scotland.gov.uk

6.1: Lease identification

A lease is a contract that conveys the right to use an asset for a period of time

Leases are not complete or do not exist

4. Under IFRS 16, a contract is an agreement that creates enforceable rights and obligations. The FReM adapts that definition to include intra-government agreements where non-performance may not be enforceable by law. A lease is a contract if it conveys the right to control the use of an identified asset (the underlying asset) for a period of time.

5. Control means having the right to obtain substantially all of the economic benefits and service potential from the underlying asset throughout the period of use. Paragraphs B9 to B31 of IFRS 16 provide guidance in the assessment of control.

6. It should be noted that:

- The FReM adapts the definition of a lease in IFRS 16 to remove the need for 'consideration'. This means that leases include those agreements that do not include the provision of consideration (referred to as peppercorn leases at nil consideration).
- A body is required to assess whether a contract meets the definition of a lease at inception of a contract (i.e. the earlier of the date of a lease agreement and the date of commitment by the parties to the principal terms and conditions of the lease).
- A body should not reassess control on transition to IFRS 16 at 1 April 2022 except in relation to leases for nil consideration. Instead, the body is required to apply IFRS 16 only to contracts that were previously identified as leases under IAS 17 and related standards.
- Reassessment of the right to control use is required only where the terms and conditions of the contract are changed.
- Each lease component within a contract should generally be accounted for as a lease separately from any non-lease components.

7. In a lease, a body may be either:

- the lessor, if it conveys the right to use the asset to another entity (section 2)
- the lessee, where the right to use the asset is conveyed to the body (section 3).

8. Auditors should evaluate whether a body has identified all its leases, as defined by the FReM, at 31 March 2023.

7.2: Body as lessor

A body as lessor is required to classify a lease as either a finance lease or an operating lease. The accounting treatment of each classification is different.

Leases are not properly classified

9. Where a body is the lessor, it is required to classify a lease at its inception as either a finance lease or an operating lease. The difference is that a finance lease transfers substantially all the risks and rewards incidental to ownership of an asset. Classification depends on the substance of the transaction, rather than the form of the contract. [IFRS 16](#) provides the following guidance:

- Paragraph 63 provides examples of situations that individually or in combination would normally lead to a lease being classified as a finance lease.
- Paragraph 64 gives indicators of situations that could also lead to a lease being classified as a finance lease.

10. Paragraph 65 of IFRS 16 advises that the above examples and indicators are not always conclusive, and the lease should be classified as an operating lease if it is clear that the lease does not transfer substantially all risks and rewards incidental to ownership.

11. Paragraph B55 advises that the land and buildings elements of a lease should be considered separately for the purposes of lease classification. The land element is normally classified as an operating lease unless title is expected to pass to the lessee by the end of the lease term.

12. Under paragraph 66, the classification of a lease should only be reassessed if there is a lease modification (i.e. a change in the scope of the lease that was not part of the original terms). Changes in estimates (e.g., in respect of the economic life or the residual value of the leased property) or changes in circumstances (e.g. default by the lessee) should not result in reclassification.

13. When classifying a sublease, if the body (as intermediate lessee) has accounted for the head lease as a short-term lease, paragraph B58 requires it to (as intermediate lessor) classify the sublease as an operating lease. Where the head lease is not accounted for as a short-term lease, the body should classify the sublease by reference to the right to use the asset arising from the head lease.

14. On transition to IFRS 16 on 1 April 2022, a body as intermediate lessor is required by paragraph C15 of IFRS 16 to:

- reassess subleases that were classified as operating leases applying IAS 17 that are ongoing at 1 April 2022 to determine whether each sublease should be classified as an operating lease or a finance lease applying IFRS 16. The assessment should be on the basis of the remaining contractual terms and conditions
- for subleases that were classified as operating leases applying IAS 17 but finance leases applying IFRS 16, account for the sublease as a new finance lease entered into at 1 April 2022.

15. Auditors should evaluate whether for leases at 31 March 2023:

- lease classification has been made by the body at the inception of the lease
- the body has considered the examples and indicators of a finance lease in IFRS 16 (auditors may find it useful to use the checklist in the appendix to this module)
- the land and buildings elements of a lease have been considered separately
- reclassification has been considered if there has been a lease modification
- subleases have been properly classified.

Accounting entries for finance leases are not appropriate

16. Accounting requirements where the body is the lessor in a finance lease are set out at paragraphs 67 to 80 of IFRS 16. For finance leases at 31 March 2023 where the body is the lessor, auditors should evaluate whether:

- the assets have been recognised as a receivable at an amount equal to the net investment in the lease (i.e., the lease payments receivable by the body as lessor plus any unguaranteed residual value of the underlying asset discounted at the interest rate implicit in the lease)
- the lease payments included in the measurement of the net investment in the lease comprise the payments for the lessee's right to use the underlying asset (less any lease incentives payable) during the lease term that are not received at the commencement date listed at paragraph 70 of IFRS 16
- lifetime expected credit losses on the lease receivables have been recognised where appropriate (explained in Module 3)
- the lease payment receivable has been treated as repayment of principal and finance income

- the finance income has been calculated so as to produce a constant periodic rate of return on the net investment
- a lease modification has been accounted for as a separate lease if it adds the right to use one or more underlying assets and the consideration for the lease increases by an amount commensurate with the stand-alone price.

17. On transition to IFRS 16 on 1 April 2022, where a body is lessor in a pepper corn at nil consideration, a FReM adaptation requires:

- the underlying asset being provided to the third party to be derecognised
- any unguaranteed residual value to be recognised
- comparative information to not be restated
- the effect to be recognised as an adjustment to the opening balance of reserves at 1 April 2022.

18. Auditors should evaluate whether leases for nil consideration have been properly accounted for at 1 April 2022.

Accounting entries for operating leases are not appropriate

19. Accounting requirements where the body is the lessor in an operating lease are set out at paragraphs 81 to 88 of IFRS 16. For operating leases at 31 March 2023 where the body is the lessor, auditors should evaluate whether:

- the assets are properly presented in the Statement of Financial Position
- costs incurred in earning the lease income have been recognised in the SoCNE
- the depreciation policy for the underlying asset is consistent with the depreciation policy for similar assets, and depreciation has been accounted for in the same way
- income has been recognised on a straight-line basis over the lease term, or another systematic basis that is more representative of the pattern in which the benefit from the use of the underlying asset is diminished
- initial direct costs incurred in obtaining an operating lease have been added to the carrying amount of the underlying asset and recognised as an expense over the lease term on the same basis as the lease income.

Sale and lease back transactions where the body is buyer/lessor are not complete

20. A sale and leaseback transaction involves another entity (seller/lessee) transferring an asset to the body (buyer/lessor) and then leasing it back.

21. Auditors should evaluate whether the body has identified all sale and leaseback transactions where it is the buyer/lessor during 2022/23.

Accounting entries for sale and lease back transactions where the body is buyer/lessor are not appropriate

22. The appropriate accounting treatment for sale and lease back transactions depends on whether the asset transfer satisfies the requirements of IFRS 15 to be treated as a sale. The options are summarised in the following table:

Action	Sale	Not a sale
Transfer	Recognise purchase of asset	No recognition of asset
Leaseback	Account for as a lease	Recognise a financial asset equal to transfer proceeds

23. If the fair value of the consideration for the sale of an asset does not equal the fair value of the asset, or if the payments for the lease are not at market rates, paragraph 101 of IFRS 16 requires the adjustments set out in the following table to measure the sale proceeds at fair value:

Market terms	Account for as
Below	Prepayment of lease payments
Above	Additional financing provided by the buyer/lessor

24. Auditors should evaluate whether the body has properly accounted for all sale and leaseback transactions during 2022/23 where it is the buyer/lessor.

Information on leases where the body is lessor is not properly disclosed

25. The disclosure requirements where the body is the lessor in a lease are set out at paragraphs 89 to 97 of IFRS 16. They are summarised in the following table:

Finance	Operating
Finance income on the net investment in the lease; and income relating to variable lease payments not included in the measurement of the net investment in the lease.	Lease income, separately disclosing income relating to variable lease payments that do not depend on an index or a rate.
Qualitative and quantitative explanation of the significant changes in the carrying amount of the net investment in finance leases.	For items of property, plant and equipment, a disclosures required by IAS 16 (by class of underlying asset) separately from owned assets.
A reconciliation of the undiscounted lease payments to the net investment in the lease.	

Finance	Operating
<p>Maturity analysis of the lease payments receivable, showing the undiscounted lease payments to be received on an annual basis for a minimum of each of the first five years and a total of the amounts for the remaining years.</p>	
<p>Additional qualitative and quantitative information about leasing activities necessary for users to assess the effect that leases have on the financial position, financial performance and cash flows of the body.</p>	
<p>26. Auditors should evaluate whether the body as lessor has properly disclosed the required information in 2022/23.</p>	

7.3: Body as lessee

Where a body is lessee, there is no distinction between finance leases and operating leases. Lessees are required to recognise a right-of-use asset and any lease liability.

Right-of-use assets are not properly measured

27. A right-of-use asset represents a lessee's right to use the underlying asset for the lease term. Measurement requirements are set out at paragraphs 23 to 25 and 29 to 35 of IFRS 16, and are summarised in the following table:

Measurement	Requirement
Initial measurement – commercial terms	<p>At cost, i.e:</p> <ul style="list-style-type: none"> the amount of the initial measurement of the lease liability any lease payments made at or before the commencement date (less any lease incentives received) any initial direct costs incurred by the lessee an estimate of dismantling, removal and restoration costs.
Initial measurement – peppercorn or for nominal lease payments	Current value in existing use or fair value, depending on whether the right-of-use asset will be held for its service potential.
Subsequent measurement	<p>The FReM requires current value in accordance with the adaptations to IAS 16 (explained in Module 1).</p> <p>As a practical expedient, the cost model (explained below this table) can be used as a proxy for current value where appropriate.</p>
Depreciation	<p>Depreciation should be charged from the commencement date of the lease until either the:</p> <ul style="list-style-type: none"> end of the useful life of the underlying asset (if the lease transfers ownership); or earlier of (i) the end of the useful life of the right-of-use asset or (ii) the end of the lease term (if the lease does not transfer ownership).

28. Chapter 10.3 of the FReM explains the cost model that can be used as a proxy for current value. The cost model is set out at paragraphs 30 to 33 of IFRS 16 and means adjusting the cost of the right-of-use asset at initial measurement for any:

- accumulated depreciation and impairment losses

- remeasurement of the lease liability
- changes in the estimated costs of dismantling, removal or restoration.

29. The cost model is not anticipated to be an appropriate proxy for current value where:

- a longer-term lease has no terms that require lease payments to be updated for market conditions (such as rent reviews), or there is a significant period of time between those updates
- the fair value or current value in existing use of the underlying asset is likely to fluctuate significantly due to changes in market prices (e.g. property assets).

30. There are two exemptions to the measurement and presentation requirements, one of which is optional. Lease payments associated with leases that meet the exemption definitions should be recognised as an expense. The exemptions are summarised in the following table:

Exemption	Definition	Scope
Short term lease (required)	A lease that, at the commencement date, has a lease term of 12 months or less, unless it contains a purchase option.	Measurement of right-of-use asset and lease liability, and presentation requirements.
Low value (optional)	The underlying asset is of low value when new. Guidance on making the assessment is provided by IFRS 16.	

31. Auditors should evaluate whether right-of-use assets at 31 March 2023 are properly measured.

Lease liability is not properly measured

32. The lease liability is the obligation to make lease payments over the lease term. Measurement requirements are set out at paragraphs 26 to 28 and 36 to 38 of IFRS 16. The requirements are summarised in the following table:

Measurement	Requirement
Initial measurement – commercial terms	<p>The present value of outstanding lease payments (listed at paragraph 27 of IFRS 16) discounted using the implicit interest rate. Where that rate cannot be readily determined, the FReM requires:</p> <ul style="list-style-type: none"> • a nominal lease discount rate of 3.51% to be used as the incremental borrowing rate as set out in PES(2022)8 or • an external borrowing rate, if more appropriate.

Measurement	Requirement
Initial measurement – peppercorn or for nominal lease payments, or for nil consideration	As above, but the difference between the fair value of the right-of-use asset and the lease liability is recognised as part of the adjustment to opening balances.
Subsequent measurement	<p>The carrying amount of the lease liability is:</p> <ul style="list-style-type: none"> • increased to reflect interest • reduced to reflect the lease payments made • remeasured for any reassessment or lease modifications or to reflect revised in-substance fixed lease payment (see below this table for more information on these items).

33. Paragraphs 39 to 42 of IFRS 16 require the lease liability to be remeasured where there is a change in:

- the lease payments or the lease term
- the assessment of the option to purchase the underlying asset
- the amounts expected to be payable under a residual value guarantee
- future lease payments resulting from a change in an index or a rate used to determine those payments.

34. For a lease modification that is not accounted for as a separate lease:

- paragraph 45 of IFRS 16 requires the body as lessee (at the effective date of the lease modification) to remeasure the lease liability by discounting the revised lease payments using the interest rate implicit in the lease for the remainder of the lease term (or the lessee's incremental borrowing rate if the implicit rate cannot be readily determined)
- paragraph 46 of IFRS 16 requires the body to account for the remeasurement of the lease liability by:
 - decreasing the carrying amount of the right-of-use asset to reflect the lease modifications that decrease the scope of the lease
 - making a corresponding adjustment to the right-of-use asset for all other lease modifications.

35. Paragraph B42 of IFRS 16 explains that in-substance fixed lease payments are payments that contain variability but in reality are fixed.

36. Auditors should evaluate whether the lease liability at 31 March 2023 is properly measured.

Sale and lease back transactions where the body is seller/lessee are not complete

37. A sale and leaseback transaction involves the body (seller/lessee) transferring an asset to another entity (buyer/lessor) and then leasing it back.

38. Auditors should evaluate whether the body has identified all sale and leaseback transactions where it is the seller/lessee during 2022/23.

Accounting entries for sale and lease back transactions where the body is seller/lessee are not appropriate

39. The appropriate accounting treatment depends on whether the asset transfer satisfies the requirements of IFRS 15 to be treated as a sale. The options are summarised in the following table:

Action	Sale	Not a sale
Transfer	Derecognise asset	Continue to recognise transferred asset
Leaseback	Recognise the amount of any gain or loss that relates to the rights transferred to the buyer-lessor	Recognise a financial liability equal to transfer proceeds

40. If the fair value of the consideration for the sale of an asset does not equal the fair value of the asset, or if the payments for the lease are not at market rates, paragraph 101 of IFRS 16 requires the adjustments set out in the following table to measure the sale proceeds at fair value:

Market terms	Account for as
Below	Prepayment of lease payments
Above	Additional financing provided by the buyer/lessor

41. Auditors should evaluate whether the body has properly accounted for all sale and leaseback transactions during 2022/23 where it is the seller/lessee.

Leases are not properly accounted for on transition

42. On transition to IFRS 16 at 1 April 2022, a body as lessee is required to apply IFRS 16 to its leases retrospectively with the cumulative effect of initial application recognised at that date. The body should:

- not restate comparative information
- recognise the cumulative effect of initial application as an adjustment to the opening balance of taxpayer equity.

43. The following table summarises the treatment (set out at Appendix C of IFRS 16) at initial application on 1 April 2022 of peppercorn leases at nil consideration and leases previously classified as an operating lease:

	Nil consideration	Operating lease
Right-of-use asset	Recognise at fair value. Where fair value cannot be obtained at a commensurate cost, current value should be used as a proxy.	Recognise at an amount equal to the lease liability, adjusted by the amount of any prepaid or accrued lease payments on 31 March 2022.
Lease liability	No liability due to nil consideration. Gain on transition should be recognised as a donated asset as an adjustment to opening balances of taxpayer equity.	Recognise a lease liability at the present value of the remaining lease payments, discounted using the discount rate set out by the Treasury at 1 April 2022.
Impairment	Carry out an impairment assessment, unless the body applies the practical expedient at paragraph C10 b) of IFRS 16. This expedient allows the body to rely on any assessment of whether leases are onerous under IAS 37 carried out on 31 March 2022 as an alternative to performing an impairment review. The body is required to adjust the right-of-use asset by the amount of any such provision.	
Exemptions	Apply the low value and short term lease exemptions. The short term lease exemption applies to any leases for which the lease term ends by 31 March 2023. The body should include the cost associated with those leases within the disclosure of short-term lease expense in 2022/23.	
Practical expedients	The body may use a number of practical expedients, which may be applied on a lease-by-lease basis. The body: <ul style="list-style-type: none"> • may apply a single discount rate to a portfolio of leases with reasonably similar characteristics • is required to use hindsight in determining the lease term if the contract contains options to extend or terminate the lease. 	

44. For leases that were classified as finance leases applying IAS 17, the carrying amount of the right-of-use asset and the lease liability at 1 April 2022 should be the carrying amount of the lease asset and lease liability at 31 March 2022.

45. Auditors should evaluate whether the cumulative effect of initially applying IFRS 16 at 1 April 2022 has been properly accounted for.

Leases are not properly presented in the Statement of Financial Position

46. Paragraph 47 of IFRS 16 sets out the requirements for presenting leases in the Statement of Financial Position (or disclosed in notes). They are summarised in the following table:

Item	Statement of Financial Position	Notes
Right-of-use asset	Either present: <ul style="list-style-type: none"> separately from other assets; or include within the same line item if they were owned; or within the investment property line item, where applicable. 	If not presented separately, disclose the line items in the Statement of Financial Position that includes the right-of-use assets.
Lease liabilities	Present separately from other liabilities.	If not presented separately, disclose the line items in the Statement of Financial Position that includes the lease liabilities.

47. Auditors should evaluate whether leases are properly presented in the Balance Sheet at 31 March 2023.

Information on leases where the body is the lessee is not properly disclosed

48. The disclosure requirements where the body is the lessee in a lease are set out at paragraphs 53 to 60A of IFRS 16. Information to be disclosed includes the following:

- Certain items are listed at paragraph 53 which require to be disclosed in a table (unless another format is more appropriate). These include the expense relating to leases of low-value assets, but this should exclude short-term leases.
- A maturity analysis of lease liabilities separately from the maturity analyses of other financial liabilities.
- Additional qualitative and quantitative information about leasing activities necessary for users to assess the effect that leases have on the financial position, financial performance and cash flows of the body.
- The fact that the leases of low-value assets exemption has been applied, where appropriate.

49. IFRS 16 Appendix C sets out disclosure requirements for lessees related to initial application on 1 April 2022. These include:

- a description of the transitional provisions
- the weighted average incremental borrowing rate applied to lease liabilities at 1 April 2022
- an explanation of any difference between operating lease commitments at 31 March 2022 (discounted using the incremental borrowing rate at 1 April 2022) and lease liabilities recognised at 1 April 2022
- the practical expedients applied.

50. Auditors should evaluate whether the body as lessee has properly disclosed the required information in 2022/23.

6.3: Service concession arrangements

A service concession arrangement involves a private sector operator using an asset to provide a public service and being paid over the period of the arrangement.

Service concession arrangements are not complete and do not exist

51. Paragraphs 10.1.45 to 10.1.66 of the [FReM](#) deal with the accounting treatment of contracts that meet the definition of service concession arrangements in [IFRIC 12 Service Concession Arrangements](#).

52. In a service concession arrangement the body controls:

- the services the operator must provide, the service recipients, the price levied, and location
- any significant residual interest in the asset at the end of the arrangement.

53. Non-Profit Distributing (NPD), Public Private Partnership (PPP) and Private Finance Initiative (PFI) contracts are generally service concession arrangements, but some contracts that were not planned as NPD/PFI/PPP arrangements could also meet the 'controls' criteria.

54. Other features of typical service concession arrangements are:

- the operator is responsible for at least some of the management of the service concession assets and related services and does not merely act as an agent of the body
- the contract sets initial prices levied by the operator and regulates price revisions over the period
- the operator is obliged to hand over the service concession asset to the body in a specified condition at the end of the period for little incremental consideration.

55. Arrangements that will not be service concessions include:

- a contract solely to construct a property for a public body
- a lease of a property where the only services provided by the lessor are directly related to the property itself (e.g. repairs and maintenance) and where the amounts paid are not usually abated for failure to carry out these services

- arrangements to outsource the operation of internal services (such as catering, building maintenance and finance) that have no specifications relating to a particular asset.

56. Auditors should evaluate whether the body has identified its service concession arrangements during 2022/23.

Service concession assets are not complete

57. The asset is usually constructed or developed by the operator but may also be an upgrade to an existing asset of the body. Examples of service concession assets include prisons and telecommunications networks. They also include assets for the direct use of a body which contribute to the provision of services to the public, e.g. office and administrative buildings.

58. The recognition criteria for the service concession asset (which is the same as for other property, plant and equipment explained in Module 1) may be met during the construction or development period.

59. Auditors should evaluate whether the body has recognised a service concession asset during the construction period in 2022/23 if the recognition criteria are met.

