Technical Bulletin 2021/1

Technical developments and emerging risks from January to March 2021

AUDIT SCOTLAND

Prepared for appointed auditors and audited bodies in all sectors

24 March 2021

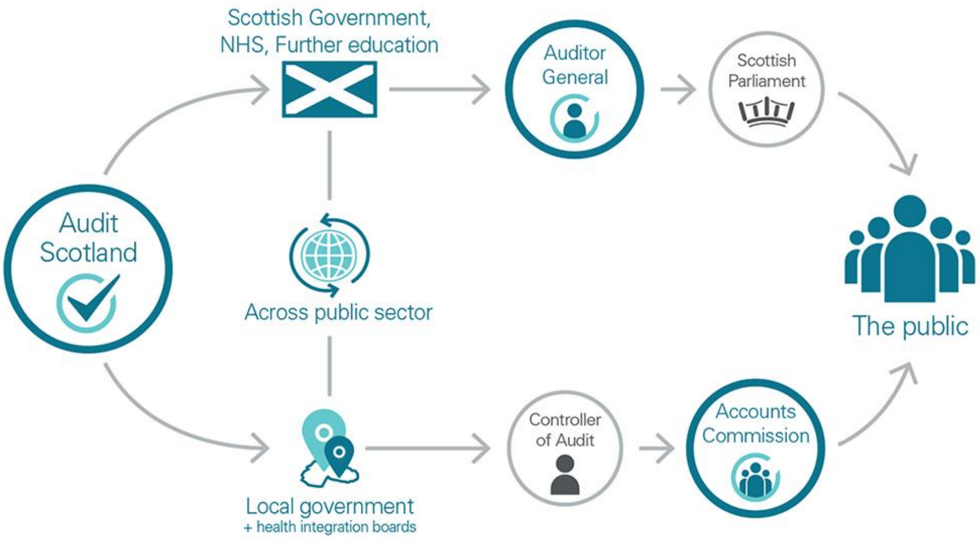
Who we are

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 2020/21 assurance protocols for LGPS and IJBs [see paragraph 7]	Professional Support has published a GPN on disclosing judgements and estimates [see paragraph 9]	Regulations have been issued to permit the deferral of loans fund repayments [see paragraph 17]
The Scottish Government has issued new statutory guidance on the use of capital receipts [see paragraph 21]	CIPFA has issued consultation papers on the prudential and treasury management codes [see paragraphs 31 and 34]	Professional Support has published guidance on risks of misstatement in 2020/21 annual accounts [see paragraphs 41 and 62]
Professional Support has published model Independent Audits Reports for 2020/21 [see paragraphs 45 and 64]	Treasury has issued the 2020/21 FReM and an addendum [see paragraphs 51 and 52]	The SG has issued guidance on 2020/21 health board accounts [see paragraph 70]
The UK Government has issued proposals related to reviews of the audit profession [see paragraph 75]	The ICAEW has issued a guide on the impact of COVID-19 on determining materiality [see paragraph 77]	The FRC has issued proposals to revise standards on audit quality [see paragraph 81]

Contact point

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

Feedback on this Technical Bulletin is welcome

Section 1
Local government sector

Auditing developments

Assurance protocols for 2020/21

7. Professional Support has published two protocols to provide agreed frameworks for auditors to seek and provide certain assurances from auditors of other public bodies. The protocols are summarised in the following table:

Protocol subject	Nature of assurances
Local Government Pension Scheme (LGPS)	LGPS pension fund auditors request assurances from employer body auditors in respect of pension contributions payable by the employer body to the pension fund. Employer body auditors request assurances from pension fund auditors in respect of information provided by the pension fund to the actuary in relation to their reports on employer bodies.
Integration joint boards (IJBs)	IJB auditors request assurances from the auditors of the constituent authorities regarding information not held by the IJB.

8. Auditors may judge that it is not necessary to request any assurances from other auditors. However, where assurances are judged to be appropriate, these protocols set out the potential range of assurances.

Auditor action
Auditors should use the protocols when seeking assurance in these areas

Financial statements developments

Good practice in disclosing judgements and estimates

9. Professional Support has published a Good Practice Note (GPN) following a review of the disclosures of judgements on the application of accounting policies (judgements) and assumptions about the future and other sources of estimation uncertainty (estimates) in local authorities' 2019/20 financial statements.

