Technical Bulletin 2020/4

Technical developments and emerging risks from October to December 2020

Prepared for appointed auditors and audited bodies in all sectors

16 December 2020

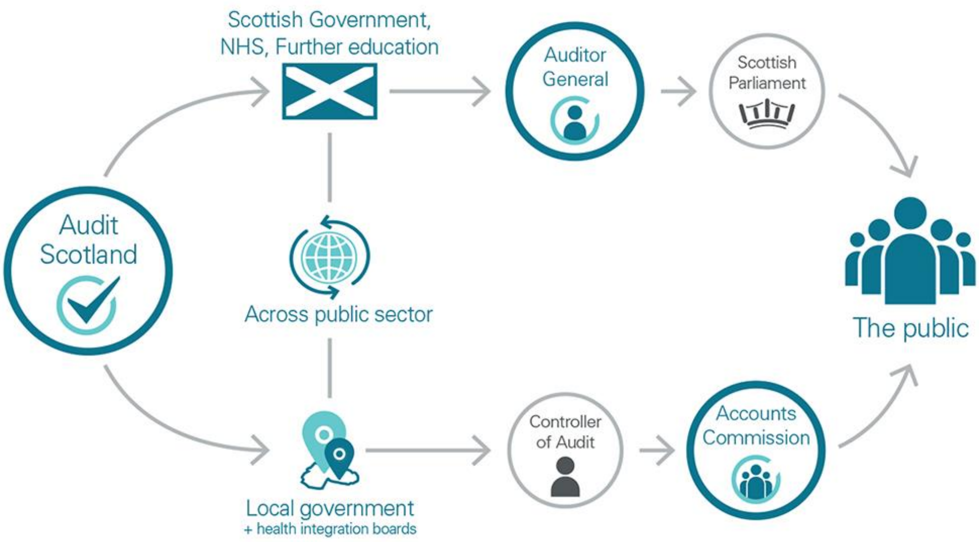
Who we are

The Auditor General, the Accounts Commission and Audit Scotland work together to deliver public audit in Scotland:

- The Auditor General is an independent crown appointment, made on the recommendation of the Scottish Parliament, to audit the Scottish Government, NHS and other bodies and report to Parliament on their financial health and performance.

- The Accounts Commission is an independent public body appointed by Scottish ministers to hold local government to account. The Controller of Audit is an independent post established by statute, with powers to report directly to the Commission on the audit of local government.

- Audit Scotland is governed by a board, consisting of the Auditor General, the chair of the Accounts Commission, a non-executive board chair, and two non-executive members appointed by the Scottish Commission for Public Audit, a commission of the Scottish Parliament.



About us

Our vision is to be a world-class audit organisation that improves the use of public money.

Through our work for the Auditor General and the Accounts Commission, we provide independent assurance to the people of Scotland that public money is spent properly and provides value. We aim to achieve this by:

- carrying out relevant and timely audits of the way the public sector manages and spends money

- reporting our findings and conclusions in public

- identifying risks, making clear and relevant recommendations.

Contents

Introduction

Purpose

Technical Bulletins provide information on developments and guidance on emerging risks

1. The purpose of Technical Bulletins from Audit Scotland's Professional Support is to provide auditors appointed by the Auditor General and Accounts Commission with:
   - information on the main technical developments in each sector during the quarter
   - information on professional matters during the quarter that are expected to have applicability to the public sector
   - guidance on any emerging risks identified in the quarter.
2. Appointed auditors are required to pay due regard to Technical Bulletins. The information on technical developments is aimed at highlighting the key points that Professional Support considers auditors in the Scottish public sector require to be aware of. It may still be necessary for auditors to read the source material if greater detail is required. These can be accessed by using the hyperlinks. They are also available from the Technical Reference Library maintained by Professional Support.
3. The actions by auditors recommended by Professional Support in respect of each item are highlighted in red and are also summarised at the end of each section.
4. Technical Bulletins are also published on the Audit Scotland website and therefore are available to audited bodies and other stakeholders. However, hyperlinks in this bulletin indicated with an asterisk link to documents on the Technical Reference Library and therefore are active only for auditors.

Highlights summary

5. Professional Support draws attention in the following table to certain items in this Technical Bulletin:

Highlights summary		
Professional Support has published guidance on planning 2020/21 audits [see paragraph 7]	PAF has issued a revised edition of PN 10 [see paragraph 11]	Professional Support has published guidance on risks of misstatement in 2020/21 local government annual accounts [see paragraph 22]
CIPFA has issued guidance notes on the 2020/21 accounting code [see paragraph 26]	CIPFA/LASAAC has issued a consultation on applying IFRS 16 to housing tenancies [see paragraph 30]	LASAAC has issued draft revised guidance on reserves for consultation [see paragraph 33]
The Scottish Government has announced financial flexibilities for councils [see paragraph 35]	The Scottish Government has announced further COVID-19 support schemes [see paragraph 41]	CIPFA/LASAAC and Treasury have deferred implementing IFRS 16 until 2022/23 [see paragraphs 30 and 62]
The FRC has issued proposed revisions to the audit standard on fraud [see paragraph 66]	The FRC has issued a report on developments in audit [see paragraph 69]	The FRC has issued a report on corporate reporting [see paragraph 86]

Contact point

Feedback on this Technical Bulletin is welcome

6. The main contact point for this Technical Bulletin is Paul O'Brien, Senior Manager (Professional Support) – pobrien@audit-scotland.gov.uk.