Accounting entries for service concession assets are not appropriate

60. Service concession assets should be depreciated, revalued and reviewed for impairment in the same way as other property, plant and equipment.

61. Auditors should evaluate whether:

- a service concession asset constructed or developed by the operator has been initially recognised at fair value (or an existing public asset has been reclassified and the upgrade costs recognised at fair value)
- fair value agrees to the element of the payments paid to the operator for the asset in accordance with the contract (or where not separable, the estimate of fair value is reasonable)
- the asset has been subsequently revalued to current value
- depreciation, impairment and gains or losses on revaluation have been treated in the same way as other property, plant and equipment.

Service concession liabilities are not complete or not properly measured

62. Where a public body recognises a service concession asset constructed or developed by the operator, it is required to recognise a liability initially measured at the same amount as the asset but adjusted by the amount of any other consideration, e.g. cash.

63. Auditors should evaluate whether a liability has been recognised at 31 March 2023 and initially measured at the same amount as the service concession asset adjusted for any other consideration.

64. The 2022/23 FReM currently requires bodies to remeasure the lease liability when a change in indices causes a change in future lease payments and that change has taken effect in the cash flow (instead of expensing the payment as incurred). However, Treasury intends deferring that requirement until 2023/24. Professional Support will confirm whether that deferral takes place in due course.

65. Auditors should evaluate whether the liability has been remeasured at 31 March 2023 where the change in indices has affected the cash flow and resulted in a change to future lease payments.

Accounting entries for the unitary charge are not appropriate

66. The treatment of the unitary charge depends on whether the contract terms can be separated between the service element and the construction element. This is explained at paragraphs 10.1.57 to 10.1.62 of the FReM and is summarised in the following table:

Separable	Not separable
<p>Separate into the:</p> <ul style="list-style-type: none"> • service element which is expensed as incurred; and • construction element which should be analysed between the repayment of the liability (reflected in the Statement of Financial Position) and an interest element which is expensed in accordance with the requirements for a finance lease (explained at section 1) 	<p>Divide the unitary payment into:</p> <ul style="list-style-type: none"> • an estimate of the service element to be expensed • an interest element determined using the rate implicit in the contract (or if that is not available, the cost of capital rate) to be expensed • the repayment of the liability reflected in the Statement of Financial Position

67. Auditors should evaluate whether:

- the service element has been charged to operating expenditure
- the construction element has been accounted for as if it were a finance lease and allocated into a repayment of the liability and a finance charge
- the estimates are reasonable where the above cannot be separated.

Accounting entries for existing assets used in part payment are not appropriate

68. A public body may provide the operator with access to existing assets (that are not to be used in the service concession arrangement) in exchange for reduced or eliminated payments. The accounting treatment depends on whether the transfer is permanent as explained in the following table:

Permanent transfer or finance lease	Other arrangements
<ul style="list-style-type: none"> • Derecognise the asset • Recognise the reduction in the liability in the Statement of Financial Position (and any other consideration received) • Recognise any difference between the carrying amount and the total consideration in operating expenditure 	Account for arrangement as an operating lease

69. Auditors should evaluate whether the body has properly accounted in 2022/23 for any existing assets transferred to the operator in order to reduce payments.

Accounting entries for prepayments are not appropriate

70. Service concession arrangements may be structured to require payments to be made before the related service concession asset is recognised on the Statement of Financial Position. Auditors should evaluate whether these payments have been:

- recognised as prepayments
- applied to reduce the outstanding liability when it is recognised.

71. Any prepayments should be taken into account when estimating the fair value of the asset and liability and the separation of payments into the liability, interest and service charge elements.

Information on embedded derivatives is not properly disclosed

72. IFRS 7 requires disclosure of an embedded derivative in cases where an element of the unitary payment varies in accordance with an underlying measure that, rather than being based on a relevant index, is a multiplier of a relevant index (e.g. RPI plus a percentage).

73. Auditors should evaluate whether the disclosure of the embedded derivative in 2022/23 is complete, clear, concise, and free from misstatement.

Appendix 1 Indicators of finance lease

Indicators	Yes/No/N/A
<p>1. Does the lease transfers ownership of the underlying asset to the lessee by the end of the lease term?</p> <p>[Note: Generally land will be an operating lease but in this situation it would be classified as a finance lease.]</p>	
<p>2. Does the lessee have the option to purchase the underlying asset at a price that is expected to be sufficiently lower than the fair value at the date the option becomes exercisable for it to be reasonably certain that, at the inception date, that the option will be exercised?</p>	
<p>3. Is the lease term for the major part of the economic life of the underlying asset?</p> <p>[Note: This is relevant even if title is not transferred.]</p>	
<p>4. Does the present value of the lease payments at the inception date amount to at least substantially all of the fair value of the underlying asset?</p> <p>[Note: This indicator does not apply to leases on non-commercial terms, i.e., those with nominal or at peppercorn rents, or for nil consideration.]</p>	
<p>5. Is the leased property of such a specialised nature that only the lessee can use it without major modification?</p>	
<p>6. Would the lessor's losses associated with the cancellation of the lease by the lessee be borne by the lessee?</p>	
<p>7. Do gains or losses from the fluctuation in the fair value of the residual accrue to the lessee?</p>	
<p>8. Does the lessee have the ability to continue the lease for a secondary period at a rent that is substantially lower than market rent?</p>	

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Technical Guidance Note 2023/1 Module 6

Risks of misstatement in leases and service concession arrangements in 2022/23

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Audit Scotland, 4th Floor, 102 West Port, Edinburgh EH3 9DN
Phone: 0131 625 1500 Email: info@audit-scotland.gov.uk
www.audit-scotland.gov.uk

Technical Guidance Note 2023/1

Module 7

Risks of misstatement in grants and other income in
2022/23



 **AUDIT SCOTLAND**

Prepared for appointed auditors in the central government, health and college sectors

31 January 2023

Contents

Module 7: introduction	3
7.1: Grant in aid and grant	4
7.2: Income from contracts with customers	6
7.3: Income from fines and penalties	9

Module 7: introduction

Purpose and use of this module

1. This module of TGN 2023/1 provides guidance on the risks of misstatements in the following aspects of grants and other income:

- Grant in aid (from sponsor departments) and other grants (from other paying agencies) (section 1).
- Income from contracts with customers (section 2).
- Income from fines and penalties (section 3).

2. Other sources of income are covered in other modules as follows:

- Income from the disposal of property, plant and equipment (Module 1.4).
- Income from financial assets (Module 3).

Consulting with Professional Support

3. Auditors should consult Professional Support by sending an email to TechnicalQueries@audit-scotland.gov.uk.

7.1: Grant in aid and grant

Grant in aid is pre-funding provided to NDPBs by sponsor departments and is accounted for on a cash basis. Grant is received from sources other than sponsor departments and is accounted for based on IAS 20 interpreted by the [FReM](#).

Funding is not properly classified between grant in aid and grant

4. The SPFM chapter on [Grant and Grant in Aid](#) distinguishes between the two forms of funding as follows:

- Grant in aid refers to pre-funding provided to NDPBs by sponsor departments to finance their ongoing operating expenditure
- Grant is received from sources other than sponsor departments.

5. Auditors should evaluate whether the body has properly classified grant in aid and grant in 2022/23

The accounting treatment of grant in aid is not appropriate

6. Section 8.2 of the [FReM](#) requires grant in aid to be accounted for on a cash basis, unless an exception has been agreed by the sponsoring department. FReM paragraph 11.1.14 requires grant in aid to be recognised as financing (i.e. by crediting it to reserves) rather than as income, again unless an exception has been agreed.

7. Auditors should evaluate whether grant in aid in 2022/23 has been recognised as financing and on cash basis. Where either is not the case, auditors should evaluate whether there is evidence from the sponsor department supporting the treatment adopted.

The accounting treatment of grant is not appropriate

8. Section 8.2 of the FReM requires bodies to account for grants in accordance with [IAS 20 Accounting for Government Grants and Disclosure of Government Assistance](#), subject to an adaptation which requires immediate recognition rather than over the period of the related expenditure.

9. Grants received should therefore be recognised immediately as income unless any conditions that could lead to their return have not been satisfied by the year end. There is no definition of what constitutes 'reasonable assurance' in this context but, in the view of Professional Support, the body should be willing and able to comply with the conditions.

10. Any conditions attached to the grant are normally set out in the offer letter from the grant-paying body. There may be cases where there is evidence that stipulated conditions that could lead to return will not be enforced in practice, (e.g. informal communications or past practice), in which case Professional Support considers it reasonable to treat the conditions as not applying. The various scenarios, and their impact on the recognition of the grant, are summarised in the following table:

Scenario	Impact on recognition
Conditions that require return if not complied with - satisfied by year end	Recognise as income immediately
Conditions that restrict use of grant but do not require return	Recognise as income immediately
Condition that requires return if a specified future event occurs	Recognise as income immediately [Note: a return obligation should be recognised when it is expected that the condition will be breached]
Conditions that require return if not complied with - reasonable assurance at year end they will be satisfied	Recognise as a deferred credit
Conditions that require return if not complied with - no reasonable assurance they will be satisfied	Recognise liability at year end

11. Auditors should evaluate whether grants receivable in 2022/23 have been recognised:

- as income where there are no unsatisfied conditions at 31 March 2023 that could lead to their return
- as a deferred credit where there are unsatisfied conditions at 31 March 2023 that could lead to their return but there is evidence that the body is willing and able to comply with the conditions (i.e. reasonable assurance that they will be satisfied).

12. Where there is no reasonable assurance that conditions that could lead to the grant being returned are going to be met (and the grant becomes repayable), auditors should evaluate whether a liability has been recognised at 31 March 2023.

7.2: Income from contracts with customers

Income received for goods or services under a contract is accounted for in accordance with IFRS 15.

Income from contracts with customers is not complete or did not occur

13. The [FReM](#) Section 8.2 requires bodies to recognise income from contracts in accordance with [IFRS 15 Revenue from Contracts with Customers](#), subject to adaptations. IFRS 15, as adapted by the FReM, contains the following key definitions:

Term	Definition
Contract	<p>An agreement between two or more parties that creates enforceable rights and obligations. They can be written, oral or implied.</p> <p>The FReM adapts IFRS 15 to expand the definition of a contract to include legislation or regulations which provides the ability for the body to impose a charge on the customer and the requirement for the customer undertaking the relevant activities to be liable to pay the charge. Guidance is provided in chapter 1 of application guidance from Treasury.</p>
Customer	A party that has contracted with a body to obtain goods or services that are an output of the body's normal operating activities in exchange for consideration.

14. A body is required to account for a contract with a customer where all the criteria at paragraph 9 of IFRS 15 (summarised in the following table) are satisfied:

Criteria	Explanation
Approval and commitment	The parties have approved the contract and are committed to perform their respective obligations.
Rights	The body can identify each party's rights.
Payment terms	The body can identify the payment terms.
Commercial substance	The contract has commercial substance (i.e. the risk, timing or amount of the body's future cash flows is expected to change as a result of the contract).
Consideration	It is probable that the body will collect the expected consideration.

15. Auditors should evaluate whether the body has identified all its contracts with customers during 2022/23 which meet all the above criteria. This may include application fees for IT services, retail sales, levies etc.

Income from contracts is not recognised as performance obligations are satisfied

16. A body is required to identify at the inception of the contract each promise to transfer to the customer a distinct good or service (i.e. each performance obligation). These include:

- performing a contractually agreed task
- selling goods purchased or produced by the body
- developing an asset on behalf of a customer.

17. Income should be recognised when the body satisfies each performance obligation (i.e. when the customer obtains control). This is straightforward when the obligations are satisfied at a point in time. However, obligations are satisfied over time if:

- the customer simultaneously receives and consumes the benefits as the body performs
- the body's performance creates an asset that the customer controls as it is created.

18. For each performance obligation satisfied over time, income should be recognised by measuring the progress towards complete satisfaction of that performance obligation.

19. Auditors should evaluate whether the body has:

- identified each performance obligation at the inception of contracts with customers
- determined whether each obligation is satisfied over time or at a point in time
- recognised income in 2022/23 when (or as) it satisfies each performance obligation.

Income from contracts is not properly measured

20. When (or as) a performance obligation is satisfied, the body is required to recognise as income the amount of the transaction price (i.e. the expected consideration) that is allocated to that obligation. The consideration should be adjusted for the effects of the time value of money if the period between transfer and payment is expected to be more than one year.

21. Auditors should evaluate whether:

- the amount of the transaction price allocated to each performance obligation has been recognised during 2022/23 when (or as) the obligation is satisfied
- the estimate of any variable amount is reasonable
- the time value of money has been taken into account where significant.

The contract is not properly reflected in the Statement of Financial Position

22. The contract should be reflected in the Statement of Financial Position as a contract liability, asset, or receivable as explained in the following table:

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

23. Auditors should evaluate whether the presentation of contracts in the Statement of Financial Position at 31 March 2023 is complete and free from misstatement.

Loss allowances on receivables and contract assets are not properly measured

24. A loss allowance for expected credit losses on receivables and contract assets requires to be recognised (unless the counter-party is a department or agency). The calculation of expected credit losses is explained at Module 3, but the body may adopt a simplified approach and use lifetime expected credit losses for receivables or contract assets that either:

- do not contain a significant financing component (or the body applies the practical expedient for contracts that are one year or less); or
- contain a significant financing component but the body chooses as its accounting policy to measure the loss allowance at an amount equal to lifetime expected credit losses.

25. Auditors should evaluate whether the loss allowance at 31 March 2023 is free from misstatement.

7.3: Income from fines and penalties

Fines and penalties are a form of non-exchange transaction but they are accounted for under IFRS 15 where the body acts as principal.

Income from fines and penalties is not properly accounted for

26. The [FReM](#) sets out the accounting requirements for income collected on an agency basis (see Module 8.8). This includes most fines and penalties where a body collects them as an agent for the Scottish Government.

27. However, where a body is permitted to retain revenue from fines and penalties, it should be recognised as income. IFRS 15 does not normally apply to non-exchange transactions such as fines and penalties; however, the FReM adapts IFRS 15 so that it does apply. Guidance is provided at chapter 2 of the Treasury's [application guidance](#).

28. Auditors should evaluate whether fines and penalties collected during 2022/23 have been accounted for:

- under IFRS 15 where the body is permitted to retain the sums collected
- as an agency transaction where the body is acting as an agent for the Scottish Government.

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Risks of misstatement in grants and other income in 2022/23

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Audit Scotland, 4th Floor, 102 West Port, Edinburgh EH3 9DN
Phone: 0131 625 1500 Email: **info@audit-scotland.gov.uk**
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Technical Guidance Note 2023/1

Module 8

**Risks of misstatement in other financial statement
areas in 2022/23**



Prepared for appointed auditors in the central government, health and college sectors
31 January 2023

Contents

Module 8 introduction	3
8.1: Heritage assets	4
8.2: Fair value measurement	6
8.3: Investment property	10
8.4: Intangible assets	13
8.5: Assets held for sale	16
8.6: Cash and cash equivalents	18
8.7: Miscellaneous disclosures	19

Module 8 introduction

Purpose and use of this module

1. This module of TGN 2023/1 provides guidance on the risks of misstatements in the following financial statement areas:

- Heritage assets (section 1).
- Fair value measurement (section 2).
- Investment property (section 3).
- Intangible assets (section 4).
- Assets held for sale (section 5).
- Cash and cash equivalents (section 6).
- Disclosures (section 7) on:
 - new accounting standards
 - operating segments
 - related parties.

Consulting with Professional Support

2. Auditors should consult with Professional Support by sending an email to TechnicalQueries@audit-scotland.gov.uk

8.1: Heritage assets

Heritage assets are held for their contribution to knowledge and culture. As there is no IFRS that deals with heritage assets, the FReM sets out the requirements.

Heritage assets are not complete

3. Heritage assets are defined at FReM paragraph 10.1.32 as assets held principally for their contribution to knowledge and culture. They include for example historical buildings, archaeological sites, military and scientific equipment of historical importance, museum and gallery collections and works of art.

4. Auditors should evaluate whether the body has examined its property, plant and equipment in 2022/23 to identify those that are heritage assets.

Heritage assets are incorrectly classified

5. Any assets which, in addition to being held for their heritage characteristics, are also used by the body for other activities or to provide other services should be classified as operational assets and accounted for as property, plant and equipment.

6. Auditors should evaluate whether all heritage assets in 2022/23 have been appropriately classified.

Heritage assets are not properly measured

7. Paragraphs 10.1.37 to 10.1.40 of the FReM set out the valuation requirements for heritage assets. This includes setting out that these should, where possible, be valued at either current value in existing use or fair value. In particular:

- valuations may be made by any method that is appropriate and relevant, e.g. insurance valuations may be appropriate for museum collections
- valuations need not be carried out or verified by external valuers.

8. Auditors should evaluate whether the arrangements for valuations, including the individuals involved, are appropriate.

9. There is no prescribed minimum period between valuations. However, the FReM requires the valuation to be reviewed with sufficient regularity to ensure it remains current. Auditors should evaluate whether the frequency of valuations is reasonable. If a body uses insurance valuations, auditors should evaluate whether:

- there is evidence that demonstrates that they provide an appropriate valuation basis
- the valuation is current at 31 March 2023.

10. Where it is not practicable to obtain a valuation, paragraph 10.1.38 allows them to be measured at historical cost (less accumulated depreciation and impairment). Auditors should evaluate whether it is genuinely not practicable to obtain a valuation (e.g. because there is no market for the item and it is not possible to provide a reliable estimate of the replacement cost).

Accounting entries for heritage assets are not appropriate

11. FReM paragraph 10.1.37 requires a heritage asset to be recognised in the Statement of Financial Position where a body has information on its cost or value (or can obtain it at a cost commensurate with the benefits). When assessing materiality, the cultural or historical significance of the item may be particularly relevant, and the assessment should not be restricted to solely the amount involved.

12. FReM paragraph 10.1.41 advises that depreciation is not required on heritage assets which have indefinite lives, but paragraph 10.1.42 requires an impairment review to be carried out where an asset has suffered physical deterioration or breakage, or where new doubts arise as to its authenticity.

13. Auditors should evaluate whether:

- heritage assets have been recognised in the Statement of Financial Position at 31 March 2023 where the body has information on the cost or value
- depreciation has been charged unless the asset has an indefinite life
- an impairment review has been carried out, where required.

Information on heritage assets is not properly disclosed

14. The disclosure requirements for heritage assets are detailed at paragraphs 10.1.44 to 10.1.49 of the FReM. Some disclosures vary depending on whether the assets are recognised in the Statement of Financial Position.

15. Auditors should evaluate whether:

- the required disclosures have been made for heritage assets in 2022/23
- the disclosures are complete, clear, concise, and free from misstatement.

8.2: Fair value measurement

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction in the principal market at the measurement date under current market conditions. The [FReM](#) requires bodies to adopt [IFRS 13 Fair Value Measurement](#).

Items measured at fair value are not complete or that basis is not appropriate

16. IFRS 13 applies when another applicable standard requires or permits fair value measurements or disclosures about fair value measurements. Auditors should evaluate whether items measured at fair value in 2022/23 are those required (or permitted) by an applicable standard. This will include:

- surplus assets (when there are no restrictions on entering the market)
- leases at initial recognition
- financial assets
- investment property
- intangible assets (where there is an active market)
- assets held for sale
- debtors and creditors.

Items at fair value are not properly measured

17. Paragraph 24 of IFRS 13 defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction in the principal (or most advantageous) market at the measurement date under current market conditions (i.e. an exit price). The price may be available from a market or estimated using a valuation technique.

18. The following table provides guidelines on interpreting the above definition:

Term	Explanation
Orderly transaction	This assumes the body has access to the market before the measurement date (i.e. 31 March 2023) to allow for the usual marketing activities.
Principal market	The market with the greatest volume and activity for the asset or liability.

Term	Explanation
Most advantageous market	The market that maximises the amount that would be received to sell the asset or minimises the amount that would be paid to transfer the liability.
Exit price	The price that would be received to sell an asset or paid to transfer a liability. It takes into account the body's ability to generate economic benefits by either using the asset in its highest and best use or by selling it.

19. It is assumed that buyers and sellers in the principal (or most advantageous) market for the asset or liability are:

- independent of each other, i.e. they are not related parties
- knowledgeable, and have a reasonable understanding based on all available information
- willing and able to enter into a transaction for the asset or liability.

20. Bodies should take into account the characteristics of the asset or liability that market participants would take into account when measuring fair value, e.g. the condition and location of the asset, and any restrictions on its sale or use. The exit price used should not be adjusted for transaction costs (the treatment of transaction costs varies and should be in accordance with the relevant standard).

21. Auditors should evaluate whether the body has in 2022/23:

- used the IFRS 13 definition of fair value for applicable assets and liabilities
- used the exit price without any adjustment for transaction costs
- taken into account the characteristics of the asset or liability that market participants would take into account.