10. These disclosures were chosen for a good practice review because of their fundamental importance in understanding the financial statements, along with indications that the quality of the disclosures was variable. Good practice is illustrated, where possible, using examples taken from the 2019/20 financial statements of the councils reviewed. The GPN also includes points for local authorities to consider in striving to achieve good practice.

11. The review was carried out by a team with knowledge of the relevant financial reporting framework. However, the team does not have a detailed understanding of each authority's particular circumstances or the specific underlying transactions.

12. Local government bodies are encouraged to use the findings in this GPN to assess and enhance their own disclosures in 2020/21.

Auditor action
Auditors should encourage bodies to use the GPN

2020/21 disclosure checklist

13. The Chartered Institute of Public Finance and Accountancy (CIPFA) has issued a disclosure checklist* for the 2020/21 annual accounts. It is intended for use as an aide-memoire to assist in meeting the requirements of the Code of Practice on Local Authority Accounting in the United Kingdom (the accounting code).

The checklist is an aide-memoire

14. The checklist is in the form of a series of questions and the implications of the answers are set out in the following table:

Answer	Implication
Yes	The accounting code is being complied with.
No	A justification for departing from the accounting code should be given. For example, a legitimate justification may be that the information resulting from that disclosure is not material.

15. When evaluating whether the accounting code's disclosure requirements have been met, auditors should:

- request that the body completes the 2020/21 disclosure checklist
- investigate the reasons for any non-compliance that the checklist highlights
- evaluate whether the body's responses in the checklist are consistent with auditor's knowledge.

Auditor action
Auditors should request completion of the checklist

16. Where the body declines to complete the checklist, auditors should establish the alternative means by which it satisfies itself regarding the completeness of disclosures, and evaluate the adequacy of the arrangements. Where the arrangements are not adequate, auditors should consider completing the checklist as part of their audit procedures.

Regulations on deferring loans fund repayments

17. The Local Authority (Capital Finance and Accounting)(Scotland)(Coronavirus) Amendment Regulations 2021 have been issued to allow a local authority to defer loans fund repayments in either 2020/21 or 2021/22.

Loans fund repayments can be deferred in 2020/21 or 2021/22

18. Regulation 3 of the amendment regulations adds Regulation 14A to The Local Authority (Capital Finance and Accounting) (Scotland) Regulations 2016 (the 2016 regulations) to allow this deferral. However, if a local authority has decided since 31 March 2020 to increase an existing repayment, the increased element is not available for deferral.

19. 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. However, the local authority may use its powers under regulation 14(2) of the 2016 regulations to vary the repayment period.

20. In addition, Regulation 6 of the amendment regulations amends Regulation 13 of the 2016 regulations to allow the existing repayment provisions to be replaced with statutory guidance from 1 April 2022.

New statutory guidance on use of capital receipts

21. The Scottish Government has issued Finance Circular 2/2021 which contain statutory guidance in respect of the use of capital receipts to fund the financial impact of COVID-19. Key aspects of the guidance are summarised in the following table:

Aspect	Provisions in guidance
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 will 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.

Pension fund illustrative accounts for 2020/21

22. CIPFA has issued revised illustrative financial statements* for LGPS pension funds. They set out a fund account and a net assets statement, as well as information to be disclosed in the notes, that comply with the 2020/21 accounting code. The publication also includes a disclosure checklist that identifies the accounting code's requirements in relation to pension funds.

23. The most significant changes arise from amendments to section 6.5 of the 2020/21 accounting code in respect of:

- the removal of the requirement to analyse assets between quoted/unquoted and UK/ overseas
- the revised analysis requirement for pooled investment holdings (Note 14)
- more detailed disclosure requirements in respect of investment management fees (Note 11a).