Section 1

Cross-sector

Guidance on planning 2020/21 audits

7. Professional Support has issued guidance to assist all appointed auditors in planning their 2020/21 audits of public bodies. The guidance is available to auditors with other supporting materials on SharePoint* but is also freely available on the Audit Scotland website.

8. The guidance covers the main activities that comprise core audit work and the products associated with each activity. It recognises the impact of COVID-19 on the timing of the 2019/20 audits and the consequent late start to 2020/21 audits, the challenges in completing audits remotely, and the additional complexities and uncertainties.

9. The following table provides a summary of the key changes from last year, along with the section of the guidance in which further information is provided:

Nature of change	Relevant section
Submission deadlines for Annual Audit Plans have been moved back a month	1
Rates for additional audit work have been revised	1
Submission deadlines for audited annual accounts have been provisionally moved	2
Guidance has been provided to focus auditors' risk assessments on the audit dimensions in light of the impact of COVID-19	3A
Reporting on the risk of fraud and corruption in the procurement function may be in 2020/21 or 2021/22 Annual Audit Reports	3A
Submission deadline for Best Value Audit Plans have been moved back to 30 April	3B
The list of councils where a Best Value Assurance Report is required has been updated	3B
Guidance added clarifying Best Value work in other local government bodies	3B
Auditors in local government are not required to consider Strategic Audit Priorities	3C
Guidance updated on considering the arrangements for statutory performance information in local government	3D
No requirement for auditors to contribute to performance audit reports or impact reports	4
Guidance updated on involvement in National Fraud Initiative	5K

10. The guidance supplements the Code of Audit Practice, and auditors are therefore required to plan their 2020/21 audits in accordance with it.

Auditor action

Auditors should plan their 2020/21 audits in accordance with this guidance

Revised practice note on auditing public bodies

Auditor action
Auditors should pay due regard to PN 10

11. The Public Audit Forum has issued a revised version of Practice Note 10 Audit of Financial Statements and Regularity of Public Sector Bodies in the UK (PN 10). Audit Scotland and the other UK audit agencies require auditors to pay due regard to PN 10. It comprises the following two parts:

- Part 1 contains guidance on the application of quality control and auditing standards to the audit of public sector bodies. It is based on standards which were in effect at 1 September 2020. Paragraph 1-1 indicates the standards on which application guidance is provided.
- Part 2 sets out guidance on the audit of, and expressing an opinion on, the regularity of transactions.

12. A significant aspect of PN 10 is the guidance on applying ISA (UK) 570 Going Concern to the public sector. Paragraphs 1-147 to 1-183 of PN 10 have been extensively revised to clarify the importance of the applicable financial reporting framework in determining the extent of the auditor's procedures.

Guidance on going concern has been refreshed

13. If the financial reporting framework requires the adoption of the going concern basis of accounting due to the anticipated continuation of service provision, auditors apply paragraphs 1-157 to 1-164. In essence, the going concern basis of accounting will continue to be appropriate at least until there is an intention to wind up the body.

14. Where there is a known intention to wind up a body, paragraphs 1-167 to 1-176 apply. Where the body's activities are likely to be transferred elsewhere in the public sector, the going concern basis of accounting is likely to remain appropriate. If the activities are not to be transferred within the public sector, auditors may decide to request that the body secures from the relevant department a letter of support.

15. A summary of the other main changes to PN 10 is provided in the following table:

ISA (UK)	Key changes
540	The issue in December 2019 of the revised standard on auditing estimates has been reflected. Guidance has been added at paragraph 1-116 on inherent risk factors relevant to the public sector, with examples such as • a very high degree of estimation uncertainty caused by the need to project forecasts far into the future, such as liabilities relating to defined benefit pension schemes • areas where there may be a lack of available comparators for estimates that are unique to the public sector, such as the valuation of important public assets • the existence of possible constructive obligations created by political statements or past practice of carrying out actions that may be expected of public authorities but are not required by law • general political uncertainty and the possibility of future changes in public policy having an impact on the assumptions used to prepare accounting estimates.
560	The guidance on determining the date the financial statements are authorised for issue and the date they are issued has been refreshed. Paragraph 1-136 has been amended to advise that central government financial statements are considered to be issued on the date of laying rather than the date of despatch for laying.
720	Paragraph 1-226 has been added to provide guidance on when the reporting framework requires that the 'other information' presented is fair, balanced and understandable. Paragraph 1-228 has been added on statutory other information, on which the auditor is required to express a positive statement in the auditor's report.

Guidance for auditors on 2019/20 Whole of Government Accounts

16. Professional Support has published Technical Guidance Note 2020/7 to provide auditors with guidance on examining and reporting on the 2019/20 Whole of Government Accounts (WGA) returns of relevant public bodies. The TGN is available with supporting material to auditors on SharePoint and is also freely available from the Audit Scotland website.