22. Auditors should evaluate whether the body has measured fair value for applicable assets and liabilities using valuation techniques that are appropriate in the circumstances. Paragraphs B5 to B11 of IFRS 13 set out the three main approaches summarised in the following table:

Approach	Explanation
Market	Prices and other relevant information generated by market transactions involving identical or comparable (i.e. similar) assets and liabilities.
Cost	The amount that would be required currently to replace the service capacity of an asset (often referred to as current replacement cost).
Income	Future cash flows converted to a discounted amount.

23. Auditors should evaluate whether the body has followed the fair value hierarchy prescribed by paragraphs 76 to 90 of IFRS 13 which categorises into three levels the inputs to the above valuation techniques. Inputs are the assumptions that buyers and sellers would use when pricing the asset or liability. They are summarised in the following table:

Level	Inputs	Explanation
1	Quoted prices that are observable in active markets for identical assets or liabilities	<p>This provides the most reliable evidence and auditors should evaluate whether it has been used without adjustment whenever the information is available. The emphasis is on determining:</p> <ul style="list-style-type: none"> the principal market for the asset or liability or, in the absence of a principal market, the most advantageous market; and whether the body can enter into a transaction for the asset or liability at the price in that market at the measurement date. <p>Fair value should be measured as the product of the quoted price for the individual asset or liability and the quantity held.</p>
2	Inputs other than quoted prices that are observable for the asset or liability, either directly or indirectly	<p>Inputs include:</p> <ul style="list-style-type: none"> quoted prices for similar assets or liabilities in active markets quoted prices for identical or similar assets or liabilities in markets that are not active inputs other than quoted prices that are observable. <p>Adjustments will vary depending on factors specific to the asset or liability. Those factors include the:</p> <ul style="list-style-type: none"> condition or location of the asset extent to which inputs relate to items that are comparable volume or level of activity in the markets.
3	Unobservable inputs	<p>In the absence of observable inputs, unobservable inputs have to be used. These should reflect the assumptions that buyers and sellers would use when pricing the asset or liability. Auditors should evaluate whether the body (probably using a relevant expert) has developed unobservable inputs using the best information available in the circumstances.</p>

Information on fair value measurement is not properly disclosed

24. The disclosures required are set out at paragraph 91 of IFRS 13. Auditors should evaluate whether:

- the required disclosures have been made in 2022/23 for all relevant assets and liabilities measured at fair value
- information is disclosed to help users evaluate the valuation techniques and inputs used to develop the measurements for assets and liabilities that are measured at fair value after initial recognition

- information is disclosed to help users evaluate the effect of recurring fair value measurements using significant unobservable inputs (level 3) on net expenditure
- the disclosures are complete, clear, concise, and free from misstatement.

8.3: Investment property

Investment property is land or buildings held solely to earn rentals and/or for capital appreciation. The FReM requires bodies to account for investment properties in accordance with IAS 40 Investment Properties, subject to interpretations.

Investment properties are not complete

25. IAS 40 defines investment properties as those held solely to earn rentals and/or for capital appreciation, and not used to deliver services or for administrative purposes.

26. Auditors should evaluate whether the body has reviewed its land and buildings at 31 March 2023 to identify those that are investment property.

Investment properties are not properly classified

27. A property, notwithstanding that it otherwise meets the definition of an investment property, should be accounted for as property, plant and equipment where:

- it is owner-occupied (i.e. the body owns and occupies it for use in the delivery of services, or the production of goods, or for administrative purposes); or
- the rentals arise from the body's regeneration policy.

28. Where a body uses part of a building itself and leases the remainder, the building should be classified as follows:

- Where the elements of the building could be disposed of individually, each element should be accounted for separately, i.e. as owner-occupied property or investment property.
- Where the building cannot be split between the relevant elements, the **whole** building should be classified as owner-occupied unless that element is insignificant, in which case the whole building should be classified as an investment property.

29. Where a body leases property to a subsidiary, it should be accounted for as an investment property (assuming the definition is met) in its own financial statements, but as property, plant and equipment in the group financial statements.

30. Auditors should evaluate whether properties:

- used to deliver services (including part use) at 31 March 2023 are properly classified
- leased to a subsidiary are properly classified in the body-only and group financial statements.

Investment properties are not properly measured

31. The FReM interprets IAS 40 and requires investment property, after initial recognition at cost, to be carried at fair value. Fair value should be in accordance with IFRS 13 (as explained at section 2 of this Module). In order to reflect market conditions each year end, it is expected that an annual valuation will be required.

32. Auditors should evaluate whether:

- investment properties at 31 March 2023 are carried at fair value
- a revaluation at that date has taken place
- the valuation at 31 March 2023 is free from misstatement.

33. Exceptionally, where there is evidence when a property first becomes an investment property that the fair value is not reliably determinable on a continuing basis (i.e there is no active market for comparable properties), paragraph 53 of IAS 40 requires bodies to measure them at historical cost (less accumulated depreciation and impairment). For any new investment property during 2022/23 measured at historical cost, auditors should evaluate whether the fair value was reliably determinable.

Accounting entries for investment properties are not appropriate

34. Investment properties held at fair value should not be depreciated. However, auditors should evaluate whether investment property held at cost is being depreciated over its useful life, with the residual value assumed to be zero.

35. Changes in fair value, any depreciation or impairment charges, and gains or losses on disposal should be recognised in net operating expenditure. Any compensation received from third parties for investment property that becomes impaired, lost or is given up should also be recognised in net operating expenditure.

36. Auditors should evaluate whether gains and losses, depreciation or compensation during 2022/23 are free from misstatement.

Transfers to or from investment property are not appropriate

37. Under paragraphs 57 to 65 of IAS 40, transfers to or from the investment property classification, should be made when, and only when, there has been a change in use. The requirements are as follows:

- For a transfer from investment property, the deemed cost for subsequent accounting should be fair value at the date of transfer.
- For a transfer to investment property, bodies should apply IAS 16, including depreciation and impairment losses, up to the transfer. Any difference in carrying amount should be treated in the same way as a normal revaluation.

38. Auditors should evaluate whether transfers to or from investment property during 2022/23 have been properly accounted for.

8.4: Intangible assets

An intangible asset is an identifiable non-monetary asset without physical substance. The FReM requires bodies to account for intangible assets in accordance with IAS 38 Intangible Assets, as interpreted.

Intangible assets are not complete

39. An intangible asset is defined at paragraph 8 of IAS 38 as an identifiable non-monetary asset without physical substance. An intangible asset requires to be recognised if (and only if) it is controlled by the body as a result of past events, and future economic or service benefits are expected to flow from the asset to the body.

40. Development expenditure should be recognised as an internally generated intangible asset when it meets the following criteria set out at paragraph 57 of IAS 38:

- The technical feasibility of completing the intangible asset so that it will be available for use or sale must be demonstrated.
- There must be an intention to complete the intangible asset and use or sell it.
- The body must be able to use or sell the intangible asset.
- The body must be able to demonstrate how the intangible asset will generate future economic benefits or future service potential, e.g. existence of a market for the output of the intangible or, if it is to be used internally, the usefulness of the intangible asset.
- Adequate resources must be available to complete the development of the asset and to use or sell it.
- The body must be able to reliably measure the expenditure incurred during the development of the intangible asset.

41. Auditors should evaluate whether the body has reviewed its expenditure during 2022/23 to identify amounts that meet IAS 38's definition of an intangible asset. For example, it is expected that in most cases purchased computer software will meet the definition.

Recognised intangible assets do not exist

42. Auditors should evaluate whether the following expenditure has been recognised in operating expenditure when it is incurred during 2022/23 rather than as an intangible asset:

- Expenditure to acquire or generate an item that does not meet the definition of an intangible asset (e.g. research expenditure)
- Subsequent expenditure incurred on an intangible asset unless exceptionally it meets the recognition criteria.

43. [SIC 32 Intangible Assets – Website Costs](#) provides guidance on the types of expenditure to be considered for internally generated website projects. It states that expenditure on developing a website for promoting and advertising a body's own products and services should be recognised as an expense. As the primary purpose of a public body's website is to provide information about services or objectives, auditors should confirm that an internally-generated website has not been recognised as an intangible asset.

44. Under cloud computing arrangements, central government bodies access and use a supplier's underlying software as needed (e.g. through the internet or via a dedicated line). IFRS does not contain explicit guidance on a customer's accounting for cloud computing arrangements and therefore a body needs to use judgement in determining which standard is the most appropriate to apply. The standards most likely to be applicable are IFRS 16 (covered at Module 6) or IAS 38.

45. An intangible asset should be recognised by the body under IAS 38 if it controls the software, future economic or service benefits are expected, and the body can restrict others' access to those benefits. Where a contract conveys only the right to receive access to the supplier's software over the contract term, it would not give the body control of the software and therefore it would not create an intangible asset for the body. If the cloud arrangement does not fall within the scope of these standards, it is likely to be a service contract in which case expenditure should be recognised when the service is received.

46. In determining whether a cloud arrangement is or contains a lease, bodies should use IFRS 16 (explained in Module 6) and evaluate whether the arrangement conveys a right for them to control the use of the asset (e.g. underlying servers). The IFRS Interpretations Committee has decided that a right to receive future access to the supplier's infrastructure does not in itself give the customer any rights to control the use of the asset.

Intangible assets are not properly measured

47. Following initial recognition at cost, the FReM adaptation requires the revaluation model to be adopted. The application of the model depends on whether an active market exists as summarised in the following table:

Active market?	Treatment
Yes	Measure asset at current value in existing use
No	Measure asset at lower of depreciated replacement cost or value in use (using indices or some suitable model)

48. Auditors should evaluate whether an intangible asset is:

- measured initially at cost
- carried at 31 March 2023 at either:
 - current value in existing use (where an active market exists); or
 - lower of depreciated replacement cost or value in use (where no active market exists).

Accounting entries for intangible assets are not appropriate

49. An intangible asset with a finite useful life should be amortised; the residual value is normally zero. An asset with an indefinite life is not amortised but should be tested for impairment annually. Amortisation and impairment should be charged to operating expenditure.

50. Auditors should evaluate whether an intangible asset recognised at 31 March 2022:

- with a finite useful life has been amortised; or
- with an indefinite life has been tested for impairment.

51. Auditors should evaluate whether amortisation and impairment have been charged to operating expenditure.

8.5: Assets held for sale

An asset is classified as held for sale if its carrying amount will be recovered principally through a sale. The FReM requires bodies to account for assets held for sale in accordance with IFRS 5 Non-current Assets Held for Sale and Discontinued Operations.

Assets held for sale are not complete

52. Paragraph 6 of IFRS 5 requires an asset to be classified as held for sale if its carrying amount will be recovered principally through a sale rather than its continued use

53. Auditors should evaluate whether the body has reviewed its property, plant and equipment at 31 March 2023 to identify any assets which should be classified as held for sale.

Assets held for sale are inappropriately classified

54. Where an asset is categorised as being held for sale at 31 March 2023, auditors should evaluate whether it is available for immediate sale in its present condition, and whether the sale is highly probable. For the sale to be highly probable:

- the appropriate level of management must be committed to a plan of sale, and an active programme to locate a buyer and complete the plan must have been initiated
- the asset must be actively marketed at a reasonable price
- the sale should be expected to be completed within one year of the classification. Where a sale is not completed within one year due to circumstances beyond the body's control, the asset may remain categorised as being held for sale provided there is sufficient evidence that the body remains committed to the sale. Appendix B of IFRS 5 sets out the situations where this may apply.

55. In the event that the criteria have not been met, auditors should evaluate whether the following circumstances apply:

- Assets which do not meet the criteria of an asset held for sale because the body is not actively marketing the asset may meet the criteria to be classified as investment property (explained at section 3 of this module).
- Assets which do not meet the criteria to be classified as either held for sale or as an investment property should be classified as a surplus asset

(which is a sub-classification of property, plant and equipment explained in Module 1).

Assets held for sale are not properly measured

56. Paragraph 15 of IFRS 5 requires an asset classified as held for sale to be measured at the lower of its carrying value and fair value less costs to sell. Fair value should be determined in accordance with IFRS 13 (as explained at section 2 of this module). Auditors should evaluate whether the valuation at 31 March 2023 is free from misstatement.

57. When the sale is expected to occur beyond one year, auditors should evaluate whether:

- the body has measured the cost to sell at its present value
- any increase in the present value of the costs to sell that arises from the passage of time has been treated as a financing cost
- the fair value has been kept up to date.

58. For any assets reclassified as held for sale during 2022/23, auditors should evaluate whether:

- immediately before the reclassification, the carrying amount had been measured in accordance with normal requirements for property, plant and equipment (explained at Module 1)
- following reclassification, the subsequent amount of revaluation gains recognised has been limited to the cumulative impairment loss that has been previously recognised.

The accounting treatment of assets held for sale is not appropriate

59. Asset held for sale should not be depreciated but may be impaired. Any impairment or revaluation losses on assets held for sale should be recognised in operating expenditure, even where there is a balance on the Revaluation Reserve in respect of that asset.

60. Auditors should evaluate whether impairment losses or revaluation decreases during 2022/23 are free from misstatement and have been included in operating expenditure.

8.6: Cash and cash equivalents

The [FReM](#) requires bodies to comply with [IAS 7 Statement of Cash Flows](#) in respect of cash and cash-equivalents.

Cash is not complete or does not exist

61. Cash includes cash in hand and on demand deposits, which are generally accepted to be deposits that are repayable on demand and available within 24 hours without penalty.

62. Auditors should evaluate whether the cash balance at 31 March 2023 is free from misstatement.

Cash equivalents are not complete or do not exist

63. The body should have adopted a policy for determining cash equivalents.

64. The policy should cover short-term, highly liquid investments that are readily convertible to known amounts of cash and which are subject to an insignificant risk of changes in value. Paragraph 7 of IAS 7 suggests that 'short term' is a period of no more than three months from the date of acquisition of the investment.

65. Auditors should evaluate whether the body has:

- a reasonable policy for determining cash equivalents
- applied the policy consistently in 2022/23.

Cash and cash equivalents are not properly presented

66. IAS 7 requires cash equivalents to be reported along with cash in the Statement of Financial Position and the Statement of Cash Flow.

67. Paragraph 8 of IAS 7 requires cash and cash equivalents to include bank overdrafts where they are an integral part of the body's cash management. This would be where the balance often fluctuates from being in credit to being overdrawn. Although not explicit, this applies only to the Cash Flow Statement (overdrafts should be presented separately in the Statement of Financial Position). Auditors should evaluate whether an overdraft at 31 March 2023 is presented separately:

- as a liability in the Statement of Financial Position
- as borrowing in the Statement of Cash Flow where the account is rarely if ever in credit and is in effect an arrangement for borrowing.

8.7: Miscellaneous disclosures

Information should be disclosed on changes required by a new accounting standard that has been issued but not yet adopted.

Information on new accounting standards is not disclosed

68. Paragraph 30 of [IAS 8 Accounting Policies, Changes in Accounting Estimates and Errors](#) requires a body to disclose information relating to the impact of a new standard that has been issued but not yet adopted.

69. Auditors should evaluate whether the body has considered the impact and materiality of the new standards and, where required, has disclosed:

- the title of the new standard
- the nature of the impending changes in accounting policy
- the date by which application of the standard, as adopted by the FReM, is required
- a clear and concise discussion of the impact that initial application of the standard as adopted by the FReM is expected to have on the body's financial statements (or, if that impact is not known or reasonably estimable, a statement to that effect).

Disclosed operating segments are not complete

70. Section 8.1 of the [FReM](#) requires bodies to report information on their operating segments in accordance with [IFRS 8 Operating Segments](#). Paragraph 5 of IFRS 8 requires the operating segments of a body to be based on the organisational structure used by the body for internal management reporting when it assesses the performance of services. When determining which segments to disclose in a note, the following requirements set out at paragraphs 12 to 19 of IFRS 8 apply:

- Not all segments require to be disclosed separately.
- Information on a segment should be disclosed separately where:
 - its net expenditure is 10% or more of the total net expenditure; or
 - its income is 10% or more of total income.
- A body is permitted to disclose segments that do not meet the above criteria.

- Where the operating segments identified by applying the '10%' criteria do not reach in total 75% of income, additional segments require to be disclosed separately until that level is reached (i.e. aggregation of the segments not presented separately cannot be more than 25%).
- Segments, which would otherwise require separate presentation, may be aggregated (i.e. presented together) where they are similar in terms of economic characteristics, nature and type of service recipient.
- There is a practical upper limit of ten in terms of separate reporting segments.
- The factors used to identify the segments require to be disclosed.

71. Auditors should evaluate whether:

- the operating segments in 2022/23 have been based on the organisational structure used for internal management reporting
- segment information has been disclosed separately where the 10% limit is exceeded
- the total expenditure on separately disclosed segments meets the 75% level
- the number of segments disclosed is appropriate
- the factors used to identify the segments have been disclosed.

Information on operating segments is not complete

72. Paragraph 7.6.10 of the FReM requires bodies to provide an analysis of the items summarised in the following table:

Required analysis	IFRS 8 requirement
Operating segments	Paragraphs 20 to 28 require disclosure of specified general information, information about net expenditure, and specified reconciliations.
Products and services	Paragraph 32 requires the disclosure of financial information on products and services.
Geographical areas	Paragraph 33 requires the disclosure of financial information on geographical areas.
Major customers	Paragraph 34 requires the disclosure of financial information on major customers.

73. Auditors should evaluate whether the required disclosures in 2022/23 are complete, clear, concise, and free from misstatement.

Information on related parties requires to be disclosed. A related party is a person or entity that is related to the entity that is preparing its financial statements

Disclosed related parties are not complete

74. The [FReM](#) requires bodies to make related party disclosures in accordance with [IAS 24 Related Party Disclosures](#), as interpreted by section 8.2. In accordance with [ISA \(UK\) 550 Related Parties](#), auditors should evaluate whether the body has identified its related parties in 2022/23. The objective of the disclosure is to draw attention to the risk that a body's financial position or performance may be affected by a relationship with another party.

75. A related party is defined at paragraph 9 of IAS 24. In summary, a related party relationship exists where there is some element of control or influence by one party over another, or by another party over the two. Such a relationship exists when the body is either exerting the control/influence or is the subject of it.

76. Possible related parties of public bodies therefore include:

- the Scottish Government
- members of the body's management board (including non-executive members) having authority or responsibility for directing or controlling the major activities
- close family members expected to have the ability to influence members or officers
- partnerships, companies, trusts or any entities in which members/officers or a member of their close family or the same household has a controlling interest
- other public bodies subject to common control by the Scottish Government, e.g. non-departmental public bodies (NDPBs), health boards and local government bodies
- subsidiaries controlled by the body
- associates and joint ventures where the body has sufficient influence to inhibit the entity from pursuing its separate interests.

Related party transactions are not complete

77. A related party transaction is a transfer of resources or obligations between related parties, regardless of whether a price is charged. This includes sales, transfers and exchanges of non-current assets, leases, guarantees, the provision of goods and services, secondment of staff and the making of loans and investments.

78. Auditors should evaluate whether the body has identified all of its transactions with related parties during 2022/23.

Information on related parties is not properly disclosed

79. Related parties can comprise other public bodies and individuals. The FReM interprets IAS 24 in respect of other public bodies so that the body is required to disclose:

- the name of the parent department and the fact that it exerts significant influence through legislation and grant funding
- the main bodies within government with which the body has had dealings. There is no requirement for information to be given on the transactions.

80. Where the related party is an individual, a body is required to disclose for material transactions:

- a description of the nature of the related party relationships
- the amount of transactions that have occurred
- the amount of outstanding balances.

81. There is also a requirement to disclose any amounts incurred by the body for the provision of key management personnel services that are provided by a separate management entity.

82. Annex 2 of the FReM provides a suggested form of words for the disclosure. Transactions and balances only need to be disclosed in the related parties note if they are not disclosed elsewhere in the annual report and accounts. However, a cross-reference should be included in the related parties note to where the relevant disclosures can be found.

83. Auditors should evaluate whether:

- the body has met the disclosure requirements in 2022/23
- related party relationships where control exists have been disclosed irrespective of whether there have been transactions between the related parties
- transactions have not been disclosed on an aggregated basis where disclosure of an individual transaction is necessary for an understanding of its impact
- the body has judged materiality from the perspective of the related party as well as from its own perspective
- the disclosures are complete, clear, concise, and free from misstatement.

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Technical Guidance Note 2023/1 - Module 8

Risks of misstatement in other financial statement areas in 2022/23

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Audit Scotland, 4th Floor, 102 West Port, Edinburgh EH3 9DN
Phone: 0131 625 1500 Email: info@audit-scotland.gov.uk
www.audit-scotland.gov.uk

Technical Guidance Note 2023/1

Module 9

Risks of irregular transactions in 2022/23



 **AUDIT SCOTLAND**

Prepared for appointed auditors in the central government, health and college sectors

31 January 2023

Contents

Module 9 introduction	3
9.1: Summary of responsibilities	4
9.2: Regularity test procedures	5

Module 9 introduction

Purpose and use of this module

1. This module of TGN 2023/1 provides guidance on the risks of irregular transactions.

Consulting with Professional Support

2. Auditors should consult Professional Support by sending an email to TechnicalQueries@audit-scotland.gov.uk.

9.1: Summary of responsibilities

Accountable Officers

3. Accountable Officers have a personal responsibility in respect of expenditure and income to ensure:

- regularity, which involves compliance with relevant legislation and guidance issued by the Scottish Ministers
- propriety, which involves respecting Parliament's intentions and conventions and adhering to values and behaviours appropriate to the public sector.