Changes to 2020/21 annual accounts deadlines

24. The Local Authority Accounts (Scotland) Regulations 2014 (2014 regulations) have been amended in respect of approval and publication dates for the 2020/21 annual accounts. Regulation 5 of The Local Authority (Capital Finance and Accounting)(Scotland)(Coronavirus) Amendment Regulations 2021 amends the dates as set out in the following table:

Action	Normal date	2020/21 date
Approval to sign off accounts	30 September	31 October
Publication of accounts	31 October	15 November

Statutory other information

Bulletin on 2020/21 Annual Governance Statements

25. CIPFA has issued a bulletin on the impact on governance in local government in 2020/21 of COVID-19 and the introduction on a 'shadow' basis of the Financial Management (FM) Code. The main issues covered in the bulletin are summarised in the following table:

Area	Summary of main issues
COVID-19 impact	• Identify changes made to governance arrangements to adapt to COVID-19. • Explain in the Annual Governance Statement (AGS) the significant adaptations to governance arrangements. • Disclose in the AGS any limitation of scope on the opinion provided by the Head of Internal Audit on governance, risk management and internal control. • Report a clear conclusion in the AGS on whether the arrangements are fit for purpose. • Include in the action plan any actions needed to restore aspects of governance arrangements.
Introduction of FM Code	• Assess the extent to which the body's financial management arrangements comply with the principles in the FM Code. • Report an overall conclusion in the AGS of the above assessment and explain how it was carried out. • Include outstanding matters or areas for improvement in the action plan.

26. Appendix A to the bulletin provides a summary of the key content of an AGS for 2020/21.

Grant claims and returns

Technical Guidance Notes

27. Professional Support has published a number of Technical Guidance Notes (TGNs) on certifying 2020/21 grant claims and returns. The TGNs are provided with supporting material to auditors on SharePoint* and are also the Audit Scotland website. They are summarised in the following table:

TGN	Claim
TGN/GEN/21	General guidance on all claims
TGN/EMA/21	Education Maintenance Allowances
TGN/BEL/21	Bellwin Scheme for Special Financial Assistance for Local Authorities

Housing benefits

28. The Department for Work and Pensions (DWP) has issued:

- the housing benefit (HB) subsidy claim form and notes for its completion for 2020/21
- Module 2* of the Housing Benefit Assurance Process (HBAP) approach to the certification of HB subsidy claims for 2020/21. Module 2 contains a checklist to help ensure the correct benefit parameters are used.

Non-domestic rates

29. The Scottish Government has issued statutory guidance with Finance Circular 3/2021 in respect of discretionary relief from non-domestic rates for sports clubs. Local authorities are required to have regard to this guidance when choosing to award sports relief from 2021/22. The guidance advises authorities to consider targeting sports relief at organisations that provide facilities for recreation and:

- are set up with a formal constitution or governing document
- are open to the whole community (taking into account reasonable exclusions)

- have affordable membership and/or participation fees
- are organised on an amateur basis
- are managed by 'fit and proper persons'.

30. Local authorities can adopt additional specifications or local policies if they wish to do so.

Wider audit scope developments

Proposed changes to prudential code

31. CIPFA has issued a consultation paper which proposes changes to the Prudential Code for Capital Finance in Local Authorities (the prudential code). The prudential code provides a framework for local authorities to ensure their capital investment plans are affordable, prudent and sustainable.

32. Since the current edition was published in 2017, local authorities in the UK have increasingly invested in commercial properties. Many of the proposals are intended to strengthen the code's provisions in that area. The proposals are summarised in the following table:

Paras	Area	Summary of proposals
1	Augmenting the objectives of the code	Option appraisal should ensure that capital expenditure is sustainable in accordance with the corporate objectives of the authority. Capital expenditure and investment plans should be proportionate. Any commercial investment undertaken should be consistent with statutory provisions, proportionate to service budgets and consistent with effective treasury management practice.
23	Strengthening the provisions related to commercial activity	The capital strategy should include: • an assessment of affordability of commercial activities • details of the risks involved.
45	Strengthening the provisions related to borrowing in advance of need	Authorities must not borrow more than or in advance of their needs primarily (rather than the current 'purely') in order to profit from the investment of the extra sums borrowed. An explicit statement that authorities must not borrow to fund primarily yield-generating investments.
78 - 81	New prudential indicators for affordability	External debt to net revenue stream ratio - intended to ensure that the amount of debt incurred is proportionate to a local authority's total service expenditure on a taxation basis.
82 - 85		Net income from commercial and service investments to net revenue stream - considers an authority' exposure to risk from commercial and service investment income.
90 - 92		Liability benchmark - to measure borrowing levels and the profile of debt over time.