17. The National Audit Office (NAO) is the group auditor for WGA and has prescribed a threshold for auditor assurance of £500 million for 2019/20 for all public bodies in Scotland. No examination is required for bodies below the threshold but auditors are required to partially complete the Assurance Statement and submit it to the NAO. Testing and other procedures that auditors are required to undertake in respect of providing assurance to the NAO on 2019/20 WGA returns above the threshold are set out in the TGN.

18. The main changes from 2018/19 are as follows:

- Data will be collected for the 2019/20 WGA by bodies inputting information directly to the Online System for Central Accounting and Reporting.
- Bodies will be able to run the counterparty matches report (now called the Matches Analysis Tool) themselves.
- Gateway tests are no longer required. The validation test, that was previously a gateway test, is now conducted as a fieldwork test.
- Auditors are required to submit an Audit Completion Template and the final WGA return to Treasury.

Auditor action
Auditors should examine the 2019/20 WGA returns in accordance with this guidance

19. Auditors are required to examine and report on 2019/20 WGA returns in accordance with this TGN.

Summary of auditor actions in this section

Paragraphs	Auditor actions
7 - 10	Plan 2020/21 audits in accordance with the guidance on planning
11 - 15	Pay due regard to the revised PN10 in applying auditing standards to the audit of public bodies
16 – 19	Examine and report on 2019/20 WGA returns in accordance with TGN 2020/7

Contact point for this section

20. The contact for this section of the Technical Bulletin is Paul O'Brien, Senior Manager (Professional Support) - pobrien@audit-scotland.gov.uk.

Section 2

Local government sector

Auditing developments

Technical Guidance Note on risks of misstatement in 2020/21

22. Professional Support has published Technical Guidance Note (TGN) 2020/8(LG) to provide auditors with guidance on risks of misstatement in 2020/21 annual accounts of local government bodies. The TGN is available with supporting material to auditors on SharePoint* and is also freely available from the Audit Scotland website.

Auditor action
Auditors should pay due regard to TGN 2020/8(LG)

23. The TGN is intended to inform auditors' judgement when identifying and assessing the risks of material misstatement in 2020/21. The TGN supplements the Code of Audit Practice and auditors are expected to pay it due regard and use it as a primary reference source when performing 2020/21 audits.

24. The TGN structure comprises a number of modules as summarised in the following table:

Module	Risks of misstatement area	Purpose
Overview	Areas that are pervasive to the financial statements as a whole	Explains the appropriate related accounting treatment and sets out the action auditors should undertake to evaluate whether the body has followed the required treatment
1 - 9	Specific classes of transactions, balances and disclosures in the financial statements.	
10	Audited part of the Remuneration Report	Explains the requirements and sets out the action auditors should undertake
11	Statutory Other Information (e.g. Management Commentary and Annual Governance Statement)	Sets out the procedures for considering the Statutory Other Information
12	Integration joint boards	Provides guidance on the application of the above modules to these specific bodies
13	Pension fund accounts	
14	Section 106 charities	

25. The risks of misstatement for 2020/21 have been updated to reflect new requirements and risks which emerged during the 2019/20 audits that remain applicable.

Financial statements developments

2020/21 guidance notes

26. The Chartered Institute of Public Finance and Accountancy (CIPFA) has issued guidance notes* on the 2020/21 accounting code*. The overall aim of the guidance notes is to explain and illustrate how to apply the accounting requirements of the accounting code, provide background to those requirements, and illustrate how they might be applied in practical situations. The guidance is not mandatory.

The guidance notes are not mandatory

27. This edition of the guidance notes has been updated to reflect changes to the 2020/21 accounting code including the following:

- Amendments to reflect changes to the definition of material which now makes reference to the concept of obscuring information.
- Implementation of amendments to IAS 19 in respect of a pension scheme amendment, curtailment or settlement occurring during the year.
- Amendments to the disclosure requirements for pension funds in respect of pooled investment vehicles.
- Clarifications in respect of aspects of financial instruments.

The guidance notes have been updated to reflect changes to the 2020/21 accounting code

Proposed change to accounts deadlines for 2020/21

28. The Scottish Government is consulting* on proposed changes to the approval and publication deadlines for the 2020/21 annual accounts. The proposed changes are set out in the following table:

Action	Current date	Proposed date
Approval to sign off accounts	30 September	31 October
Publication of accounts	31 October	15 November

29. There are no proposed changes to the 30 June deadline for the unaudited accounts.

Consultation on secure tenancies under IFRS 16

30. The CIPFA/LASAAC Local Authority Code Board (CIPFA/LASAAC) will shortly be issuing for consultation proposals on how housing secure tenancy agreements should be treated under IFRS 16 Leases. CIPFA/LASAAC has announced the further deferral of the implementation of IFRS 16 until 1 April 2022. The proposals in the consultation are therefore expected to affect the 2022/23 accounting code.

31. The consultation questions, with additional information, are summarised in the following table:

Question	Consideration and proposal
Is a secure tenancy agreement a lease for accounting purposes?	On the balance of factors, the proposal is that secure tenancy agreements meet the definition of a lease in IFRS 16.
Is it a finance or an operating lease?	Based on a consideration of both primary and secondary indicators, secure housing tenancy agreements are operating leases. There is a proposal to include an interpretation in the accounting code so that housing tenancy agreements are classified as operating leases.
What disclosures are requirement?	Disclosure requirements for operating leases are either already met by existing disclosures or are not relevant. There is a proposal to include an interpretation that operating lease disclosure requirements do not apply.