Auditors

4. Auditors are required by [section 22\(1\)](#) of the Public Finance and Accountability (Scotland) Act 2000 to report their findings on whether:

- the expenditure and income shown in the financial statements were incurred or applied in accordance with:
 - any enactment by virtue of which the expenditure was incurred or the income received
 - any applicable guidance (whether as to propriety or otherwise) issued by the Scottish Ministers
 - the relevant Budget Act
 - [sections 4 to 7](#) of the Public Finance and Accountability (Scotland) Act 2000.
- the sums paid out of the Scottish Consolidated Fund (SCF) for the purpose of meeting the expenditure shown in the financial statements were applied in accordance with [section 65](#) of the Scotland Act 1998.

5. Auditors are therefore required to express an opinion in their Independent Auditor's Report on whether expenditure and income were incurred or applied, in all material respects, in accordance with applicable enactments and guidance issued by the Scottish Ministers. This is generally referred to as the regularity opinion.

6. Practice Note 10 (PN 10) Audit of Financial Statements of Public Sector Bodies in the UK provides guidance on the audit of regularity in part 2. It states that auditors should adopt an integrated audit approach to covering the audit of the financial statements supplemented by additional testing of regularity, where necessary.

9.2: Regularity test procedures

Governing legislation not complied with

Test procedure 1 - compliance with governing legislation

Auditors should evaluate whether in 2022/23 expenditure has been incurred and income applied in accordance with the body's governing legislation

7. In order to incur expenditure, a body is required to have the statutory power to undertake the activity giving rise to the expenditure. It is likely that these powers will be set out in the legislation governing the audited body and its activities, such as the Act that establishes the body and any regulations issued under it.

8. Auditors should obtain an understanding of the governing legislation for each body sufficient to identify events, transactions and practices which may have a material effect on the regularity of expenditure and income in the financial statements.

9. Auditors should consider the governing legislation and distinguish between those:

- which are specific to the body and provide direct authority for its financial transactions. The auditor's work on legislation need only focus on those that are relevant to the body's financial transactions, such as those that govern the powers of the body to make payments or receive money, or set out the value of such payments or receipts
- and those which provide the general framework within which it conducts its activities (e.g. those relating to health and safety, environmental protection and employment). It is not concerned with administrative rules or regulations that are not directly linked to financial transactions. Non-compliance with the general framework does not affect the auditor's opinion on regularity.

10. Auditors should consider how the Accountable Officer ensures compliance with the governing legislation and, where relevant, addresses the risk of material irregular transactions through controls. This involves an assessment of the general control environment and control procedures relating to individual transaction streams that are designed to prevent or detect and correct material irregular transactions.

11. Auditors may need to evaluate whether legislation is appropriately translated into relevant procedures and guidelines. This would involve examining the legislation to identify the provisions that authorise activities and

evaluating the process for their translation and interpretation in subsidiary regulations and guidelines. It may also extend to the process for translation of legislation into working manuals or other key documentation.

12. Fraudulent transactions, such as the misappropriation of assets, are always irregular as they are without proper authority. Fraudulent financial reporting is not itself irregular, but it may disguise underlying irregular transactions.

13. Audit procedures designed to obtain assurance over the regularity of expenditure and income are usually based on a combination of tests of controls and substantive procedures. Evidence in relation to regularity can be gathered as part of an integrated approach with the audit of financial statements. Additional testing to identify activities and transactions that are not in accordance with the governing legislation may be necessary.

Applicable guidance not complied with

Test procedure 2 – compliance with applicable guidance

Auditors should evaluate whether in 2022/23 expenditure has been incurred and income applied in accordance with applicable guidance

14. The guidance contained in the [Scottish Public Finance Manual](#) (SPFM) and any other relevant guidance issued by the Scottish Ministers e.g. finance guidance notes, should be regarded as applicable guidance by all bodies. Treasury guidance has no direct application unless explicitly adopted by the Scottish Ministers.

15. As with legislation, auditors should focus on guidance that is relevant to the body's financial transactions.

Expenditure not authorised in Budget Act

Test procedure 3 – Budget Act

Auditors should evaluate whether expenditure in 2022/23 has been authorised in the relevant Budget Act

16. [Section 64](#) of the Scotland Act 1998 makes provision for the Scottish Consolidated Fund (SCF). The UK Parliament provides the Secretary of State for Scotland with the resources to pay into the SCF. The management of those resources falls thereafter to the Parliament and to the Scottish Ministers.

17. Section 1 of the Public Finance and Accountability (Scotland) Act 2000 provides that the use of resources by the Scottish Administration and other bodies funded directly from the Scottish Consolidated Fund must be authorised on an annual basis by Budget Act. The [Budget Act](#) (as amended by subsequent Orders), supported by budget documents, specifies the purpose for which resources may be used in each financial year.

18. The principles and procedures for the annual budgeting process, the format of the budget documents and procedures for in-year reallocation of budgetary provision are the subject of a [written agreement](#) between the Scottish Government and the Scottish Parliament Finance Committee.

19. [Section 3](#) of the Public Finance and Accountability (Scotland) Act 2000 sets out contingency arrangements to allow for the use of resources in certain circumstances where expenditure has not been authorised by Budget Act. This is intended to cover instances where there is an urgent need, but no time to seek parliamentary approval. All use of the power requires to be reported to the Parliament and the procedure should only be used exceptionally when it is not practical to seek a Budget revision.

20. A particular issue is losses and special payments which Parliament could not have contemplated when approving the annual Budget Act and subsequent Amendment Orders. A formal approval procedure is therefore required in order to regularise such transactions and is set in the [losses and special payments](#) section of the SPFM. This includes disclosure in the annual report and accounts (explained at Module 11).

21. Auditors of bodies directly funded from the SCF should evaluate whether expenditure for 2022/23 has been authorised in the relevant Budget Act. Where this is not the case, auditors should confirm that contingency arrangements under section 3 have been made.

Section 4 to 7 not complied with

Test procedure 4 - compliance with sections 4 to 7

Auditors should evaluate whether in 2022/23 expenditure has been incurred and income applied in accordance with sections 4 to 7 of the 2000 Act

22. [Section 65](#)(2) of the Scotland Act requires sums paid out of the SCF under that section (or other enactment) to meet expenditure of the Scottish Administration to be in accordance with sections 4 to 6 of the 2000 Act. The sum paid out cannot be more than the maximum amount set out in the Budget Act (as amended) for the relevant year. Section 7 allows receipts during the year to be applied to fund authorised expenditure.

23. Auditors of bodies directly funded from the SCF should evaluate whether expenditure has been incurred and income applied in accordance with [sections 4 to 7](#) of the 2000 Act. Paragraph 33 of PN 10 advises that expenditure of any amount in excess of the Budget Act may be considered material.

Section 65 not complied with

Test procedure 5 - compliance with section 65

Auditors should evaluate whether the sums paid out of the SCF in 2022/23 for the purpose of meeting the expenditure shown in the financial statements were applied in accordance with section 65 of the Scotland Act 1998

24. Section 65(3) of the Scotland Act provides that sums paid out of the SCF should not be applied for any purpose other than that for which they were paid out.

25. Auditors of bodies directly funded from the SCF should evaluate whether sums paid out of the SCF during 2022/23 were applied for the purpose for which they were paid out.

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Technical Guidance Note 2023/1- Module 9

Risks of irregular transactions in 2022/23

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Phone: 0131 625 1500 Email: **info@audit-scotland.gov.uk**
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Technical Guidance Note 2023/1

Module 10

**Risks of misstatement in Remuneration and Staff
Report (audited part) in 2022/23**



 **AUDIT SCOTLAND**

Prepared for appointed auditors in the central government, health and college sector

31 January 2023

Contents

Module 10 introduction	3
10.1. Inclusion of directors	5
10.2. Remuneration information	6
10.3. Pension entitlement information	9
10.4. Staff report	11
10.5. Other disclosed information	13

Module 10 introduction

Purpose and use of this module

1. This module of TGN 2023/1 provides guidance on the risks of misstatements in the following aspects of the audited part of the Remuneration and Staff Report:

- Inclusion of directors (section 1).
- Remuneration information (section 2).
- Pension entitlement information (section 3).
- Staff report, including information on exit packages (section 4).
- Other disclosed information, including on compensation payments, payments to past directors and information on fair pay (section 5).

2. The following requirements for a Remuneration and Staff Report are set out at section 6.5 of the [FReM](#).

- Information subject to audit is set out at paragraphs 6.5.8 to 6.5.29, and 6.5.30 b) and I). The FReM requires bodies to clearly identify the information as audited.
- The items required by paragraph 6.5.7 and the other elements of paragraph 6.5.30 are not audited. Guidance on the risks of misstatement in the unaudited part of the Remuneration and Staff Report is provided at Module 11.3.

3. Paragraph 4.4.1 clarifies that the FReM's disclosure requirements apply to Scottish bodies only where they originate in the Companies Act 2006. Guidance on which audited disclosures are applicable is provided in this module. Scottish bodies are not required to make disclosures that are not based on the Companies Act (e.g. those imposed by Treasury) but may choose to do so.

4. The audit should enable auditors to form an opinion on whether the audited part of the Remuneration and Staff Report has been properly prepared in accordance with the FReM. Auditors are required to obtain reasonable assurance about whether the audited part of the Remuneration Staff Report is free from material misstatement, whether due to fraud or error. Reasonable assurance is obtained when sufficient appropriate audit evidence is obtained to reduce audit risk to an acceptably low level. Auditors should refer to paragraph A11 of ISA (UK) 320 when judging whether it is appropriate to set a materiality threshold for the Remuneration and Staff Report that is lower than that set for the financial statements overall.

5. As explained more fully in Module 11.3, the unaudited elements of the Remuneration and Staff Report fall within the definition in ISA (UK) 720 of 'Statutory Other Information'. Auditors are not required to obtain evidence in respect of the unaudited elements beyond that already required to form an opinion on the financial statements or the audited part of the Remuneration and Staff Report. Auditors are required to read and consider the unaudited elements and report any uncorrected material misstatements.

Consulting with Professional Support

6. Auditors should consult Professional by sending an email to TechnicalQueries@audit-scotland.gov.uk.

10.1. Inclusion of directors

Information requires to be disclosed for any individual who meets the definition of director.

Disclosed directors are not complete

7. The FReM requires information to be disclosed in the Remuneration and Staff Report for each director. FReM paragraph 6.4.3 describes directors as the management board (including advisory and non-executive members) having authority or responsibility for directing or controlling the major activities of the body during the year.

8. Auditors should presume (in line with FReM paragraph 6.5.3) that information on named individuals will be given in all circumstances. However, [Article 21](#) of the General Data Protection Regulation gives individuals the right to object to disclosure. The individual must give specific reasons, based upon their particular situation, for objecting to the disclosure. Bodies can still make the disclosure if they can demonstrate compelling legitimate grounds for disclosing the information which override the rights of the individual. Professional Support's view is that the requirement for public accountability represents compelling legitimate grounds for the required disclosures to be made, but bodies may need to obtain legal advice particularly if the objection is on the grounds that disclosure would cause the individual substantial damage or distress.

9. However, FReM paragraph 6.5.4 set out the actions a body should take if an individual does not agree to disclosure. Where non-disclosure is agreed, the body should disclose the fact that certain disclosures have been omitted.

10. Settlement agreements (explained at Module 4.3) sometimes contain confidentiality clauses which attempt to restrict the disclosure of certain remuneration information. For the avoidance of doubt, the requirement to disclose information in the Remuneration Report is not affected by any 'confidentiality clauses'.

11. Auditors should evaluate whether all directors are included in the Remuneration and Staff Report for 2022/23. Where a director is omitted, auditors should evaluate whether:

- the reason for non-disclosure is acceptable
- the fact of non-disclosure has been disclosed.

12. Where a director has been omitted without an acceptable reason, it is expected that the omission will generally be judged by auditors to be a material misstatement which would lead to a qualified opinion.

10.2. Remuneration information

Remuneration includes salary, bonuses, ex-gratia payments and the estimated value of the increase in pension benefits and any non-cash benefits.

Remuneration information categories have not been properly disclosed

13. FReM paragraph 6.5.8 requires bodies to disclose each component and the overall single total remuneration figure for each director. This is based on requirements in regulations issued under the Companies Act and therefore in accordance with FReM paragraph 4.4.1, applies to Scottish bodies.

14. The disclosure is required to be in the format set out by the Cabinet Office in an Employer Pension Notice (EPN). Professional Support will advise auditors on the [Latest Technical News](#) page and in [Technical Bulletins](#) when the EPN for 2022/23 is available.

15. The components of the single total remuneration figure are set out at FReM paragraph 6.5.8 and are summarised as follows:

- Salary and allowances in bands of £5,000.
- Performance pay or bonuses in bands of £5,000.
- Non-cash benefits (i.e. benefits-in-kind) to the nearest £100.
- Accrued pension benefits.
- Additional columns for other components of remuneration. Bodies are required to disclose the basis on which the amounts were calculated, and any other information to help users understand the amounts.

16. FReM paragraph 6.5.10 clarifies that any any element of remuneration reported in a previous year that is the subject of a recovery or withholding in 2022/23 should be disclosed in a separate column as a negative value

17. Where there are changes to directors during 2022/23, the Cabinet Office's Employer Pension Guide suggests that:

- the annual remuneration (i.e. full year equivalent), together with their leaving/starting date, should be disclosed in addition to the actual remuneration
- where an employee has been promoted to (or 'acting up' as) a director from a position that does not require disclosure, only the remuneration

which relates to their **new** appointment should be disclosed. Prior year comparator information is not required.

18. Auditors should evaluate whether:

- the single total figure of remuneration disclosures for 2022/23 have been made in the format set out in the EPN
- remuneration has been disclosed beside the post and name of each director in the required bands
- the components of remuneration required by the FReM have been used
- total remuneration for 2022/23 and 2021/22 have been disclosed.

Remuneration information is not accurate

19. The amount of salary reported should reflect the amount payable to each director for 2022/23 as recognised in the financial statements. Salary covers both pensionable and non-pensionable amounts and includes: gross salaries; overtime; recruitment and retention allowances; and other taxable allowances and any ex-gratia payments. Salary does not include reimbursement of legitimate expenses.

20. FReM paragraph 6.5.8 a) also includes severance payments within the definition of salary. This is not based on a Companies Act requirement and, in light of FReM paragraph 4.4.1, it is unclear whether it applies in Scotland. Where a body nevertheless includes severance payments within remuneration, Professional Support recommends that in the interests of comparability and transparency, it should either be disclosed in separate column or that a footnote be added explaining its inclusion within salary.

21. Bonuses are based on performance levels attained and are usually part of an appraisal process. Bonuses relate to the performance in the year in which they become payable to the individual. i.e. bonuses reported in 2022/23 should relate to performance in 2022/23. The bonus disclosure should only include non-consolidated payments, i.e. a payment that does not permanently increase the salary of the individual (consolidated performance pay in contrast should be disclosed as part of salary rather than bonuses). FReM paragraph 6.5.13 requires bodies to disclose how the performance pay and bonus award was determined.

22. Any expense or benefit reported on a P11D or P9D is to be disclosed as part of a director's remuneration. Where a body has a dispensation with HM Revenue and Customs not to report certain expenses or benefits, they do not form part of the remuneration to be disclosed.

23. The cost of providing non-cash benefits, including housing, cars and free or subsidised goods or services, should be reported according to the same principles as benefits payable in cash. The amount reported should be the cost to the employer of providing the benefit. FReM paragraph 6.5.12 requires disclosure of:

- the types of non-cash benefits
- the value (where significant).

24. FReM paragraph 6.5.8 d) requires the value of pension benefits to be calculated as:

- the real increase in pension over the year multiplied by 20; plus
- the real increase in any lump sum; less
- employee contributions made by the individual.

25. The real increases exclude increases due to inflation or any change due to a transfer of pension rights.

26. If bodies have included any amounts as an estimate in previous years, FReM paragraph 6.5.11 requires them to disclose the actual amount, and details of the calculation of the revised amount.

27. Auditors should evaluate whether the remuneration amounts in 2022/23 are free from misstatement.

10.3. Pension entitlement information

Pension entitlement information has not been properly disclosed

28. FReM paragraph 6.5.15 requires bodies to disclose pension entitlements for each director in the format set out in the EPN. This is based on requirements in regulations issued under the Companies Act and therefore applies to Scottish bodies.

29. The required information is summarised in the following table:

Disclosure	Explanation and auditor action
Value of each director's accrued pension benefits and any related lump sum at pension age as at the end of the year	<p>Bodies are required to disclose the pension that the director would receive if 31 March 2023 was their last day in service.</p> <p>Auditors should evaluate whether the pension entitlement information at 31 March 2023</p> <ul style="list-style-type: none"> • includes any benefits that have accrued from the individual buying added years • includes transfers of benefits from another pension fund (unless the individual chooses not to transfer) • is disclosed in bands of £5,000 • is complete and free from misstatement.
Real increase during the year in the pension and any related lump sum at pension age	<p>This is the increase in the value of the pension over the year after considering the effect of inflation.</p> <p>Auditors should evaluate whether the real increase between the accrued pension benefit and any related lump sum as at 31 March 2023 and the equivalent value as at 31 March 2022</p> <ul style="list-style-type: none"> • is disclosed in bands of £2,500 • is free from misstatement.
The value of the cash equivalent transfer value (CETV) at the start and end of the year, and the real increase during the year, both to the nearest £1,000.	<p>CETV is the capital value of the pension and is worked out using guidance provided by the scheme actuary. It is an assessment of what it costs the scheme to provide these pension benefits.</p> <p>Auditors should evaluate whether the CETV at 1 April 2022 and 31 March 2023 is free from misstatement.</p>

Disclosure	Explanation and auditor action
	<p>Auditors should evaluate whether the real increase in CETV:</p> <ul style="list-style-type: none"> • reflects the increase in accrued pension that is funded by the employer • excludes the increase due to inflation • excludes contributions paid by the employee (including the value of any benefits transferred from another pension scheme).

30. The treatment of particular issues that may arise is summarised in the following table:

Issue	Treatment and auditor action
Opt out	Where a director has opted out of the pension arrangements for the whole of 2022/23, there are no pension figures to be reported but auditors should evaluate whether a clear and concise footnote explanation has been disclosed. If a director opts out or in during 2022/23, they should have been treated as a leaver or joiner.
Pension sharing order on divorce	Where a director's pension has been subject to a pension sharing order on divorce, auditors should evaluate whether the gross pension before the pension debit is applied has been disclosed.
Partial retirement	<p>Where a director has taken partial retirement during 2022/23, benefits should have been reported as a combination of active and pensioner benefits. Auditors should evaluate whether the body has disclosed:</p> <ul style="list-style-type: none"> • total pension • details of how much pension is in payment.
Partnership pension account	Where a director has a partnership pension account the above disclosures do not apply, and auditors should evaluate whether the employer's contribution has been disclosed.

10.4. Staff report

FReM paragraph 6.5.31 sets out the information that requires to be disclosed in the staff report section. The information in the staff report is not restricted to directors. There are only two FReM requirements that both apply to Scottish bodies and require to be audited:

- the disclosure of an analysis of staff costs and numbers
- summary data on the use of exit packages.

Where the body discloses some financial information in the staff report on a voluntary basis, e.g. expenditure on consultancy, it should also be audited.

Disclosures in the staff report that apply to Scottish bodies but do not require to be audited are explained Module 11.3.

Information on staff costs and numbers is not properly disclosed

31. The disclosure of an analysis of staff costs and numbers should distinguish between:

- staff with a permanent UK employment contract
- other staff (e.g. short-term contract staff, agency/temporary staff, locally engaged staff overseas and inward secondments). Where the number of staff under any one category of 'other staff' is significant, that category should be separately disclosed.

32. Auditors should evaluate whether:

- the required analysis of staff costs and numbers has been disclosed in 2022/23
- the disclosures are complete, clear, concise and free from misstatement.

An exit package means any agreement by which a body and an employee agree that the employee will relinquish employment with the body in exchange for compensation

Disclosed exit packages are not complete or do not exist

33. The summary data on the use of exit packages should be disclosed in the format required by the Cabinet Office in their EPN.

34. Exit packages equate to termination benefits explained at Module 4.3. The disclosure requirement applies to those exit packages that have been agreed between 1 April 2022 and 31 March 2023. A package should be considered as 'agreed' when the offer has been accepted by the employee.