32. Comments on the proposals should be sent to cipfalasac@cipfa.org.

Consultation on revised reserves guidance

33. The Local Authority (Scotland) Accounts Advisory Committee (LASAAC) has issued a consultation paper of updated guidance on the statutory basis and accounting for reserves. The guidance issued in 2005 is being revised for changes in the financial reporting framework in the period since then. It is also proposed that the status of the guidance should be changed to mandatory.

34. Comments should be sent to lasaac@cipfa.org by 29 January 2021. They are particularly requested on the aspects of the guidance set out in the following table:

Aspect	Paragraph	Nature of change
The recommended distinction between mandatory and discretionary earmarking	20	It is recommended that local government bodies draw a distinction between: • 'mandatory earmarked balances', e.g. gains on financial assets classified as fair value through profit or loss; and • 'voluntary earmarked balances', e.g. reflecting the body's discretionary financial management plans for the use of funds.
The new requirement to separately disclose any deferred capital receipts	30	Deferred capital receipts include sales proceeds paid in instalments. Where deferred capital receipts are held in the Capital Fund, it is proposed that the relevant balance should be specifically disclosed in the notes.
The guidance on the treatment of capital expenditure funded from the Renewal and Repair Fund	32	An amount equivalent to the capital expenditure incurred should be transferred from the Renewal and Repair Fund to the Capital Adjustment Account.
The specified treatment for the valuation element of depreciation	50	The accounting code allows local government bodies to either: • treat all depreciation as a statutory adjustment; or • split depreciation into the historical cost element (statutory adjustment to Capital Adjustment Account) and the valuation element (reserve transfer to Revaluation Reserve). For consistency of reporting, the guidance proposes making the second option mandatory. The option treating the valuation element of depreciation as a statutory adjustment would therefore be withdrawn.
The requirement to disclose earmarked elements of the General Fund	54	The accounting code requires an analysis of earmarked reserves to be disclosed in a note. The guidance proposes applying that requirement to earmarked elements of the General Fund or other statutory fund.

Financial flexibilities for 2020/21 and 2021/22

35. A package of financial flexibilities has been agreed between the Scottish Government and the Convention of Scottish Local Authorities to address the funding pressures faced by local government due to COVID-19.

36. The flexibilities will be available in 2020/21 and/or 2021/22, and are summarised in the following table:

Area	Years	Nature of flexibility
Application of capital receipts	2020/21 and 2021/22	Councils will be permitted to use capital receipts to finance the financial impact of COVID-19.
Revision of statutory charge for leases and service concession arrangements	Apply from 2020/21 or 2021/22	Councils will be allowed to charge depreciation to the General Fund over the life of the asset rather than charge the debt element over the contract period. Councils will have the flexibility to apply this change in either 2020/21 or 2021/22 and this approach will apply to all such arrangements from the implementation of IFRS 16 Leases.

Area	Years	Nature of flexibility
Loans fund repayment holiday	2020/21 or 2021/22	Councils will be permitted to defer loans fund repayments due to be repaid in either 2020/21 or 2021/22.

37. The Scottish Government expects councils to consider:

- the contribution their reserve balances can make to meeting their funding pressures
- the resources available from capital receipts and the change in accounting arrangements for leases and service concession arrangements before taking advantage of a loans fund repayment holiday.

Capital receipts

38. Draft statutory guidance* has been issued in respect of the use of capital receipts. Key aspects of the proposals are summarised in the following table:

Aspect	Proposal
Qualifying expenditure	The statutory guidance does not define qualifying expenditure. The local authority will be required to demonstrate, by reporting to full council, how the capital receipts are to be used to fund the financial impact of COVID-19. Full council will be required to approve the use.
Qualifying capital receipts	Only capital receipts received in 2020/21 or 2021/22 can be applied. The decision on use is required to be made in the year the capital receipt is recognised.
Accounting treatment	The capital receipt requires to be transferred as a statutory adjustment to the Capital Grant and Receipts Unapplied Account in the year of receipt. Capital receipts so transferred in 2020/21 can be applied in that year or in 2021/22. Any unused capital receipts at 21 March 2022 would be transferred to the Capital Fund.
Disclosure requirements	The reason for each transfer of capital receipts from the Capital Grants and Receipts Unapplied Account to the General Fund or Capital Fund should be disclosed. All the elements of the balance on the Capital Grants and Receipts Unapplied Account are to be disclosed separately.

39. Comments should be sent to Hazel.Black@gov.scot by 18 January 2021.

Loans fund repayment holiday

40. The Local Authority (Capital Finance and Accounting)(Scotland)(Coronavirus) Amendment Regulations 2021* are being prepared in respect of the loans fund repayment holiday. This will allow a council to defer loans fund repayments due in either 2020/21 or 2021/22 (but not both years). Any deferred repayment is to be repaid within the shorter of:

- the remaining period of the loans fund advance to which that deferral relates; or
- 20 years.