35. As explained at Module 4.3, the termination benefits liability should be recognised at the point that any restriction on the body's ability to withdraw the offer takes effect which could be before the employee accepts the offer. That could lead to circumstances where the termination benefits liability is recognised at 31 March 2023 but the exit package is accepted after 1 April 2023 and hence it is not disclosed as an exit package until 2023/24.

36. Auditors should evaluate whether the body has identified all exit packages agreed by 31 March 2023.

Information on exit packages is not properly disclosed

37. Auditors should evaluate whether:

- the body has disclosed for 2022/23 (with 2021/22 comparatives):
 - the number of exit packages agreed in each cost band
 - the total cost of packages agreed in each band
 - an analysis between compulsory redundancies and other departures.
- the disclosures are complete, clear, concise and free from misstatement

10.5. Other disclosed information

Information on compensation payments is not properly disclosed

38. FReM paragraph 6.5.16 requires disclosure where a payment for compensation on early retirement or for loss of office has been made to a director under the terms of an approved compensation scheme. This is based on requirements in regulations issued under the Companies Act and therefore applies to Scottish bodies.

39. Where a body has entered into a compromise or settlement agreement with an individual, it is expected that disclosure will still be required. The [SPFM](#) makes it clear that bodies are required to report on the use of compromise/settlement agreements and compensation payments in compliance with disclosure requirements for the annual report and accounts.

40. Any confidentiality clause within such an agreement should expressly state that it does not prevent disclosure of information about the individual's compensation where required for the annual report and accounts. The Cabinet Office's Employer Pension Guide clarifies that, where that is the case, an individual's permission to disclose is not required.

41. Auditors should evaluate whether:

- the body has disclosed:
 - the fact that such a payment has been made
 - a description of the compensation payment
 - details of the total amounts paid. The cost to be used should include any top-up to compensation provided by the body to buy out the actuarial reduction on an individual's pension.
- the disclosures are complete, clear, concise and free from misstatement.

Information on payments to past directors is not properly disclosed

42. FReM paragraph 6.5.17 requires bodies to disclose any payments made to past directors. Disclosure is required unless:

- already disclosed within a previous year's Remuneration and Staff Report
- disclosed in the 2022/23 single total remuneration disclosure or within the disclosure of compensation for early retirement or loss of office.

43. All payments should be disclosed except:

- regular pension benefits which commenced in previous years
- payments in respect of employment other than as a director.

44. Auditors should evaluate whether:

- relevant payments to past directors in 2022/23 have been disclosed
- the disclosures are complete, clear, concise and free from misstatement.

Information on fair pay is not properly disclosed

45. The requirements of the FReM in respect of disclosing information on fair pay have changed in 2022/23 as a result of amendments to the regulations that apply in the private sector.

46. FReM paragraph 6.5.24 requires bodies to disclose the ratio of the mid-point of highest paid director's remuneration to the staff member in the lower quartile (i.e. 25th percentile), median (i.e. 50th percentile) and upper quartile (i.e. 75th percentile).

47. In addition, paragraph 6.5.19 of the FReM requires disclosure of the percentage change from the previous year for salary and allowances, performance pay and bonuses payable in respect of:

- the highest paid director (based on the mid-point of the band for each component)
- the employees of the body taken as a whole (i.e. average percentage change excluding the highest paid director).

48. FReM paragraphs 6.5.23 and 6.5.27 do not require comparative amounts for the new disclosures in 2021/22.

49. As the FReM requirements for fair pay disclosures are based on regulations issued under the Companies Act, they apply to Scottish bodies (although the requirement did not apply in Scotland before 2021/22, most bodies made the disclosure on a voluntary basis). Guidance from the Treasury has been updated to reflect the requirements in [Fair Pay Disclosures - Implementation Guidance](#).

50. The requirements apply to the highest paid director regardless of whether another employee who does not meet the definition of director is paid more. The implementation guidance encourages (but does not require) bodies to disclose information if there are any employees with remuneration in excess of the highest paid director.

51. Auditors should evaluate whether the body has disclosed:

- the percentage changes from 2021/22 in the highest paid director's salary and allowances; performance pay; and bonuses payable.

- the average percentage changes from 2021/22 for all employees for salary and allowances; performance pay: and bonuses payable.
- total pay and benefits, and the salary component separately, for the 25th, 50th and 75th percentiles. This should be based on annualised, full-time equivalent remuneration of all staff (including temporary and agency staff) as at 31 March 2023. For the purpose of this disclosure, pay and benefits excludes the value of pension benefits and severance payments.
- the 25th, 50th and 75th percentile pay ratio
- the range of staff remuneration (excluding pension benefit) for 2022/23 including directors
- a summary for 2022/23 explaining:
 - whether movement in the ratios is attributable to a change in the highest paid director's remuneration or the employees, or a change in the body's employment models
 - trends in the median pay ratio
 - whether the body believes that the median pay ratio reflects the pay, rewards and progression policy for employees as a whole.

52. Auditors should evaluate whether the disclosures are complete, clear, concise, and free from misstatement.

Technical Guidance Note 2022/1 - Module 10

Risks of misstatement in Remuneration and Staff Report (audited part) in 2022/23

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Audit Scotland, 4th Floor, 102 West Port, Edinburgh EH3 9DN
Phone: 0131 625 1500 Email: info@audit-scotland.gov.uk
www.audit-scotland.gov.uk

Technical Guidance Note 2023/1

Module 11

Risks of misstatement in Statutory Other Information
in 2022/23



 **AUDIT SCOTLAND**

Prepared for appointed auditors in the central government, health and colleges sector
31 January 2023

Contents

Module 11 introduction	3
11.1: Performance Report	5
11.2: Governance Statement	11
11.3: Other statements	15
Appendix 1 Performance Report	19
Appendix 2 Content of Performance Report	20
Appendix 3 Governance Statement	21
Appendix 4 Content of Governance Statement	22

Module 11 introduction

Purpose and use of this module

1. This module of TGN 2023/1 provides guidance on the risks of misstatements in the following Statutory Other Information:

- Performance Report (section 1).
- Governance Statement (section 2).
- Directors' Report, Statement of Responsibilities, and unaudited part of Remuneration and Staff Report (section 3).

2. The [FReM](#) sets out the requirements for the above. However, paragraph 4.4.1 clarifies that the FReM's disclosure requirements apply to Scottish bodies only where they originate in the Companies Act 2006. Guidance on which disclosures are applicable is provided in this module.

Summary of auditors' responsibilities

3. Components of the annual report and accounts required by the FReM (other than the financial statements and audited part of the Remuneration and Staff Report) fall within the definition in [ISA \(UK\) 720](#) of Statutory Other Information. This comprises the Performance Report, Governance Statement, unaudited part of the Remuneration and Staff Report, and the Statement of Responsibilities.

4. ISA (UK) 720 does not require auditors to obtain evidence beyond that required to form an opinion on the financial statements. However, it requires auditors to read and consider the Statutory Other Information and report any uncorrected material misstatements in the Independent Auditor's Report.

5. Misstatements represent information that is incorrectly stated, has not been prepared in accordance with applicable requirements, or is otherwise misleading. FReM paragraphs 2.6.8 to 2.6.10 provide guidance on the application of materiality to Statutory Other Information.

6. In addition, the Auditor General requires auditors to express an opinion in the Independent Auditor's Report on whether the information in the Performance Report and Governance Statement:

- is consistent with the financial statements
- has been prepared in accordance with requirements.

7. The test procedures that auditors should undertake to meet the above responsibilities are set out throughout this module and, in respect of the Performance Report and Governance Statement, are summarised in checklists.

8. The model Independent Auditor's Report for 2022/23 will be provided in a separate [Technical Guidance Note](#) and will include further guidance on reporting including the wording for the required opinions.

Changes in risks in 2022/23

9. There are changes in the following risk:

- Performance Report is not in accordance with the accounts direction

Consulting with Professional Support

10. Auditors should consult Professional Support by sending an email to TechnicalQueries@audit-scotland.gov.uk.

11.1: Performance Report

The [FReM](#) requires the annual report and accounts to include a Performance Report.

Performance Report is not consistent with the financial statements

11. Auditors should carry out test procedure 1 to consider whether there are any material inconsistencies in 2022/23 between information in the Performance Report and the financial statements:

Test procedure 1 – consistency with financial statements

Auditors should:

- **select amounts or other items in the Performance Report and compare them with the corresponding amounts or other items in the financial statements**
 - **conclude whether an inconsistency means there is a misstatement**
 - **request that any material misstatements be corrected**
-

12. The Performance Report may include amounts that are intended to be the same as, to summarise, or to provide greater detail about, the amounts in the financial statements. Examples of such amounts or other items may include:

- tables, charts or graphs containing extracts of the financial statements
- disclosure providing greater detail about an item shown in the financial statements
- descriptions of the financial results.

13. In order to evaluate their consistency, auditors should select a sample of amounts or other items in the Performance Report and compare them with the corresponding amounts or other items in the financial statements. When making the selection, auditors should consider:

- the significance of the amount or other item in the context in which it is presented, (e.g. a key ratio or amount)
- the relative size of the amount compared with amounts or items in the financial statements or the Performance Report to which they relate
- the sensitivity of the particular amount or other item in the Performance Report.

14. When evaluating the consistency of the selected items, auditors should:

- compare the information to the financial statements (where it is intended to be the same)
- obtain a reconciliation between an amount in the Performance Report and the financial statements and:
 - compare items in the reconciliation to the financial statements and the Performance Report; and
 - check whether the calculations within the reconciliation are arithmetically accurate.
- for information intended to convey the same meaning as disclosures in the financial statements, compare the words used and consider whether any differences imply different meanings.

15. If auditors identify an inconsistency between information in the Performance Report and the financial statements, auditors should:

- conclude whether there is a misstatement in the Performance Report (or the financial statements)
- request that the body corrects any material misstatement identified.

Performance Report is not in accordance with the accounts direction

16. Auditors should carry out test procedure 2 to consider whether the Performance Report for 2022/23 has been prepared in accordance with the accounts direction:

Test procedure 2 - non-compliance with accounts direction

Auditors should:

- **use the checklist at Appendix 2 to evaluate whether information required by the FReM has been omitted from the Performance Report**
- **evaluate whether items comply with the FReM**
- request that any material misstatements be corrected**

17. The accounts directions require compliance with the disclosure requirements of the FReM. FReM paragraph 5.2.1 requires the Performance Report to provide a fair, balanced and understandable analysis of the body's performance. Paragraph 5.1.3 requires the Performance Report to have an overview and an analysis section.

18. The overview section should give the user sufficient information to understand the body, its purpose, its objectives, its performance and both the impact of and management of key risks. The minimum contents are set out at FReM paragraph 5.3.3. In accordance with FReM paragraph 4.4.1, the following table sets out the application of each requirement to Scottish bodies:

FReM requirement	Application to Scottish bodies	Explanation of application to Scottish bodies
A short summary explaining the purpose of the overview section	No	No requirement in Companies Act, and no equivalent requirement in Scottish legislation or the SPFM.
A statement from the body's lead Minister or Chief Executive	No	
A statement of the purpose and activities of the body including a brief description of the business model and environment, and organisational structure	Yes	Based on Section 414C(2) of the Companies Act and The Companies, Partnerships and Groups (Accounts and Non-Financial Reporting) Regulations 2016.
A summary of organisational strategic objectives and goals	Yes	
A summary of the principal risks faced and how these have affected the delivery of strategic objectives, how they have changed, how they have been mitigated and any emerging risks that may affect future performance	Yes	
A summary performance appraisal, providing a synopsis of the performance analysis section, and outlining progress towards strategic objectives.	Yes	Based on Section 414C(3) of the Companies Act and therefore applies to Scottish bodies.
(Primarily for arms-length bodies) an explanation of the adoption of the going concern basis where this might be called into doubt.	Yes	IAS 1 requires disclosure of material uncertainties regarding the adoption of the going concern basis and therefore this applies to Scottish bodies.

19. The performance analysis section is where bodies are required to provide a detailed view of their performance. The FReM sets out mandatory requirements, 'comply or explain' requirements, and best practice recommendations.

20. The mandatory requirements are set out at FReM paragraph 5.4.4 and apply in Scotland because they are based on section 414C(3) of the Companies Act. The requirements at items a) to d) apply only to the Scottish Government. Item e) requires other bodies to report on their objectives and progress made against them, using unbiased indicators, incorporating qualitative, quantitative and prior year information. The following table sets out the application of each requirement at f) to m) of paragraph 5.4.4 to Scottish bodies.

FReM requirement	Application to Scottish bodies	Explanation of Application
A short explanation detailing the purpose of the performance analysis section and its structure	No	No requirement in Companies Act, and no equivalent requirement in Scottish legislation or the SPFM.
Further detail on the structure of the body where beneficial	Yes	Based on Section 414C(2) of the Companies Act and The Companies, Partnerships and Groups (Accounts and Non-Financial Reporting) Regulations 2016.
Unit costs if central to decision-making or accountability	No	No requirement in Companies Act, and no equivalent requirement in Scottish legislation or the SPFM.
Trend information in indicators	Yes	Based on Section 414C(3) of the Companies Act.
Performance against any further key financial indicators or measures	Yes	
Detail on future plans, and expected future performance, including anticipated changes in the structure or strategic objectives	Yes	
A financial review, detailing financial performance	Yes	
References to any accountability issues or breaches	No	No requirement in Companies Act, and no equivalent requirement in Scottish legislation or the SPFM.
Entities must also comply with mandatory sustainability reporting requirements.	No	A sustainability report does not require to be published as part of the annual report and accounts.

21. The 'comply or explain' items are set out at paragraph 5.4.5. FReM paragraph 1.4.3 explains that bodies must either follow the requirements or, exceptionally, provide an explanation for their preferred alternative. However, paragraph 5.4.5 is clear that it only applies to bodies that produce a Statement of Outturn against Parliamentary Supply. It does not therefore apply to Scottish bodies.

22. The FRC's [Guidance on the strategic report](#) provides further information on the elements of the Performance Report required under the Companies Act.

23. In order to evaluate whether required information has been omitted, auditors should evaluate whether the Performance Report includes the items summarised at Appendix 2 to this module. An omission includes situations where a mandatory item has been presented in another part of the annual report and accounts without appropriate cross-reference.

24. In evaluating whether the Performance Report complies with the FReM, auditors should consider whether:

- it is fair, balanced, understandable, comprehensive and concise
- the principal risks described reflect the risk register which is itself complete
- the key performance measures, where reported, are corroborated by supporting documents.

25. Bodies should be including climate change in their consideration of principal risks and making disclosures accordingly. Narrative reporting should adequately reflect the body's exposure to climate-related issues and how it is monitoring and managing these risks. Narrative reporting requirements and expectations should relate to both the body's impact on the environment, and the impact climate change may have on the body's future.

26. If auditors are of the opinion that the Performance Report omits an item set out at Appendix 2, or that reported items do not comply with the FReM, this represents a misstatement. Where material, auditors should request that the body makes the necessary correction.

Performance Report is inconsistent with auditor's knowledge

27. Auditors should carry out test procedure 3 to consider whether there are any material inconsistencies in 2022/23 between information in the Performance Report and their knowledge obtained in the audit.

Test procedure 3 - inconsistency with auditor's knowledge

Auditors should:

- **consider whether there is a material inconsistency between the Performance Report and the knowledge they have obtained in the audit**
request that any material misstatements be corrected
-

28. Auditors' knowledge includes the understanding of the body and its environment obtained in accordance with [ISA \(UK\) 315](#). Auditors may focus on those matters that are of sufficient importance that a misstatement in relation to that matter could be material.

29. There is no requirement to obtain audit evidence beyond that required to form an opinion on the financial statements. Auditors' recollection of the audit evidence obtained and conclusions reached may be sufficient, or auditors may have to refer to relevant audit documentation.

30. If auditors identify a material inconsistency between information in the Performance Report and their knowledge, auditors should:

- conclude whether there is a misstatement in the Performance Report
- consider whether their understanding of the body needs to be updated
- request the body to correct any material misstatement identified.

Information in the Performance Report is misleading

31. Auditors should carry out test procedure 4 to consider whether information in the Performance Report is misleading:

Test procedure 4 – misleading information

Auditors should:

- **consider whether any information in the Performance Report is misleading**
 - **request that any material misstatements be corrected**
-

32. A misstatement in the Performance Report can also exist when the information is misleading. This includes situations where information necessary for a proper understanding of a matter disclosed in the Performance Report is omitted or obscured. Examples of misleading information are:

- if the Performance Report purports to address the key performance indicators, but a key performance indicator has been omitted
- a significant or unusual transaction or event has been omitted such as a large land acquisition
- there is an inappropriate focus on positive issues.

33. If auditors identify any information in the Performance Report that is misleading, auditors should request the body to correct any material misstatement identified.

11.2: Governance Statement

The [FReM](#) requires bodies to include a Governance Statement in the annual report and accounts.

Governance Statement is inconsistent with the financial statements

34. Auditors should carry out test procedure 1 to consider whether there are any material inconsistencies in 2022/23 between information in the Governance Statement and the financial statements.

Test procedure 1 - inconsistencies with financial statements

Auditors should:

- **select items in the Governance Statement and compare them with the corresponding items in the financial statements**
- **conclude whether an inconsistency means there is a misstatement**
- **request that any material misstatements be corrected**

35. The Governance Statement may include items that are intended to be the same as, to summarise, or to provide greater detail about, items in the financial statements. In order to evaluate their consistency, auditors should select significant items in the Governance Statement and compare them with the corresponding items in the financial statements.

36. When evaluating the consistency of the selected items, auditors should:

- compare the information to the financial statements (where it is intended to be the same)
- obtain a reconciliation between an amount within the Governance Statement and the financial statements and:
 - compare items in the reconciliation to the financial statements and the Governance Statement; and
 - check whether the calculations within the reconciliation are arithmetically accurate.
- for information intended to convey the same meaning as disclosures in the financial statements, compare the words used and consider whether any differences imply different meanings.

37. If auditors identify a material inconsistency between information in the Governance Statement and the financial statements, auditors should:

- conclude whether there is a misstatement in the Governance Statement (or the financial statements)
- request that the body corrects any material misstatement identified.

Governance Statement is not in accordance with the accounts direction

38. Auditors should carry out test procedure 2 to consider whether the Governance Statement for 2022/23 has been prepared in accordance with the accounts direction:

Test procedure 2 - non-compliance with accounts direction

Auditors should:

- **use the checklist at Appendix 4 to evaluate whether information required by the FReM and SPFM has been omitted from the Governance Statement**
- **request that any material misstatements be corrected**

39. Auditors should evaluate whether the body has undertaken a review of its risk management arrangements and internal control during 2022/23 to inform the content of the Governance Statement. Where the body has failed to undertake a review, auditors should:

- confirm that the failure has been disclosed and explained in the statement
- consider whether the explanation is consistent with auditors' understanding.

40. The accounts directions require compliance with the disclosure requirements of the FReM. In previous years, the FReM simply referred bodies to the [Governance Statement section](#) of the Scottish Public Finance Manual (SPFM). However, FReM paragraph 6.4.8 now sets out the minimum that a Governance Statement should acknowledge and explain. Paragraph 6.4.7 states that the SPFM provides guidance on content. In Professional Support's view, the Governance Statement should meet the requirements of both the FReM and the SPFM.

41. FReM paragraph 6.4.8 f) includes the extent to which arrangements comply with requirements for specific sectors and jurisdictions. This includes guidance in the SPFM and any sector specific guidance such as section 2 of [On board: A guide for members of statutory boards](#).

42. In order to evaluate whether any items required by the SPFM or FReM have been omitted, auditors should evaluate whether the Governance Statement includes the items summarised at Appendix 4 to this module. The addendum which permitted bodies to simply refer to another publication containing the

required information in the previous two years does not apply in 2022/23. An omission includes situations where required information has been presented in another part of the annual report and accounts without appropriate cross-reference.

43. Auditors should evaluate whether the body has considered the following indicators in deciding whether a governance issue is significant:

- The issue seriously prejudices or prevents achievement of a key objective.
- The issue has resulted in a need to seek additional funding to allow it to be resolved, or has resulted in significant diversion of resources from another aspect of the business.
- It has a material impact on the financial statements.
- The audit committee, or equivalent, advises it should be considered significant for this purpose.
- The Head of Internal Audit reports on it as being significant.
- The issue, or its impact, has attracted significant public interest, or has seriously damaged the reputation of the body.

44. If auditors are of the opinion that the Governance Statement omits any item (or appropriate reference to any item) set out at Appendix 4, this represents a misstatement. Where material, auditors should request that the body makes the necessary correction.

Governance Statement is inconsistent with auditor's knowledge

45. Auditors should carry out test procedure 3 to consider whether there are any material inconsistencies in 2022/23 between information in the Governance Statement and the auditor's knowledge obtained in the audit:

Test procedure 3 – inconsistency with auditor's knowledge

Auditors should:

- **consider whether there is a material inconsistency between the Governance Statement and the knowledge they have obtained in the audit**
- **request that any material misstatements be corrected**

46. Auditors' knowledge includes the understanding of the body and its environment, including the body's internal control, obtained in accordance with ISA (UK) 315 and matters such as a statutory report from the Auditor General on governance issues. Auditors may focus on those matters that are of sufficient importance that a misstatement in relation to that matter could be material.

47. There is no requirement to obtain audit evidence beyond that required to form an opinion on the financial statements. Auditors' recollection of the audit evidence obtained and conclusions reached may be sufficient, or auditors may have to refer to relevant audit documentation.

48. If auditors identify an inconsistency between information in the Governance Statement and their knowledge, auditors should:

- conclude whether there is a misstatement in the Governance Statement
- consider whether their understanding of the body needs to be updated
- request that the body corrects any misstatement identified.

Information in the Governance Statement is misleading

49. Auditors should carry out test procedure 4 to consider whether information in the Governance Statement for 2022/23 is misleading:

Test procedure 4 - misleading information

Auditors should:

- **consider whether any information in the Governance Statement is misleading**
- **request that any material misstatements be corrected**

50. A misstatement in the Governance Statement can also exist when the information is misleading. This includes situations where information necessary for a proper understanding of a matter disclosed in the Governance Statement is omitted or obscured. For example, if the Governance Statement purports to address significant governance issues, omission of such an issue could indicate that the information is misleading.

51. If auditors identify any information in the Governance Statement that is misleading, auditors should:

- conclude whether there is a misstatement in the Governance Statement
- request the body to correct any material misstatement identified.

11.3: Other statements

Directors' Report is not in accordance with the accounts direction

52. The required contents of the Directors' Report are set out at [FReM](#) paragraph 6.4.3 a) to f).

53. Auditors should evaluate whether any required information has been omitted. If the Directors' Report omits a required item or reference to a publication where the information has been provided, this represents a misstatement. Auditors should request that the body makes the necessary correction.

Statement of Responsibilities is not in accordance with the accounts direction

54. The required contents of the statement of Accountable Officer's responsibilities are set out at FReM paragraphs 6.4.4 to 6.4.6.

55. Auditors should evaluate whether information in the Statement of Responsibilities required by the FReM has been omitted. If the Statement of Responsibilities omits a required item or reference to a publication where the information has been provided, this represents a misstatement. Where material, auditors should request that the body makes the necessary correction.

Parliamentary and Accountability Report is not in accordance with the accounts direction

56. FReM paragraph 6.5.40 sets out its requirements for the Parliamentary Accountability Report. Further detail is provided at FReM paragraph 6.7.1 which clarifies that the specific disclosures apply to bodies covered by Managing Public Money (MPM). In accordance with FReM paragraph 4.4.1, the following table sets out the application of each requirement to Scottish bodies, and also highlights where there are equivalent requirements:

FReM requirement	Application to Scottish bodies	Explanation of application
Statement of Parliamentary Supply and supporting notes	No	No requirement in Companies Act, and no equivalent requirement in Scottish legislation or the SPFM.
A brief description of the nature of each of the entity's material remote contingent liabilities (that is, those that are disclosed under Parliamentary reporting requirements and not under IAS 37) and, where practical, an estimate of its financial effect	No - but equivalent requirement	The equivalent requirement is in the contingent liabilities section of the SPFM which requires disclosure in accordance with the FReM of legally enforceable undertakings given in the form of a guarantee or indemnity which would bind the body into providing the resources in the event of the guarantee or indemnity maturing; or a letter or general statement of comfort which could be considered to impose a moral financial obligation.
(Public Sector Information Holders only) a statement is required if the entity has not complied with the cost allocation and charging requirements set out in HM Treasury guidance	No	No requirement in Companies Act, and no equivalent requirement in Scottish legislation or the SPFM.
Regularity - A statement of losses and special payments where the total amounts incurred are over the limits proscribed in Managing Public Money	No - but equivalent requirement	The equivalent requirement is in the losses and special payments section of the SPFM which requires total losses exceeding £300,000 and total special payments exceeding £300,000 to be disclosed in the annual accounts.
Notation of gifts made over the limits proscribed in Managing Public Money	No - but equivalent requirement	The equivalent requirement is in the gifts section of the SPFM which requires gifts to be reported in notes to the annual accounts. Individual gifts of more than £250,000 should be noted separately.
Entities should provide an analysis of fees and charges income where material	No - but equivalent requirement	The equivalent requirement is in the fees and charges section of the SPFM which requires the following information to be provided for each service where the full annual cost is £1 million or more, or (if lower) where the amount of the income and full cost of the service are material to the financial statements:

FReM requirement	Application to Scottish bodies	Explanation of application
		<ul style="list-style-type: none"> Financial objective performance against that objective. The standard approach to setting charges for public services is full cost recovery, i.e. recovering a 3.5% return on capital, but the SPFM lists some exceptions, e.g. subsidised services. Full cost of the service. Income from charging for the service. Surplus or deficit.

57. Auditors should evaluate whether information in the Parliamentary and Accountability Report required by the FReM or SPFM has been omitted. If the Parliamentary and Accountability Report omits a required item or reference to a publication where the information has been provided, this represents a misstatement. Where material, auditors should request that the body makes the necessary correction.

Unaudited part of the Remuneration and Staff Report is not in accordance with the accounts direction

58. FReM paragraph 6.5.7 requires bodies to disclose their remuneration policy for the current and future years within the Remuneration and Staff Report.

59. FReM paragraph 6.5.31 sets out the information to be included in the staff report section. The following unaudited items apply to Scottish bodies:

- An analysis of the number of persons of each sex who were directors, senior civil servants and employees.
- Sickness absence data
- Staff policies applied during the financial year for disabled persons
- Employee matters such as diversity issues and equal treatment in employment
- Disclosures under [The Trade Union \(Facility Time Publication Requirements\) Regulations 2017](#) which require employers to publish a range of information in relation to their usage and spend of trade union facility time. [Guidance](#) is available from the Cabinet Office.

60. Auditors should evaluate whether required information has been omitted in 2022/23. If the unaudited part of the Remuneration and Staff Report omits a required item or reference to a publication where the information has been provided, this represents a misstatement. Where material, auditors should request that the body makes the necessary correction.

Voluntary information disclosed is inconsistent with the financial statements

61. Any information provided voluntarily by bodies should be included, depending on its nature, within the Performance Report or Accountability Report. This can be done by either physically locating the information within the relevant report or by simply adding a cross-reference to it (e.g. A statement within the Performance Report that states “The Foreword on page x forms part of this Performance Report”). Voluntary information also requires to be considered for any inconsistencies with the financial statements. If auditors identify an inconsistency in 2022/23, auditors should:

- conclude whether there is a misstatement in the voluntary information (or in the financial statements)
- request the body to correct any material misstatement identified.

Information is inconsistent with auditor's knowledge

62. Auditors should evaluate whether there is a material inconsistency between the Directors’ Report, Statement of Responsibilities, unaudited part of the Remuneration and Staff Report, or any information provided voluntarily and the auditor's knowledge obtained in the audit.

63. If a material inconsistency is identified, auditors should:

- conclude whether there is a misstatement in the information
- request the body to correct any material misstatement identified.

Information disclosed is misleading

64. A misstatement can also exist when the information is misleading. This includes situations where information necessary for a proper understanding of a matter disclosed is omitted or obscured.

65. If auditors identify any information that is misleading, auditors should:

- conclude whether there is a misstatement in the information
- request the body to correct any material misstatement identified.

Appendix 1 Performance Report

Auditor action checklist

Test procedures	Yes/No/N/A	Initials/date	W/P ref
<p>1 Have you</p> <ul style="list-style-type: none"> selected amounts or other items in the Performance Report and compared them with the corresponding amounts or other items in the financial statements? concluded whether an inconsistency with the financial statements means there is a misstatement in the Performance Report? requested that any material misstatement be corrected? 			
<p>2 Have you</p> <ul style="list-style-type: none"> used the checklist at Appendix 2 to evaluate whether information required by the FReM has been omitted from the Performance Report? evaluated whether the reported items comply with the FReM? requested that any material misstatements be corrected? 			
<p>3 Have you</p> <ul style="list-style-type: none"> considered whether there is a material inconsistency between the Performance Report and the knowledge you have obtained in the audit? requested that any material misstatements be corrected? 			
<p>4 Have you</p> <ul style="list-style-type: none"> considered whether any information in the Performance Report is misleading? requested that any material misstatements be corrected? 			
<p>5 Have you discussed any uncorrected material misstatement in the Performance Report with Audit Scotland's Professional Support?</p>			

Appendix 2 Content of Performance Report Checklist

Required item	Yes/No/N/A
Performance Overview	
1 A statement of the purpose and activities of the body including a brief description of the business model and environment, and organisational structure	
2 A summary of organisational strategic objectives and goals	
3 A summary performance appraisal, providing a synopsis of the performance analysis section, and outlining progress towards strategic objectives	
4 A summary of the principal risks faced and how these have affected the delivery of objectives, how they have changed, how they have been mitigated and any emerging risks that may affect future performance	
5 Explanation of the adoption of the going concern basis where this might be called into doubt	
Performance Analysis	
6 Objectives and progress made against them, using unbiased indicators, incorporating qualitative, quantitative and prior year information	
7 Further detail on the structure of the body where beneficial	
8 Trend information in indicators	
9 Detail on future plans, and expected future performance, including anticipated changes in the structure or strategic objectives	
10 A financial review, detailing financial performance using any further key financial indicators or measures	

Appendix 3 Governance Statement

Auditor action Checklist

Test procedures	Yes/No/N/A	Initials/date	W/P ref
<p>1 Have you</p> <ul style="list-style-type: none"> selected items in the Governance Statement and compared them with the corresponding items in the financial statements? concluded whether an inconsistency with the financial statements means there is a misstatement in the Governance Statement? requested that any material misstatement be corrected? 			
<p>2 Have you</p> <ul style="list-style-type: none"> used the checklist at Appendix 4 to evaluate whether information required by the SPFM has been omitted from the Governance Statement? requested that any material misstatement be corrected? 			
<p>3 Have you</p> <ul style="list-style-type: none"> considered whether there is a material inconsistency between the Governance Statement and the knowledge you have obtained in the audit? requested that any material misstatements be corrected? 			
<p>4 Have you</p> <ul style="list-style-type: none"> considered whether any information in the Governance Statement is misleading? requested that any material misstatements be corrected? 			
<p>5 Have you discussed any uncorrected material misstatement in the Governance Statement with Audit Scotland's Professional Support?</p>			

Appendix 4 Content of Governance Statement Checklist

Required item	Yes/No/N/A
1 The governance framework, including information about the committee structure.	
2 The operation of the governing board during the period.	
3 The ongoing process and structures used to identify, evaluate and manage the principal and emerging risks face.	
4 A statement that the systems have been in place for the year under review and up to the date of approval of the annual report and accounts.	
5 The main features that support regular monitoring, review and assurance.	
6 The process applied in reviewing the effectiveness of the system of risk management and internal control, including explaining what actions have been or are being taken to remedy any significant failings or weaknesses.	
7 A record of any written authorities provided to the Accountable Officer.	
8 Details of any significant lapses of data security.	
Other requirements	Yes/No/N/A
9 The body should have undertaken a review of its arrangements for corporate governance and risk management during 2022/23 to inform the Governance Statement.	
10 The Governance Statement should: <ul style="list-style-type: none"> relate to the governance system as it applied during 2022/23 include any significant events up to the authorised for issue date. 	

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Technical Guidance Note 2023/1 - Module 11

Risks of misstatement in Statutory Other Information in 2022/23

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Audit Scotland, 4th Floor, 102 West Port, Edinburgh EH3 9DN
Phone: 0131 625 1500 Email: **info@audit-scotland.gov.uk**
www.audit-scotland.gov.uk

Technical Guidance Note 2023/1

Module 12

Risks of misstatement in Charitable NDPBs in
2022/23



 **AUDIT SCOTLAND**

Prepared for appointed auditors in the central government sector

31 January 2022

Contents

Module 12 introduction	3
12.1: Application of other modules to charitable NDPBs	4
12.2: Fund accounting	6
12.3: Presentation of financial statements	9
12.4: Donations and legacies	12
12.5: Disclosure of trustees' and staff remuneration	15
12.6: Trustees' Annual Report	17
Appendix 1 Auditor action checklist - Trustees' Annual Report	20
Appendix 2 Checklist - content of Trustees' Annual Report	21

Module 12 introduction

Purpose and use of this module

1. This module of TGN 2023/1 provides guidance on applying the other modules to the audit of the statement of accounts of non-departmental public bodies that are registered charities (charitable NDPBs).
2. It also provides guidance on the risks of misstatements in the following areas of a charitable NDPB's statement of accounts:
 - Fund accounting (section 2).
 - Presentation of financial statements (section 3).
 - Donations and legacies (section 4).
 - Disclosures on trustees' and staff remuneration (section 5).
 - Trustees' Annual Report (section 6).
3. The preparation of statement of accounts prepared by registered charities is regulated by the Charities and Trustee Investment (Scotland) Act 2005 (the 2005 Act) and [The Charities Accounts \(Scotland\) Regulations 2006](#) (the 2006 regulations). The 2006 regulations require the statement of accounts to be prepared in accordance with the methods and principles set out in the [Charities SORP \(FRS 102\)](#).
4. [FReM](#) paragraph 4.4.14 confirms that charitable NDPBs should comply with the 2006 regulations and the Charities SORP. It also states that they should go further, if necessary, to follow the guidance or principles set out in the FReM.

Consulting with Professional Support

5. Auditors should consult Professional Support by sending an email to TechnicalQueries@audit-scotland.gov.uk.

12.1: Application of other modules to charitable NDPBs

Overview Module

6. The following table summarises the application of the Overview Module which largely applies in full, other than the presentation of financial statements, though there are additional considerations:

Section	Applicability	Supplementary guidance
Introduction	Applies	No further guidance required.
Section 1 Presentation of financial statements	Not applicable	Guidance on the presentation of the financial statements is provided at section 3 of this module.
Section 2 Accounting policies, estimates and prior year errors	Applies in principle	SORP paragraph 3.14 requires trustees to make their own assessment of the charity's ability to continue as a going concern. It is expected this will be straight-forward in the case of a charitable NDPB unless there are plans to discontinue the body or its services. The principles apply but auditors should be alert to differences in terminology used by FRS 102.
Section 3 Events after the reporting period	Applies	No further guidance required.
Section 4 Significant judgements and estimation uncertainty	Applies	No further guidance required.

Modules 1 to 9

7. Modules 1 to 9 apply in principle to charitable NDPBs but auditors should be alert to slight differences required by [FRS 102](#) or the Charities SORP.

8. Supplementary guidance in this module is provided on fund accounting (in section 2) and donations and legacies (in section 4).

Module 10 Remuneration and Staff Report

9. The FReM previously disapplied the disclosure requirements in respect of Remuneration and Staff Reports for charitable NDPBs. This disapplication was removed from the FReM in 2021/22. Guidance on remuneration disclosures is provided at section 5 of this module.

Module 11 Statutory Other Information

10. . The following table lists the sections in Module 11 which apply to charitable NDPBs along with some supplementary guidance:

Section	Applicability	Supplementary guidance and action
Section 1 Performance report	Partially applies	Guidance on the Trustees' Annual Report is provided at section 6 of this module.
Section 2 Governance statement	Applies	No further guidance is required.
Section 3 Other statements	Applies	No further guidance required.

12.2: Fund accounting

Charitable funds are not properly classified

11. Module 2 of the Charities SORP sets out the requirements for the analysis and presentation of a charity's funds. Fund accounting distinguishes between four classes of fund as explained in the following table:

Class of fund	Explanation
Unrestricted funds	<p>These can be spent or applied at the discretion of the trustees to further any of the charity's purposes. Unrestricted funds can be used to supplement expenditure made from restricted funds.</p> <p>They include funds that the trustees have decided to designate for a particular purpose. This may be because the donor expressed a non-binding preference as to the use of the funds, which falls short of imposing a restriction in trust law.</p>
Restricted income funds	<p>These require to be spent or applied within a reasonable period from their receipt to further a specific purpose of the charity. Restrictions on the use of the funds are generally declared by the donor when making the gift. It is possible that a charity may have several individual restricted funds, each for a particular purpose of the charity.</p>
Permanent endowment funds (also known as capital funds).	<p>An endowment where there is no power to convert the capital into income is known as a permanent endowment fund, which must normally be held indefinitely. Trust law requires a charity to invest the assets of an endowment, or retain them for the charity's use to further its purposes.</p>
Expendable endowments	<p>Where trustees have the power to convert endowment funds into income, such funds are known as expendable endowments. These are distinguishable from restricted income funds in that there is no actual requirement to spend or apply the capital until the trustees decide to do so.</p>

12. Auditors should evaluate whether charitable funds in 2022/23 have been properly classified.

Charitable funds have not been properly accounted for

13. Auditors should evaluate whether:

- restricted income funds have been spent or applied during 2022/23:

- within a reasonable period from their receipt
- to further one or more (but not all) of the charity's charitable purposes. If the funds can be applied to all the charity's purposes, or the charity only has one purpose, they should be classified as unrestricted.
- each restricted fund, and the income received and expenditure made from it, has been separately identified in the accounting records
- costs charged to a restricted income fund relate to the activities undertaken to further the specific charitable purposes the fund was established to support. These costs include both direct and support costs associated with the activities undertaken
- expenditure has been charged to a restricted income fund which is in deficit only when there is a realistic expectation that future income will be received to cover the shortfall
- the only expenses charged to permanent endowment funds are those incurred on the administration or protection of the investments or property of the endowment. Where the endowment has insufficient funds to meet the expenses (or the terms of the trust prohibit the charging of expenses), the expenses have been charged to restricted income funds
- if the trustees exercised the power to spend or apply the capital of an expendable endowment during 2022/23, the relevant funds have become:
 - unrestricted funds where the terms of the gift permit expenditure for any of the charity's purposes
 - restricted income funds where the terms permit expenditure only for specific purposes.

Transfers between funds have not been properly presented

14. A transfer may be made between funds, for example to transfer assets from unrestricted funds to finance a deficit on a restricted fund, or where restricted funds have been lawfully released and transferred to unrestricted funds.

15. Auditors should evaluate whether any transfers during 2022/23 have been presented in the transfer line in the Statement of Financial Activities (SoFA).

Information on funds has not been properly disclosed

16. Charities SORP paragraph 2.28 requires a charity to disclose information on material individual fund balances, movements, and the purposes for which the funds are held. Disclosures should differentiate between unrestricted funds, restricted income funds, permanently endowed funds and expendable endowments. Table 1 in the Charities SORP provides an example of how the movements in material funds may be shown. Further disclosures are required by SORP paragraph 2.29.

17. Auditors should evaluate whether:

- the trustees have complied with paragraphs 2.28 and 2.29 of the SORP in 2022/23
- the disclosures are complete, clear, concise, and free from misstatement.

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12.3: Presentation of financial statements

The set of financial statements are not complete or are not properly presented

18. Regulation 8 of the 2006 Regulations requires a complete set of financial statements to comprise:

- a SoFA which shows the total incoming resources and application of the resources, together with any movements in the total resources, of the charity during 2022/23
- a Balance Sheet which shows the state of affairs of the charity as at 31 March 2023
- a cash flow statement, if appropriate
- notes to the accounts

19. Auditors should evaluate whether the charity has:

- presented a complete set of financial statements for 2022/23
- clearly identified the financial statements and distinguished them from the other information in the statement of accounts
- clearly identified each financial statement and the notes
- used signage or brackets in a manner that is correct, clear and consistent
- offset assets and liabilities or income and expenses only where required or permitted by the FRS 102 or the Charities SORP
- presented corresponding amounts in respect of 2022/23 for each item presented
- adopted the same format as 2022/23 (or the change is explained in the notes)
- omitted any line where there is nothing to report in 2022/23 and 2021/22.

Statement of financial activities is not properly presented

20. Module 4 of the Charities SORP sets out the requirements for the SoFA which is a single accounting statement that should include all income, gains, expenditure and losses recognised for 2022/23. The SoFA provides the user with an analysis of the income and endowment funds received and the expenditure by the charity on its activities, as well as a reconciliation of the movements in a charity's funds for 2022/23.

21. The structure, format and headings of the SoFA are set out in Table 2 of the Charities SORP (page 38). Auditors should evaluate whether the columns of the SoFA distinguish between restricted income funds, unrestricted funds, and endowment funds.

22. If a class of funds is not considered material, it may be combined with another class of funds and shown as a single combined funds column. Where the charity applies this approach, the heading should be changed appropriately (e.g. to 'all unrestricted and restricted funds').

Balance Sheet is not properly presented

23. Module 10 of the Charities SORP sets out the requirements for the Balance Sheet. The objective of the Balance Sheet is to show the resources available to the charity and whether these are available for all purposes of the charity or for specific purposes.

24. Table 5 of the Charities SORP (page 83) sets out the format of a charity's Balance Sheet and the headings used to present its assets, liabilities and funds. The Balance Sheet may also be presented in a columnar format that analyses Balance Sheet items by class of fund.