New COVID-19 support schemes

41. The Scottish Government has provided information on the following two new COVID-19 support schemes that are being administered by councils:

- Restrictions Fund
- Strategic Framework Business Fund.

42. The Restrictions Fund ran from 9 October until 1 November and was intended to support employees and businesses impacted by the COVID-19 restrictions that came into force in that period. The four individual funds comprising the Restrictions Fund are summarised in the following table:

Fund	Applicability	Rateable Value (RV)	Grant
Closure Fund	Business premises in the five health board areas that had to close	RV of up to and including £51,000	£2,875
		RV of £51,001 and above	£4,310
Furlough Costs Fund	Business premises in the five health boards that were required to close and furlough employees	N/A	£1,650
Hardship Fund	Business premises that remained open but were significantly impacted by the restrictions including those in the direct supply chains of firms that closed	RV of up to and including £51,000	£1,440
		RV of £51,001 and above	£2,155
Contingency Fund of £11 million	Businesses not covered by the above funds (night clubs and soft play)	RV of up to and including £18,000	£10,000
		RV of between £18,001 - £51,000	£25,000
		RV of above £51,001	£50,000

43. The Strategic Framework Business Fund is intended to support businesses required to close by law, or to significantly change their operations, due to COVID-19 restrictions from 2 November 2020. The two grants are summarised in the following table:

Grant	RV up to and including £51,000	RV more than £51,000
Temporary closure	£2,000	£3,000
Business restrictions grant (business is specifically required to modify its operations)	£1,400	£2,100

44. Grants will be paid every 4 weeks in arrears as long as restrictions last. Grant funding for eligible businesses will cover the period of any closures or restrictions with the earliest claim date being 2 November 2020.

Bulletin on McCloud and Goodwin cases

45. CIPFA issued a supplement to CIPFA Bulletin 5 to provide an update on the McCloud and Goodwin cases in respect of pension liabilities. It confirmed that the Scottish Government consultation on proposals to provide a remedy to the McCloud and Sargeant cases is an adjusting event.

46. Local government bodies were advised to assess whether the change in the assumptions would make a material difference to the estimate of pension liabilities. If the difference was material, bodies were advised to commission revised IAS 19 reports and adjust the 2019/20 accounts accordingly.

47. For the Goodwin case, although proposals have not yet been published, a statement from the Treasury confirmed that changes will be required that will increase pension liabilities. The bulletin advised bodies to consider, in discussion with their actuaries, the materiality of the impact on pension liabilities and therefore whether an adjustment is required in 2019/20.

Statutory Other Information developments

Guidance on internal audit assurance

48. CIPFA has issued guidance on the provision of internal audit assurances in 2020/21. The impact of COVID-19 has raised the question of whether internal audit will be able to undertake sufficient work during 2020/21 to fulfil the requirements of the Public Sector Internal Audit Standards (PSIAS). Specifically, the head of internal audit (HIA) is required to issue an annual opinion on the overall adequacy and effectiveness of the body's framework of governance, risk management and control.

49. The guidance confirms that the professional and regulatory expectations on local government bodies to ensure that their internal audit arrangements conform with PSIAS have not changed. HIAs need to consider whether they can still issue the annual opinion or whether there will need to be a limitation of scope. A limitation of scope arises where the HIA is unable to draw on sufficient assurance to issue a complete annual opinion in accordance with the professional standards.

HIAs need to consider a limitation of scope

50. This guidance addresses the importance of early identification of the risk of limitation of scope. It suggests the following mitigating actions to avoid such a limitation where possible:

- The HIA should plan to obtain sufficient assurance to support the annual opinion, taking into account both internal audit work and other sources of assurance. The reliance the HIA is placing on other sources of assurance should be disclosed in the overall opinion.
- The HIA, leadership team and audit committee should review and discuss internal audit capacity where there are concerns and develop an action plan to mitigate the risk.
- The HIA should make best use of their audit resources to maximise assurance.
- Where the HIA considers that a limitation of scope is likely, the leadership team and audit committee should be advised promptly. The HIA should set out the likely consequences assessed and advise on remedial action to avoid a limitation of scope.

51. If a limitation of scope does become necessary, page six of the guidance suggests possible wording for the HIA to use in the report depending on the type of limitation.

52. The HIA opinion is one of the sources of assurance that the body relies on for its annual governance statement. Where the HIA annual opinion contains a limitation of scope, the guidance advises the body to state this in the annual governance statement.

Grant claim certification

Housing subsidy certification

53. The Department for Work and Pensions (DWP) has revised the software diagnostic tool component (Module 5) of the approach to the certification of the 2019/20 housing benefit subsidy claims for councils using Capita benefit systems.

54. The Social Security (Scotland) Act 2018 (Information-Sharing and Scottish Child Payment) (Consequential Provision and Modifications) Order 2020 provides for the new Scottish Child Payment to be disregarded as income or capital when determining a claimant's entitlement to housing benefit.

Summary of auditor actions in this section

Paragraphs	Auditor actions
22 - 25	Pay due regard to TGN 2020/8(LG) when planning and performing the audit of the 2020/21 annual accounts

Contact point for this section

55. The contact point for this section of the Technical Bulletin is Paul O'Brien, Senior Manager (Professional Support) - pobrien@audit-scotland.gov.uk

Section 3

Central government sector

Financial statements developments

2020/21 discount rates

56. HM Treasury has issued PES(2020)12* which announces the change in the discount rate for general provisions, post-employment benefits liabilities, and financial instruments as at 31 March 2021.

57. The nominal discount rates to be applied as at 31 March 2021 for discounting general provisions recognised under IAS 37 are set out in the following table:

Category	Period	Percentage
Short term	Within 5 years	(0.02%)
Medium term	Between 5 and 10 years	0.18%
Long term	Between 10 and 40 years	1.99%
Very long term	More than 40 years	1.99%

Auditor action
Auditors should refer to this guidance when auditing the 2020/21 financial statements

58. 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:

- 1.2% for up to one year from the year end
- 1.6% between one and two years
- 2% for after two years.

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

Use	Rate from 31 March 2021
Real rate used for valuing unfunded pension scheme liabilities and early departure provisions	(1.03)%
Nominal rate for unwinding discount on liabilities (interest)	1.25%
Rate used for funded pension schemes	Based on returns from AA corporate bonds at 31 March

60. The financial instrument discount rates to be applied at 31 March 2021 are set out in the following table:

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

61. The paper also specifies a rate to be used for leases under IFRS 16. The 2021 nominal lease discount rate of 0.91% is only relevant for transition to IFRS 16 and for new leases that commence or are remeasured between 1 January 2021 and 31 December 2021.

IFRS 16 implementation

62. Treasury has issued a letter* announces the deferral of implementing IFRS 16 Leases until 1 April 2022. The delay is in light of pressures caused by the COVID-19 pandemic.

63. Bodies are permitted to implement IFRS 16 from 1 April 2021 provided they obtain approval from the Scottish Government.

Effective date for IFRS 16 will be 1 April 2022

Summary of auditor actions in this section

Paragraphs	Auditor actions
56 - 61	Refer to the guidance on 2020/21 discount rates

Contact point for this section

64. The main contact point for this section of the Technical Bulletin is Neil Cameron, Manager (Professional Support) – ncameron@audit-scotland.gov.uk.

Section 4
Professional matters

Auditing developments

Proposed revisions to standard on fraud

65. The Financial Reporting Council (FRC) has issued proposed revisions to ISA (UK) 240 The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements. Comments should be sent to AAT@frc.org.uk by 29 January 2021.

66. The proposed revisions are intended to:

- address the recommendation in the Brydon Review (covered in Technical Bulletin 2020/1 – paragraph 88) to clarify the obligations of auditors in respect of detecting fraud
- include enhancements of the requirements for the identification and assessment of risk of material misstatement due to fraud and the procedures to respond to those risks.

The proposals address the Bryden recommendation in respect of clarity over responsibilities

67. The main proposed revisions are summarised in the following tables:

Introduction

Paragraph	Proposal
3	Clarification that the evaluation of whether fraud is material should take into account the qualitative as well as quantitative characteristics of the fraud.
7-1	Clarification that the higher risk of not detecting a material misstatement resulting from fraud compared with error does not diminish the auditor's responsibility to obtain reasonable assurance about whether the financial statements are free of material misstatement due to fraud.

Professional scepticism

Paragraph	Proposal
12-1	New requirement that the auditor should not be biased towards obtaining evidence that may be corroborative or towards excluding audit evidence that may be contradictory.
13-1 and A9-1	Clarification that the auditor should remain alert for conditions that indicate a record or document may not be authentic. Examples are provided of conditions that may indicate a physical or electronic document is not authentic or has been tampered with.
14	New requirement for the auditor to investigate responses to inquiries that appear implausible.

Discussion among the audit team

Paragraph	Proposal
15-1 to 15-3 and A11	Specification of matters to be covered in the discussion, including how management could perpetrate and conceal fraudulent financial reporting and how assets of the entity could be misappropriated. Examples of matters that may be discussed are provided.

15-4	New requirement that the appointment lead should determine whether there should be further discussions at later stages in the audit to consider fraud risk factors. Examples of circumstances where it may be beneficial to have a further discussion are provided.

Risk assessments

Paragraph	Proposal
16	Clarification that the understanding obtained by the auditor includes the fraud risk factors relevant to the entity that affect the susceptibility of assertions to material misstatement due to fraud.
18-1	New requirement that the auditor makes inquiries of those persons who are responsible for dealing with allegations of fraud raised by employees or other parties.
21-1	Emphasis that the auditor should determine the implications for the audit if responses to inquiries of those charged with governance are inconsistent with the responses to the inquiries of management.
24-1, 27-1 and A27-1	New requirements that the auditor should determine whether the audit team requires specialised skills or knowledge to perform particular procedures and, whether a forensic expert is needed to investigate a fraud further. Examples of matters that may affect the auditor's determination are provided.