25. Auditors should evaluate whether:

- the Balance Sheet has been properly presented in accordance with table 5 or in a columnar format
- where the corresponding amount for 2021/22 is not comparable due to a change in accounting policy, it has been adjusted and the reason for the adjustment disclosed
- the Balance Sheet has been signed by one or more authorised trustee
- the Balance Sheet specifies the date the accounts were approved by the trustee body.

Statement of cash flows is not properly presented

26. Module 14 of the Charities SORP requires the format of the Statement of Cash Flows to follow the requirements of section 7 of FRS 102. The SORP provides a template for the statement of cash flows in table 8 (page 115). The statement is required to analyse cash flows using three standard headings of operating activities, investing activities and financing activities. The statement

should include the movement in cash balances of unrestricted funds and restricted funds including endowment funds.

27. Auditors should evaluate whether the statement of cash flows is presented in accordance with section 7 of FRS 102.

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12.4: Donations and legacies

Donations and legacies are not complete

28. Donations and legacies include all income received by the charity that is, in substance, a gift made to it on a voluntary basis. A donation or legacy may be for any purpose of the charity (unrestricted funds) or for a particular purpose of the charity (restricted income funds or endowment funds).

29. Auditors should evaluate whether all donations and legacies in 2022/23 have been identified.

Income from donations is not properly recognised

30. Module 5 of the charities SORP sets out the requirements for the recognition of income. Income from donations should be recognised when the charity becomes entitled to it (provided receipt is probable and the amount can be measured reliably). Entitlement to a donation usually arises immediately on its receipt, unless there are any terms or conditions which must be met before the charity is entitled to the resources. A condition that simply restricts the use of a donation does not affect a charity's entitlement (although it does affect how the donation is reported in the accounts as explained in section 2).

31. Auditors should evaluate whether:

- donations received during 2022/23 have been recognised as income when there is evidence of entitlement
- the amount of income is complete and free from misstatement.

Income from legacies is not properly recognised

32. Legacies should be recognised as income when the three conditions set out in the following table are met:

Condition	Explanation
Evidence of entitlement to the legacy	Entitlement to a legacy cannot arise without the charity knowing of both the existence of a valid will and the death of the benefactor. Evidence of entitlement to a legacy exists when the charity has sufficient evidence that a gift has been left to them and the executor is satisfied that the property in question will not be required to satisfy claims in the estate.
Receipt is probable	Receipt is normally probable when:

Condition	Explanation
	<ul style="list-style-type: none"> • there has been confirmation of the will by the Sheriff Court, i.e. authority to the executor of the will to manage the disposal of assets • the executors have established that there are sufficient assets in the estate, after settling any liabilities, to pay the legacy • any conditions attached to the legacy are either within the control of the charity or have been met.
Amount can be measured reliably	In some cases, there may be uncertainty as to the amount of the payment. For example, the legacy may be subject to challenge or the charity's interest may be a residual one.

33. Auditors should evaluate whether:

- legacies arising during 2022/23 have been recognised as income when the three above conditions have been met
- the amount of income is complete and free from misstatement
- where there is uncertainty that prevents the amount from being estimated reliably, the legacy has been disclosed as a contingent asset.

34. Where a payment is received from an estate or is notified as receivable by the executors after 31 March 2023 (and before the accounts are authorised for issue) but it is clear that the payment had been agreed by the executors prior to that date, auditors should evaluate whether it has been treated as an adjusting event and accrued as income if receipt is probable.

Donated facilities and services are not complete

35. In accordance with SORP paragraph 6.13, facilities and services donated for a charity's own use which it would otherwise have purchased should be recognised as income when received.

36. Donated facilities and services should be measured on the basis of the value of the gift to the charity. This is the amount that the charity would pay in the open market for an item that would provide equivalent benefit. 'Value to the charity' may be lower than, but cannot exceed, the price the charity would pay in the open market for the item. An amount equivalent to the amount recognised as income requires to be recognised as an expense under the appropriate heading in the SoFA.

37. Auditors should evaluate whether the amount of the facilities and services has been:

- recognised in income as a donated service
- recognised as expenditure
- disclosed in the notes to the accounts.

Information on donated goods and services is not properly disclosed

38. SORP paragraph 6.31 requires a charity to disclose:

- the accounting policy for the recognition and valuation of donated goods, facilities and services
- the nature and amounts of donated goods, facilities and services receivable from non-exchange transactions recognised in the accounts, for example, seconded staff, use of property, external audit fees, etc.

39. Auditors should evaluate whether:

- the charity has followed the requirements of SORP paragraph 6.31 in 2022/23
- the disclosures are complete, clear, concise, and free from misstatement.

12.5: Disclosure of trustees' and staff remuneration

Information on trustees' remuneration has not been properly disclosed

40. SORP paragraph 9.6 requires charities to disclose whether the trustees were paid any remuneration or received any other benefits from an employment with their charity or a related entity.

41. Auditors should evaluate whether the charity had disclosed a statement that either:

- none of the trustees have been paid any relevant remuneration or received any other benefits during 2022/23; or
- one or more of the trustees has been paid remuneration or has received other benefits. Auditors should evaluate whether the charity has also disclosed the information set out at SORP paragraph 9.7 and whether the disclosure is free from misstatement.

Information on trustee's expenses has not been properly disclosed

42. Charities SORP paragraph 9.11 requires charities to disclose whether the trustees were reimbursed expenses incurred in carrying out their duties or whether similar payments were made by the charity direct to third parties on their behalf.

43. Auditors should evaluate whether the charity had disclosed either:

- that no trustee expenses have been incurred; or
- that one or more of the trustees has claimed expenses or had their expenses met by the charity. Auditors should confirm that the charity has also disclosed the information set out at SORP paragraph 9.12 and assess whether the disclosures are free from misstatement.

Information on staff costs and employee benefits has not been properly disclosed

44. SORP paragraphs 9.26 to 9.30 set out required disclosures in respect of staff costs and employee benefits. Paragraphs 9.31 and 9.32 address the senior management personnel to whom the trustees delegate day-to-day management of the charity's activities (referred to as key management personnel).

45. Auditors should evaluate whether the charity has disclosed:

- details of their total staff costs and employee benefits during 2022/23, analysed in accordance with paragraph 9.26
- information on any redundancy or termination payments in accordance with paragraph 9.27
- the average head count (number of staff employed)
- the number of employees whose total employee benefits (excluding employer pension costs) fell within each band of £10,000 from £60,000 upwards
- the total amount of any employee benefits received by trustees and its key management personnel for their services to the charity.

Information on remuneration required by the FReM is not properly disclosed

46. In previous years, the FReM explicitly disappplied the disclosure requirements in respect of Remuneration and Staff Reports for charitable NDPBs. This explicit disapplication was removed from the FReM in 2020/21. However, it is unclear whether the FReM now requires charitable NDPBs to prepare a Remuneration and Staff Report or whether existing disclosures in a note to the financial statements can simply be augmented to include any additional FReM disclosure requirements. Owing to this lack of clarity, Professional Support's view is that a charitable NDPB can choose which approach to take. Module 10 applies in substance in either case, but the individual disclosures may be made in a note.

47. Auditors should evaluate whether any additional disclosures required by the FReM have been made in 2022/23.

12.6: Trustees' Annual Report

Trustees' annual report is not presented

48. The Trustees' Annual Report is a narrative statement from the trustees which the charity regulations require to be included with the statement of accounts. It is covered at Module 1 of the Charities SORP.

49. Auditors should evaluate whether a Trustees' Annual Report has been included in the 2022/23 statement of accounts.

50. Auditors' responsibilities for a Trustees' Annual Report are the same as for another central government body's Performance Report (explained in Module 11.1). The test procedures that auditors should undertake to meet the above responsibilities are summarised in Appendix 1. The model Independent Auditor's Report for 2022/23 will be provided in a separate [TGN](#) which will include wording for the Trustees' Annual Report opinions.

Trustees' annual report is not consistent with the financial statements

51. Auditors should carry out test procedure 1 to consider whether there are any material inconsistencies in 2022/23 between information in the Trustees' Annual Report and the financial statements, and express an opinion in the Independent Auditor's Report:

Test procedure 1 - inconsistencies with financial statements

Auditors should:

- select amounts or other items in the Trustees' Annual Report and compare them with the corresponding amounts or other items in the financial statements
- conclude whether an inconsistency means there is a misstatement
- request that any misstatements be corrected.

52. Auditors should refer to Module 11.1 for guidance on the above procedures.

Trustees' annual report is not in accordance with applicable requirements

53. Auditors should carry out test procedure 2 to consider whether the Trustees' Annual Report for 2022/23 has been prepared in accordance with applicable requirements, and express an opinion in the Independent Auditor's Report.

Test procedure 2 - non-compliance with applicable requirements

Auditors should:

- use the checklist at Appendix 2 to evaluate whether information required by applicable requirements has been omitted from the Trustees' Annual Report
- evaluate whether items comply with the applicable requirements
- request that any misstatements be corrected.

54. FReM paragraph 5.2.5 states that charitable NDPBs should follow the requirements of the charity legislation and SORP but provide additional disclosures required by the FReM where these go beyond legislation/SORP. In Professional Support's view, charitable NBPBs should continue to prepare a Trustees' Annual Report but the content should meet the requirements of the SORP as well as the FReM requirements for a Performance Report.

55. In order to evaluate whether required information has been omitted, auditors should check whether the Trustees' Annual Report includes the items summarised at Appendix 2 to this Module. An omission includes situations where an item required by the SORP has been:

- included by hyperlink to a website; or
- presented in another part of the statement of accounts without appropriate cross-reference.

56. If auditors are of the opinion that the Trustees' Annual Report omits an item set out at Appendix 2, or that reported items do not comply with applicable requirements, this represents a misstatement. Where material, auditors should request that the charity makes the necessary correction.

Trustees' annual report is inconsistent with auditor's knowledge

57. Auditors should carry out test procedure 3 to consider whether there are any material inconsistencies between information in the trustees' annual report and their knowledge obtained in the audit.

Test procedure 3 - inconsistency with auditor's knowledge

Auditors should:

- consider whether there is a material inconsistency between the Trustees' Annual Report and the knowledge they have obtained in performing the audit
- request that any misstatements be corrected.

58. Auditors should refer to Module 11.1 for guidance on the above procedures.

Information in the trustees' annual report is misleading

59. Auditors should carry out test procedure 4 to consider whether information in the trustees' annual report is misleading.

Test procedure 4 - misleading information

Auditors should

- consider whether any information in the trustees' annual report is misleading
- request that any misstatements be corrected.

60. Auditors should refer to Module 11.1 for guidance on the above procedures.

Trustees' Annual Report is not properly signed

61. Auditors should confirm that the Trustees' Annual Report has been signed by one or more of the charity's trustees.

Appendix 1 Auditor action checklist - Trustees' Annual Report

Test procedures	Yes/No/N/A	Initials/date	W/P ref
<p>1 Have you</p> <ul style="list-style-type: none"> selected amounts or other items in the Trustees' Annual Report and compared them with the corresponding amounts or other items in the financial statements? concluded whether an inconsistency with the financial statements means there is a misstatement in the trustees' annual report? requested that any misstatement be corrected? 			
<p>2 Have you</p> <ul style="list-style-type: none"> used the checklist at Appendix 2 to evaluate whether information required by the applicable requirements has been omitted from the Trustees' Annual Report? requested that any misstatements be corrected? 			
<p>3 Have you</p> <ul style="list-style-type: none"> considered whether there is a material inconsistency between the Trustees' Annual Report and the knowledge you have obtained in performing the audit? requested that any misstatements be corrected? 			
<p>4 Have you</p> <ul style="list-style-type: none"> considered whether any information in the Trustees' Annual Report is misleading? requested that any misstatements be corrected? 			
<p>5 Have you discussed any uncorrected material misstatement in the Trustees' Annual Report with Audit Scotland's Professional Support?</p>			

Appendix 2 Checklist - content of Trustees' Annual Report

Required item	Yes/No/N/A
1 A summary of the purposes of the charity as set out in its governing document, and the main activities undertaken in relation to those purposes	
2 A summary of the main achievements of the charity	
3 A review of the charity's financial position at the end of the reporting period	
4 Any policy it has for holding reserves, the amounts of those reserves and why they are held. If the trustees have decided that holding reserves is unnecessary, the report must disclose this fact and provide the reasons behind this decision	
5 The identification of any fund that is materially in deficit, with an explanation of the circumstances giving rise to the deficit and the steps being taken to eliminate the deficit	
6 The nature of the governing documents, how the charity is constituted, and the methods used to appoint new trustees	
7 Reference and administrative information including the name of the charity, the names of all those who were the charity's trustees on the date the report was approved or who served as a trustee in the reporting period, and the names of the directors of any corporate trustees on the date the report was approved.	
8 The required contents for a Performance Report set out at Module 11 of this TGN	

Technical Guidance Note 2023/1 - Module 12

Risks of misstatement in Charitable NDPBs in 2022/23

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Audit Scotland, 4th Floor, 102 West Port, Edinburgh EH3 9DN
Phone: 0131 625 1500 Email: info@audit-scotland.gov.uk
www.audit-scotland.gov.uk

Technical Guidance Note 2023/1

Module 13

Risks of misstatement specific to health boards in
2022/23



 **AUDIT SCOTLAND**

Prepared for appointed auditors in the health sector

23 March 2023

Contents

Module 13 introduction	3
13.1: Application of other modules to health boards	5
13.2: Financial statement areas	7
13.3: Remuneration and Staff Report	18
13.4: Statutory other information	19
Appendix 1: Checklist – content of Performance Report	21

Module 13 introduction

Purpose and use of this module

1. This module (at section 1) provides guidance on applying the other modules of TGN 2023/1 to the audit of the annual report and accounts of health boards.
2. Section 2 provides guidance on additional risks of misstatement specific to health boards and supplementary guidance on risks of misstatement that also apply to central government bodies in the following financial statement areas:
 - Capitalisation thresholds for property, plant and equipment.
 - Provisions for clinical and medical negligence claims.
 - Calculation of early retirement provisions.
 - Accounting treatment of the GP Sustainability Loan Scheme; NHS endowments and integration joint boards (IJBs) in group financial statements: funding allocations: the NHS Pension Scheme; capital grants to other bodies; transactions with IJBs; service concession arrangements; payments to independent primary care practitioners; and personal protective equipment at no cost.
 - Disclosure of the Summary of Resource Outturn (SoRO), and agency arrangements.
3. There is also supplementary guidance on the risks of misstatements in the following areas:
 - Remuneration and Staff Report (section 3).
 - Requirements for the Performance Report, Directors' Report, and Statement of Accountable Officer's Responsibilities (section 4).
4. The annual report and accounts of health boards are audited under section 86 of the [National Health Service \(Scotland\) Act 1978](#) (the 1978 Act).
5. Boards are required under that section to prepare their accounts in accordance with a direction issued by Scottish Ministers. The accounts direction requires compliance with, not only the requirements of the [2022/23 Government Financial Reporting Manual](#) (the FReM), but also the [2022/23 Manual for the Annual Report and Accounts of NHS Boards](#) (the accounts manual). The accounts manual is prepared by the NHS Scotland Technical Accounting Group (TAG) and issued by the Scottish Government.

Change in risks in 2022/23

6. There are the following new risks:

- Service concession liabilities are not complete or not properly measured.
- The total IJB contribution is not disclosed.

7. There are changes in the following risks:

- The accounting treatment of budget allocations is not appropriate.
- SoRO is not properly disclosed.
- Performance Report is not in accordance with the accounts direction.

Consulting Professional Support

8. Auditors should consult with Professional Support by sending an email to TechnicalQueries@audit-scotland.gov.uk.

13.1: Application of other modules to health boards

9. The following tables summarise the application of the other modules of TGN 2023/1 to health boards, and either provide supplementary guidance on some risks of misstatement or indicate the section of this module in which it is provided.

Overview Module

10. All sections of the Overview Module apply to health boards.

Modules 1 to 9

11. Modules 1 to 9 apply to health boards. The following table refers to areas where supplementary guidance is provided at section 2:

Module	Supplementary guidance and action
Module 1 Property, plant and equipment	The NHSScotland Capital Accounting Manual 2022/23 (the CAM) is issued by the Scottish Government and interprets the accounting guidance contained in the FReM on capital accounting issues. Supplementary guidance is provided on capitalisation thresholds.
Module 2 Provisions, creditors and accruals	Supplementary guidance on clinical and medical negligence claims is provided.
Module 3 Financial assets	Supplementary guidance on the accounting treatment for the GP Sustainability Loan Scheme.
Module 4 Employee benefits	Supplementary guidance on early retirement provisions and the NHS Pension Scheme is provided.
Module 5 Group financial statements	Supplementary guidance on NHS endowments and IJBs is provided
Module 6 Leases and Service Concession Arrangements	Supplementary guidance on service concession arrangements is provided.
Module 7 Grants and other income	Supplementary guidance on funding allocations is provided.

Module	Supplementary guidance and action
Module 8 Other financial statements areas	Supplementary guidance on capital grants, transactions with IJBs, payments to independent primary care practitioners, personal protective equipment received at no cost, the SoRO note, and agency arrangements is provided.

Module 10 Remuneration and Staff Report

12. Module 10 applies to health boards. Supplementary guidance is provided at section 3.

Module 11 Statutory Other Information

13. All sections of Module 11 apply to health boards. The following table sets out where supplementary guidance is provided at section 4:

Section	Supplementary guidance and action
Section 1 Performance Report	Supplementary guidance on additional requirements is provided.
Section 2 Governance Statement	The accounts manual sets out most of the requirements at pages 17 to 20 and a template at Annex A.
Section 3 Other statements	Supplementary guidance on the Director's Report and Statement of Accountable Officer's Responsibilities is provided.

13.2: Financial statement areas

Property, plant and equipment

Capitalisation threshold is not properly applied

14. The [CAM](#) (at paragraph 2.6.1) sets a capitalisation threshold of £5,000 for individual assets. Auditors should evaluate whether the health board has applied the specified threshold for new capital expenditure in 2022/23.

15. The CAM allows for the capitalisation of assets of lower than £5,000 if they form part of a group (e.g. defibrillators) provided all the criteria specified by the CAM at paragraph 2.7.1 for group assets are met. The specified criteria are summarised in the following table:

Criteria for group assets treatment

Group value in excess of £20,000

Items are functionally interdependent

Items are acquired at about the same date and are planned for disposal at about the same date

Items are under single managerial control

Each individual asset in the grouped has value of over £250

16. In addition, CAM paragraph 2.7.2 allows assets acquired in the course of the initial setting up of a new building or on refurbishment to also be treated as 'grouped' for capitalisation purposes. Examples where such an approach is likely to be applied are the following:

- Large collective networked system developments where individual items of computer hardware and/or software are purchased as part of a larger system.
- Where applying the threshold would result in an exceptional charge to the Statement of Comprehensive Net Expenditure (SoCNE) in the first year of a new hospital or strategy development, boards can capitalise such expenditure as a single 'equipping' asset with a useful economic life of up to 10 years.

17. Where the board has used the grouped assets approach in 2022/23, auditors should evaluate whether the assets satisfy the specified criteria.

Provisions, creditors and liabilities

Provision for outstanding clinical and medical negligence claims is not complete

18. Health boards may have legal claims in respect of clinical and medical negligence in progress that have not been settled by 31 March 2023. Boards are notified of the progress of all such claims by the Central Legal Office (CLO) under the Clinical Negligence and Other Risks Indemnity Scheme (CNORIS). The CLO categorise the level of risk relating to the settlement of each claim. Boards should assess the likely outcome of all claims but, as a general rule, page 66 of the [accounts manual](#) expects boards to account for cases in accordance with the following table:

Category	Recognise as provision	Disclose as contingent liability
3	100%	-
2	50%	50%
1	-	100%

19. Professional Support will undertake a review of the work carried out by the CLO to establish the extent to which the information prepared by the CLO, as a management expert, can be used as audit evidence under ISA (UK) 500. An [assurance report](#) arising from the review is scheduled for April 2023.

20. Auditors should evaluate whether:

- a provision has been recognised for outstanding clinical and medical negligence claims if it is more likely than not that a present obligation exists at 31 March 2023 and the other recognition criteria are also met; or
- a contingent liability has been disclosed if it is more likely that a present obligation does not exist.

Provision for outstanding clinical and medical negligence claims are not properly measured

21. The amount recognised as a provision should reflect the full amount notified by the CLO. The accounts manual (page 113) explains that it should exclude CLO fees and outlays notified which should be charged to the SoCNE when incurred.

22. Payments for some claims are paid over a period of time rather than as a one-off lump sum. Periodic payments should be discounted where the time value of money has a material effect. The payments are also subject to inflationary increases which should also be reflected in the provision..