Responses to the assessed risks

Paragraph	Proposal
32-1	Emphasis that in evaluating possible management bias in making accounting estimates, the auditor should also comply with the relevant requirements in ISA (UK) 540.
36-1	Emphasis that in performing the overall evaluation of audit evidence, the auditor should evaluate whether: • the assessments of the risks of material misstatement at the assertion level due to fraud remain appropriate • sufficient appropriate audit evidence has been obtained regarding the assessed risks of material misstatement due to fraud, and should conclude whether the financial statements are materially misstated as a result of fraud.

Independent auditor's report

Paragraph	Proposal
39-1	Clarification that, when explaining the extent to which the audit was considered capable of detecting irregularities, including fraud, the wording should not be 'boilerplate'.

Communications to management and those charged with governance

Paragraph	Proposal
42	New requirement that the auditor should consider any matters regarding management's process for identifying and responding to the risks of fraud and the auditor's assessment of the risks of material misstatement due to fraud.

Communications to management and those charged with governance

Paragraph	Proposal
45-1	Emphasis that the auditor should document how they addressed any identified information that is inconsistent with their final conclusion regarding a significant matter.

Report on developments in audit during 2020

68. The FRC has issued its Developments in Audit report for the year. The report focuses on the work the FRC undertook to drive improvements in audit quality during 2020.

Inconsistent audit quality

69. The FRC's quality monitoring activities again showed that audit quality remained too inconsistent; 49 out of the 130 audits inspected in the 2019/20 inspection cycle required either improvement or significant improvement.

70. Insufficient challenge of the management of audited bodies remains one of the most frequent issues identified. The need to challenge management often arises when auditors evaluate their forward-looking judgements and estimates. Management may be consciously or unconsciously biased towards particular outcomes or assumptions.

Insufficient challenge of management

71. Auditors may also have an unconscious bias towards corroborating management's assumptions, rather than challenging them or seeking alternative evidence. They may also rely too much on prior knowledge, leading to a ready acceptance of management's assumptions.

72. The report highlights that establishing the extent of evidence needed to support a judgement in relation to uncertainties is a skill rather than a specific audit test. It requires the correct mindset and sufficient professional scepticism in evaluating the facts presented by management and how these compare to other evidence obtained. Auditors should form their own informed expectations as this would allow the auditor to identify and consider objectively the range of evidence relevant to the audit issue, and to ask the right questions, often through an iterative process requiring multiple discussions and time for reflection.

73. The report is clear that auditors need to understand why they continue to underperform in this area. Audit firms should encourage audit partners to take the time required when dealing with large and complex judgements. Where necessary, effective challenge of management should be given a higher priority than meeting deadlines.

Impact of COVID-19 on audit work

74. The inconsistent audit quality was found in audits that were completed before the impact of COVID-19. The economic impact of the pandemic has increased the complexity of many forward-looking accounting judgements. This makes effective challenge of management even more difficult.

75. The areas where the most significant impacts of the pandemic on auditing have been, and will continue to be, are summarised in the following table:

Area	Impact
Judgement	COVID-19 has made the business prospects of some companies highly uncertain, raising questions about whether there is a material uncertainty around going concern. Other judgements have also become more difficult, for example, valuation of illiquid or intangible assets and impairment assessments.
Remote working	The inability to meet with management face-to-face continues to create additional risks and complexities, particularly for areas where auditors normally obtain evidence in person, such as inventory counts.
Controls and fraud risk	Controls may be less effective, as some companies have cut back on the number of people involved in the internal control processes. For example, 45% of internal audit staff had been redeployed to support other areas of the business, while 15% were furloughed.

Accounting developments

IFRS adoption process

76. The FRC has issued a letter that explains the arrangements that will be in place for accounting and reporting standards after the UK leaves the EU.

77. All UK incorporated companies that are currently required to use international accounting standards that have been endorsed by the EU (EU-adopted IFRS) will need to use UK-adopted IFRS for financial years that begin on or after 1 January 2021.

IFRS will be endorsed by a UK board

78. Public sector bodies will use EU-adopted IFRS for 2020/21 and will move to UK-adopted IFRS in 2021/22.

79. On 1 January 2021, UK-adopted IFRS and EU-adopted IFRS will be identical. The UK Accounting Standards Endorsement Board is being established to endorse and adopt new or amended IFRS into the body of UK-adopted IFRS. The board is expected to be operational early in 2021.

80. The consolidated set of UK-adopted IFRS will be accessible on the UK board's website.

Thematic review on cash flow statements

81. The FRC has issued a report following their thematic review of cash flow statements. This was highlighted as an area requiring review due to the frequency of errors that had been identified. The objective of the thematic review was therefore to:

- explore in more detail the issues previously identified
- provide further guidance to avoid some of the more common errors.

82. The review found the following issues:

- material inconsistencies between items in the cash flow statement and the notes
- missing or incorrectly classified cash flows
- inconsistencies between financing cash flows and the reconciliation of changes in liabilities arising from financing activities in the notes.

Most of the errors were basic

83. Most of the errors were basic and evident from a desk top check. The appendix to the report provides more detail on each error. The FRC believes they could have been avoided by more robust checking prior to issue.

84. The review also identified several areas for improvement in the disclosure of accounting policies for the treatment of significant and large one-off transactions in the cash flow statement and the disclosures of related accounting policies and judgements.

Report on 2019/20 corporate reporting

85. The FRC has issued a report on the main findings arising from it monitoring of corporate reporting in 2019/20. It sets out:

- the current state of corporate reporting in the UK
- the main features of high quality reporting
- areas requiring improvement.

86. The report reminds entities that they need to meet the overarching objectives of accounting standards as well as their detailed disclosure requirements. This is particularly relevant where entities have to explain novel transactions or unusual circumstances, such as the effects of the COVID-19 pandemic.

87. Although COVID-19 has changed the context for corporate reporting, the key considerations of clarity, consistency, relevance and transparency remain. High quality disclosures:

- are specific to the entity
- explain clearly how COVID-19 has affected the reported financial position and performance, and how it may affect future prospects

Key reporting considerations remain despite COVID

- provide information on significant accounting judgements, sources of estimation uncertainty and other assumptions applied
- show a consistent outlook across the business model, principal risks and uncertainties, and accounting judgements and estimates.

88. The report highlights the main areas for improvement that have been identified. Those with potential relevance to the public sector are summarised in the following table:

Areas	How to address them
Estimates and judgements	Critical judgement disclosures should be tailored to each entity and not just repeat the accounting standard. They should explain the specific accounting judgements made and the effects. Sources of estimation uncertainty should be quantified. Information about sensitivities or ranges of outcomes should be disclosed to help users understand the effect of management's assumptions.
Impairment of assets	Entities which disclose significant judgements about whether to test assets for impairment need to explain the outcome of those judgements, the basis for the assumptions made and any sensitivities to changes in those assumptions.
Revenue from contracts with customers	When revenue is recognised over time, rather than at a point, entities should explain the basis for selecting this accounting policy. They should also explain the basis for monitoring how performance obligations are satisfied over time. Where entities have arrangements with multiple elements, they should explain any significant judgments made in identifying relevant performance obligations. Accounting policies should explain the nature of any variable consideration receivable and how it is estimated and constrained.
Financial instruments	Entities should give more information about liquidity risk.
Alternative performance measures (APMs)	Entities should not give undue prominence to APMs; for example, by only giving meaningful commentary on a non-GAAP (generally accepted accounting practice) basis. Reconciliations to GAAP measures should be given for all APMs, including ratios. Users should be able to relate reconciling items to GAAP measures in the accounts. Adjustments made in calculating APMs from IFRS amounts should include gains, as well as losses, when relevant to the definition of the APM.
Provisions and contingencies	Entities should disclose sufficient information to enable users to understand the nature of provisions, related uncertainties and the potential timing of cash outflows.
Fair value measurement	Fair value disclosures should be provided for all relevant areas of the financial statements, with explanations supporting judgements, and assumptions with sensitivity analyses where appropriate

Report on corporate governance reporting

89. The FRC has issued a report on corporate governance reporting in 2020. The report follows a review of the reporting by 100 companies of the UK Corporate Governance Code 2020.

90. The FRC's analysis found that companies who are not compliant with the governance code do not declare non-compliance; instead they include vague explanations and continue this pattern year on year.

Non-compliance with the code should be reported

91. The report advises that is it preferable to set out the approach to the entity's application of the code's principles, explain why this approach is appropriate for its individual circumstances and, if necessary, report the actions it has taken to mitigate the impact of not following the code.

92. The FRC expects entities to move away from boilerplate statements towards a more meaningful narrative. Use of examples is strongly encouraged, to demonstrate application of any non-compliance with the code.

93. To help navigation through the annual accounts and ensure cohesion with the corporate governance statement, entities should use signposting, linking different elements of the report, with clear reference to the code.

Discussion paper on a new corporate reporting framework

Principles-based framework for corporate reporting

94. The FRC has issued a discussion paper which contains proposals to develop a new principles-based framework for corporate reporting. It proposes a network of interconnected reports centred around a Business Report designed to facilitate better communication with a range of users.

95. The proposed network of reports is summarised in the following table:

Report	Purpose and content
Business Report	This report would be similar to a concise Strategic Report, but supported by a series of additional 'network reports'.
Network reports	These would be accessible on a standalone basis and could be a combination of 'mandatory' and 'voluntary' reports. The objective of an individual network report would drive its content, but there would be separate network reports for the full financial statements as well as, for example, corporate governance disclosures and sustainability reporting.
Public Interest Report	This new report would enable users to understand how the entity views its obligations in respect of the public interest, how it has measured its performance against those obligations and to provide information on future prospects in this area.

96. The proposed general principle for materiality is that it would be judged by reference to the communication objective of the specific report. A single definition of materiality as set out in accounting standards would not necessarily be appropriate for all reports.

97. It is proposed that there should be one common set of principles that apply to all reports. The principles would include those set out in the following table:

Principles	Explanation
System level attributes	The overarching qualitative characteristics that corporate reporting as a whole should possess.
Report level attributes	The overarching qualitative characteristics that an individual report should possess.
Content communication principles	The principles of effective communication, applied when preparing an individual report.

98. Comments should be sent to futurereporting@frc.org.uk by 5 February 2021

Contact point for this section

99. The contact point for this section of the Technical Bulletin is Paul O'Brien, Senior Manager (Professional Support) - pobrien@audit-scotland.gov.uk.

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