23. Auditors should evaluate whether the provision for outstanding clinical and medical negligence claims at 31 March 2023 is properly measured

Reimbursements for clinical and medical negligence claims are not properly presented

24. Health boards are responsible for meeting medical negligence costs up to a threshold of £25,000 per claim, and costs above that are reimbursed as part of CNORIS. In cases where the board will be reimbursed, auditors should evaluate whether:

- reimbursement related to provisions has been recognised as a debtor at 31 March 2023
- the board has disclosed the expected reimbursement as a contingent asset where reimbursement is for cases disclosed as a contingent liability.

Provision for funding CNORIS is not complete

25. CNORIS is funded by all boards contributing a share of the total value of obligations. The accounts manual requires boards to recognise a provision for their expected contribution. Further [guidance](#) is provided by the Scottish Government who also provide each board with information on the amount of the provision to be recognised.

26. Professional Support will evaluate the appropriateness of the methodology adopted by the Scottish Government to establish the total national liability for CNORIS at 31 March 2023. An [assurance report](#) arising from the review is scheduled for April 2023.

27. Auditors should evaluate whether:

- the board has recognised a provision for their expected contribution to CNORIS as at 31 March 2023
- the provision is complete and free from misstatement.

Financial assets

Accounting entries for soft loans advanced at initial recognition are not appropriate

28. Loans by health boards under the GP Sustainability Loan Scheme should be accounted for as soft loans. Chapter 13 of the CAM provides guidance but in summary all GP contractors who own their premises are eligible under the scheme to receive an interest-free secured loan from their health board of up to 20% of the existing-use value of their premises.

29. Loans are repaid when the premises cease to be used for providing primary medical services under a contract with a health board or when they are sold, whichever comes first.

30. The loan should be recognised as a soft loan in the board's financial statements at the date the agreement is signed by both parties. The loan period should be assumed to be 20 years.

Employee benefits

Accounting policy for the NHS Pension Scheme is not appropriate

31. Most employees of health boards are members of the NHS Pension Scheme, which section 8.2 of the FReM requires to be accounted for on a defined contribution basis.

32. Auditors should evaluate whether the NHS Pension Scheme has been accounted for on a defined contribution basis in 2022/23.

Provision for early retirements is not properly measured

33. Additional pension liabilities arising from early retirements are not funded by the NHS Pension Scheme except where the retirement is due to ill-health. Boards are therefore required to recognise a provision for the actuarial cost of early retirements to the extent not met by the scheme in accordance with IAS 19 Employee Benefits.

34. When calculating the provision, page 111 of the accounts manual requires boards to use the [life expectancy tables for Scotland](#) provided by the Office for National Statistics.

35. Auditors should evaluate whether the board has used the life expectancy tables for Scotland when estimating the provision at 31 March 2023.

Group financial statements

Entities in which the board has an interest are not identified

36. IFRS 10 applies in full to health boards without adaptation. When assessing whether the board has identified all the entities in which it has interest, it is expected that this will apply in practice only to NHS endowment funds and IJBs.

The accounting treatment of NHS endowment funds is not appropriate

37. NHS endowment funds were set up under the 1978 Act. Health boards control endowment funds for accounting purposes and therefore should account for them as subsidiaries.

38. As endowment trustees are also board members, health boards and endowment funds effectively operate under common control for accounting purposes. The endowments therefore should normally be consolidated into group financial statements on a merger accounting basis. However, endowment funds vary in size at individual boards, and page 55 of the accounts manual allows the option of not consolidating where the board's interest is not considered to be material.

39. Auditors should evaluate whether the board has accounted for endowments in 2022/23, where its interest is material, by:

- aligning the accounting policies of the endowment fund with the policies of the board for the purposes of the group financial statements

- combining like items of assets, liabilities, reserves, income, expenses and cash flows
- eliminating intra-group transactions and balances on consolidation.

40. Where consolidation has not been undertaken for 2022/23, auditors should evaluate whether it is reasonable to conclude that the board's interest in the endowment is not material. Auditors are expected to start from a presumption that the requirements for group financial statements should be followed, unless the board can demonstrate that its interests are clearly not material. Auditors should evaluate whether the board has:

- focussed on the potential effect of non-consolidation on the decisions or assessments of users made on the basis of the financial statements
- satisfied itself that the principal users of the financial statements would be able to see the complete economic activities of the board and its exposure to risk
- demonstrated that the board's overall financial position or performance has not been misrepresented
- assessed the qualitative aspects of materiality judged in the surrounding circumstances before considering the amounts involved.

Information on endowment funds are not properly disclosed

41. Auditors should evaluate whether:

- information on consolidation adjustments in respect of endowment funds is disclosed in a note (note 26 in the accounts manual) in 2022/23.
- the disclosures are complete, clear, concise and free from misstatement.

42. Where consolidation is not required for 2022/23 (due to materiality), auditors should evaluate whether:

- the fact that the endowment has not been consolidated on the basis of materiality has been disclosed in a note (note 1 in the accounts manual)
- relevant information has been disclosed in the note on related party transactions (note 24 in the accounts manual).

The accounting treatment of interests in IJBs is not appropriate

43. While it is expected that health boards will have joint control over IJBs with councils, auditors should evaluate whether the board has taken into account the IJB's operation in practice when forming its judgement.

44. Where joint control exists, and the interest is material, auditors should evaluate whether the board has accounted for its IJBs as a joint venture in 2022/23.

Information on IJBs is not properly disclosed

45. IFRS 12 Disclosure of Interests in Other Entities (at paragraphs 20 and 21) requires a board to disclose the nature, extent and financial effects of its interest in an IJB. Auditors should evaluate whether:

- information on IJBs required by IFRS 12 has been disclosed in the notes (note 26 in the accounts manual) in 2022/23
- the disclosures are complete, clear, concise and free from misstatement.

Service concession arrangements

Service concession liabilities are not complete or not properly measured

46. For consistency with IFRS 16, the 2022/23 FReM requires bodies to remeasure the service concession liability when a change in indices causes a change in future lease payments and that change has taken effect in the cash flow

47. The 2022/23 accounts manual (page 64) has been amended to advise that this requirement has been deferred until 2023/24. For 2022/23, health boards should continue to expense the payments as incurred.

Grants and other income

The accounting treatment of budget allocations is not appropriate

48. The Scottish Government issues allocation letters each year which provide boards with the authority to spend in accordance with the budget approved in Parliament up to their Revenue Resource Limit (RRL). Each board is provided with a core RRL and a non-core RRL (for non-cash items such as depreciation). These are referred to as budget allocations but they are in substance grant in aid and should therefore be accounted for in accordance with the FReM.

49. Some allocations may be earmarked or ring fenced for particular purposes but they should still be treated as grant in aid (rather than grant) and accounted for accordingly, unless the Scottish Government has agreed otherwise.

50. As a consequence of IJBs continuing to hold significant reserve balances relating to COVID 19 funding, Scottish Government allocations provided to health boards to contribute to IJBs in 2022/23 have been reduced. This in year budget adjustment should ensure that IJBs utilise these reserve balances in 2022/23. It is not anticipated that any additional accounting will be required by health boards as a result of this allocation adjustment.

51. Auditors should evaluate whether allocations in 2022/23 have been recognised as grant in aid; or there is evidence that the Scottish Government has agreed to another basis.

The accounting treatment of other funding is not appropriate

52. Other than budget allocations from the Scottish Government, all funding provided by NHSScotland bodies, including cross boundary funding for unplanned activities and funding to cover the provision of specified services by agreement with other NHSScotland bodies, should be recognised as income. This includes income (other than RRL funding) received from the Scottish Government, e.g. to cover the salaries of secondees.

53. Auditors should evaluate whether all funding in 2022/23 (other than budget allocations) has been recognised as income in accordance with IFRS 15.

The accounting treatment of income from research and development contracts is not appropriate

54. Health boards have a number of clinical research and development (R&D) contracts where patients are enrolled, and the boards assess and report the patients' reaction to treatment. TAG [guidance](#) on R&D income covers three aspects of these contracts as summarised in the following table:

Aspect	Summary of guidance
Accounting for staged payments	As the board has an enforceable right to payment for performance completed to date, the performance obligation is regarded as satisfied over time. Income and expenditure should be recognised and presented gross as the contract progresses.
Treatment of surplus on commercial contracts	A liability should be recognised at 31 March for the element of any surplus due to external partners (e.g. universities). Any internal recharges (e.g. reallocation to a different budget head within a board) should not be recognised in the balance sheet.
Recovering costs on infrastructure support and capacity building	An asset should be recognised at 31 March where such costs are expected to be recovered.

55. Auditors should evaluate whether boards have properly recognised income, and any liability or asset, arising from clinical R&D contracts in 2022/23.

Other financial statement areas

Recognised capital grants are not complete or did not occur

56. A capital grant is an unrequited transfer payment from a health board to another public body which is required to use the grant to procure or improve assets from which the board's residents will benefit. Additional guidance on capital grants is provided in chapter 10 of the CAM

57. Auditors should evaluate whether the board has identified payments during 2022/23 where:

- grant has been paid to other public bodies
- the body has agreed to use the grant for specific purposes that meet the definition of capital expenditure; and
- it can be demonstrated that the capital expenditure contributes to the achievement of the board's objectives.

58. When making this evaluation in 2022/23, auditors should be aware that it would be inappropriate for boards to treat the following payments as capital grants:

- A payment in respect of a property considered to represent prepayment of lease rental; this should instead be accounted for in accordance with IFRS 16 Leases.
- A payment to a primary care practitioner where the expenditure to be funded is less than the £5,000 capitalisation threshold (unless they qualify to be treated as grouped assets).
- If the board has ownership of the asset or uses it directly, any upfront payment should be treated as a capital contribution or prepayment for the service. However, it may be appropriate to treat a contribution at the outset of a project as a capital grant if the asset is owned by a third party and not used directly by the board.
- Ongoing revenue payments in respect of resource transfer accommodation, which are the equivalent of rental payments.

Capital grants are not properly accounted for

59. Capital grants should be accounted for as revenue expenditure in the SoCNE but charged against the non-core RRL. Auditors should evaluate whether capital grants for 2022/23 have been:

- included as revenue items charged to the SoCNE
- deducted from the charge against the core RRL and added to the charge against the non-core RRL in the SoRO.

Amount set aside for hospital services are not properly calculated

60. IJBs are responsible for the strategic planning of hospital services most commonly associated with emergency care. Health boards are required to calculate in accordance with [guidance](#) issued by the Scottish Government an amount 'set aside' for the provision of these delegated services and advise the IJB accordingly. The resource 'set aside' is within the control of the IJB and should be included in the overall funding contribution.

61. The extent of compliance with the guidance varies across health boards. As an extended transitional arrangement, the Scottish Government continues to allow health boards and IJBs to agree a figure for the sum set aside based on the budget to be included in the financial statements.

62. Auditors should evaluate whether the board has calculated the 'set aside' for relevant services for 2022/23 in accordance with the guidance. Where that is not the case, auditors should evaluate whether the amount has been agreed with the IJB.

Total IJB contribution is not disclosed

63. Note 3 includes a line disclosing the contribution of the health board to the IJB. Where amounts provided to the IJB by the health board are included in other lines within note 3 (e.g. resource transfer), the 2022/23 accounts manual has been amended to require the total contribution to the IJB to be disclosed and explained as a footnote.

IJB overspends are not properly accounted for

64. Where an IJB anticipates that it will overspend for 2022/23, the integration scheme will set out the arrangements for how it should be met. The integration scheme may require additional funding from the health board either in 2022/23 or in future years. The following table sets out the required accounting treatment:

Funding overspend	Treatment
Additional 2022/23 funding	IJB recognises a debtor (eliminating the deficit) and the health board (and councils) recognise a creditor at 31 March 2023 (assuming payments not made before that date)
Additional funding in future years	No recognition of debtor (IJB shows a deficit) or creditor by the health board as future funding cannot be anticipated

65. Where an IJB has an overspend at 31 March 2023, auditors should evaluate whether the health board:

- has accounted for its share of additional funding in accordance with the integration scheme
- has recognised a creditor for any additional 2022/23 funding to the IJB outstanding at 31 March 2023
- has not recognised any amounts related to additional funding in future years.

Payments to independent primary care practitioners are not complete or did not occur

66. Health boards make payments to independent primary care practitioners for dental, ophthalmic and pharmaceutical services and to GP practitioners in respect of prescriptions. The payments are processed and made by NHS National Services Scotland (NSS) on behalf of the individual boards.

67. NSS undertakes verification checks before and after the payments have been made in accordance with [DL\(2018\)19 Revised Payment Verification Protocols](#). The results of these verification checks are communicated to boards throughout the year.

68. NSS procures a service auditor report from KPMG which will be issued in May 2023 to the health boards concerned. The external auditor of the NSS will review the work of the service auditor and report the results of the review to auditors of health boards.

69. When evaluating whether primary care expenditure is free from misstatement in 2022/23, auditors should consider the results of the payment verification reports and assurance reports.

The accounting treatment of personal protective equipment received at no charge is not appropriate

70. Health boards receive personal protective equipment from NHS NSS for use by their own staff. Boards are acting as principal in the transaction as they are consuming the items of equipment rather than passing them on to third parties (i.e. they are the 'customer' in terms of IFRS 15).

71. NHS NSS provides the equipment to boards at no charge. The appropriate accounting treatment entails boards recognising a non-cash grant at fair value and an equivalent amount of notional expenditure. NHS NSS has advised that it will provide boards with the necessary information for 2022/23. The auditor of NHS NSS will provide auditors of boards with a conclusion on the reasonableness of the methodology used in producing the information.

72. Auditors should evaluate whether the board has recognised a non-cash grant at fair value for personal protective equipment received at no cost during 2022/23 and an equivalent amount of notional expenditure.

SoRO is not properly disclosed

73. Page 9 of the accounts manual requires health boards to disclose in the SoRO note their total expenditure charged against the core and non-core RRL.

74. The SoRO should disclose net expenditure in the SoCNE, with the following deducted from it:

- Non-core expenditure.
- Non-discretionary expenditure on family health services (as funding for non-discretionary expenditure is not included in the RRL).
- Endowments fund's net expenditure (where consolidated).
- Associates and joint ventures accounted for on an equity basis to ensure only board expenditure is considered

75. Auditors should evaluate whether:

- information in the SoRO for 2022/23 has been properly disclosed
- items included in the non-core RRL, non-discretionary expenditure, and the net expenditure of the endowment fund and associates and joint ventures (ie IJBs) are properly deducted from net expenditure
- the SoRO is free from misstatement.

Disclosed agency arrangements are not complete

76. There may be a number of transactions in 2022/23 where health boards are acting as agents for the Scottish Government. They include the following examples:

- The vaccination programme for COVID-19 is delivered by health boards but TAG [guidance](#) advised that the limited extent of control or discretion exercised by boards means it would be reasonable to conclude that they are acting as agents.
- The supply of testing kits to the public where boards are acting as the agent of the Scottish Government.

77. Classification as agency transactions has the following impact on accounting treatment in 2022/23:

- The cost of the vaccines/testing kits should not be recognised as expenditure and the provision of the vaccines/testing kits should not be recognised as income.
- Unused supplies of vaccines/testing kits at 31 March 2023 are third party stock and should not be recognised as an asset by boards.
- The cost to the boards of delivering the vaccines/testing kits should be recognised as expenditure and the additional funding recognised as income.

13.3: Remuneration and Staff Report

Remuneration information is not accurate

78. Pages 20 to 24 of the accounts manual set out the requirements for disclosing the remuneration of board members and other senior employees. A proforma for the disclosure is provided on page 28.

79. Page 22 requires any payment for compensation on early retirement or for loss of office made under the terms of an approved compensation scheme to be disclosed. It requires disclosure of:

- a description of the compensation payment
- details of the total amounts paid.

80. Page 25 provides guidance on cases where the movement in the value of the pension benefit component of the total remuneration figure is negative. It requires the value to be expressed as zero, i.e. negative values should not reduce the total remuneration figure.

Information on fair pay is not properly disclosed

81. Pages 30 and 31 of the accounts manual provide guidance, including a proforma, on the disclosure of the information on fair pay required by the FReM.

82. The accounts manual is clear that agency staff are excluded from the calculation. This is because they are not employees on the payroll and instead their service is charged for by invoice. However, this is contrast with the guidance from the Treasury which requires agency staff to be included. In the interests of consistency, and because it is more specific guidance, Professional Support recommends that boards follow the accounts manual and exclude agency staff.

83. In either case, auditors should evaluate whether the board has clearly disclosed the approach adopted in 2022/23.

13.4: Statutory other information

Performance Report is not in accordance with the accounts direction

84. The [accounts manual](#) sets out requirements for the Performance Report on pages 6 to 12. The accounts manual applies the following requirements of the FReM to health boards that would not otherwise be applicable in Scotland:

- A short summary explaining the purpose of the overview section.
- A statement from the Chief Executive providing their perspective on performance.
- Non-financial information including social matters, respect for human rights, anti-corruption and anti-bribery matters and diversity
- Information on sustainability reporting using wording set out on page 11 of the accounts manual.

85. The accounts manual also requires the following information to be included in the Performance Report:

- Details of events after the reporting period.
- Information on the payment of suppliers using wording set out at page 11 of the accounts manual.
- Disclosures on reporting performance against financial targets using wording set out in the accounts manual.

86. Boards are required to meet the following financial targets:

- Revenue expenditure to remain within the RRL (as explained in section 2).
- Capital expenditure to remain within the CRL, which relates to capital expenditure on both a board's own non-current assets (core) and any service concession arrangements (non-core).
- Cash requirement, which is the total cash drawn to fund the cash consequences of ongoing operations and new capital investment.

87. In 2019/20, the Scottish Government planned to monitor achievement of the financial targets over a three-year period, and consider the target to be met even if a board overspends (or underspends) up to 1% of the limit on annual basis.

88. However, due to the impact of the COVID-19 pandemic, the Scottish Government paused the three-year monitoring for 2020/21 and 2021/22. Additional funding was provided to support in-year financial balance.

89. Notwithstanding the pausing of the three-year monitoring, the financial targets continue to apply. Page 10 of the 2022/23 accounts manual highlights that boards have taken steps to return to medium term financial planning and formal three-year financial planning will take effect in 2023/24. In effect 2022/23 therefore, represents the first year of reporting achievement of financial targets across the period 2022/23 to 2024/25. The requirement on auditors to report the failure to achieve a financial target therefore remains in 2022/23. The accounts manual provides suggested wording for boards to report the performance against the financial target on pages 9 to 10.

90. As a result of the accounts manual's different requirements for a Performance Report, a checklist specific for health boards is provided at Appendix 1 to this module which auditors should use when carrying out test procedure 2 set out in Module 11.

Directors' Report is not in accordance with the accounts direction

91. The accounts manual sets out its requirements for the Directors' Report on pages 14 to 16. In addition to the requirements of the FReM, the accounts manual also requires health boards to include the following in the Directors' Report:

- the authorised for issue date
- information on the appointment of auditors
- a Statement of Board Members' Responsibilities
- third party indemnity provisions
- information on non-audit work
- confirmation of the disclosure of information to auditors.

Statement of Accountable Officer's Responsibilities is not in accordance with accounts direction

92. As indicated above, the accounts manual requires confirmation of the disclosure of information to auditors to be included in the Directors' Report. This contrasts with the FReM which requires this item to be included in the Statement of Accountable Officer's Responsibilities.

93. Where a board follows the accounts manual's approach in 2022/23, auditors should confirm that there is a cross-reference from the Statement of Accountable Officer's Responsibilities.

Appendix 1: Checklist – content of Performance Report

Required item	Yes/No/N/A
Performance Overview	
1 A short summary explaining the purpose of the overview section.	
2 A statement from the Chief Executive providing their perspective on the performance of the board for 2022/23.	
3 A statement of the purpose and activities of the board including a brief description of the business model and environment, and organisational structure.	
4 A summary of the board's strategic objectives and goals.	
5 A summary of the principal risks faced and how these have affected the delivery of objectives, how they have changed, how they have been mitigated and any emerging risks that may affect future performance.	
6 Explanation of the adoption of the going concern basis where this might be called into doubt.	
7 A summary performance appraisal, providing a synopsis of the performance analysis section, and detailing whether performance has met expectation, including an explanation if performance is below expectation.	
Performance Analysis	
8 Objectives and progress made against them, using unbiased indicators, incorporating qualitative, quantitative and prior year information.	
9 Trend information in indicators.	
10 A financial review, detailing financial performance using any further key financial indicators or measures.	
11 Detail on future plans, and expected future performance, including anticipated changes in the structure or strategic objectives.	
12 Non-financial information including social matters, respect for human rights, anti-corruption and anti-bribery matters; and diversity.	
13 An explanation of performance against financial targets.	
14 Information on the payment of suppliers.	

Required item	Yes/No/N/A
15 Information on sustainability reporting.	
16 Details of events after the reporting period.	

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Technical Guidance Note 2023/1 Module 13

Risks of misstatement specific to health boards in 2022/23

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Audit Scotland, 4th Floor, 102 West Port, Edinburgh EH3 9DN
Phone: 0131 625 1500 Email: info@audit-scotland.gov.uk
www.audit-scotland.gov.uk