33. Comments on the proposals should be sent to Policy.Technical@cipfa.org by 12 April 2021.

Proposed changes to treasury management code

34. CIPFA has issued a consultation paper which proposes changes to the Treasury Management in the Public Services Code of Practice (the TM code). The proposed changes to the treasury management practices (TMPs) set out in the TM code are summarised in the following table:

TMP	Area	Summary of proposal
10	Training and qualification	• Amendments to highlight the importance of all treasury management staff and members having the required skills and knowledge to be able to undertake their duties and responsibilities. • Bodies required to explicitly document a formal and comprehensive knowledge and skills schedule. • Bodies should consider how to assess whether treasury management staff and members have the required knowledge and skills to undertake their roles and whether they have been able to maintain those skills and keep them up to date. • Guidance to specify key competencies for treasury management roles (example in Annex 1).
12	Corporate governance	• Guidance to recommend that decisions and strategies for more complex treasury management functions should be reviewed by a dedicated committee.
13	Environment, social and governance	• A new TMP on the arrangements for the identification, management and control of environmental and social risks.

35. Comments on the proposals should be sent to Policy.Technical@cipfa.org by 12 April 2021.

Section 106 bodies

Reducing the number of charities accounts

36. Professional Support has issued a briefing for auditors* to encourage a reduction in the number of sets of accounts of registered charities that fall within the scope of section 106 of the Local Government (Scotland) Act 1973 (section 106 charities). The briefing provides information on:

- the number of section 106 charities administered by each council in 2019/20
- the number of related sets of accounts.

37. Most councils continue to administer multiple section 106 charities; ten councils administer more than five. In order to reduce the number of statements of account that require to be audited in 2020/21, auditors should strongly encourage councils with multiple charities to:

- reorganise their charities through merging or winding them up, particularly when they appear to be failing to meet their charitable aims (e.g. by not disbursing funds)
- consider appointing an external trustee as this would remove the charity from the scope of section 106.

Auditor action
Auditors should encourage councils to reduce their number of section 106 charities

38. In the meantime, there is scope for connected charities to prepare a single set of accounts. Connected charities have 'common or related purposes, or charities which have common control or unity of administration'. In Professional Support's view, the definition is met for section 106 charities administered by the same council even where trustees differ. However, in 2019/20

- five councils made only partial use of the connected charities provisions and produced 19 sets of accounts between them
- six councils made no use of the provisions and produced 20 sets of accounts.

39. Auditors should strongly encourage councils to make full use of the connected charities provisions in 2020/21.

Auditor action
Auditors should encourage councils to fully use connected charities provisions

Summary of auditor actions in this section

Paragraphs	Auditor actions
7-8	Use the protocols when seeking assurance over the LGPS and IJBs
9-12	Encourage audited bodies to make use of the GPN when disclosing judgements and estimates
13-16	Request completion of the disclosure checklist and investigate reasons for non-compliance
34-37	Encourage councils to reduce their number of section 106 charities and make full use of the connected charities provisions

Contact point for this section

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

Section 2
Central government sector

Auditing developments

Technical Guidance Note on risks of misstatement in 2020/21

41. Professional Support has published Technical Guidance Note (TGN) 2021/1 to provide auditors with guidance on risks of misstatement in the 2020/21 annual report and accounts of central 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 2021/1

42. 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.

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

<table>
<tr><th>Module</th><th>Risks of misstatement area</th><th>Purpose</th></tr>
<tr><td>Overview</td><td>Areas that are pervasive to the financial statements as a whole</td><td rowspan="2">Explains the appropriate related accounting treatment and sets out the action auditors should undertake to evaluate whether the body has followed the required treatment</td></tr>
<tr><td>1 – 8</td><td>Specific classes of transactions, balances and disclosures in the financial statements.</td></tr>
<tr><td>9</td><td>Irregularities in expenditure and income</td><td rowspan="2">Explains the requirements and sets out the action auditors should undertake</td></tr>
<tr><td>10</td><td>Audited part of the Remuneration and Staff Report</td></tr>
<tr><td>11</td><td>Statutory Other Information (e.g. Performance Report and Governance Statement)</td><td>Sets out the procedures for considering the Statutory Other Information</td></tr>
<tr><td>12</td><td>Charitable NDPBs</td><td>Provides guidance on the application of the above modules to charitable NDPBs</td></tr>
</table>

44. 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.

2020/21 model Independent Auditor's Reports

45. Professional Support has published TGN 2021/4(CG to provide auditors with the model Independent Auditor's Reports (IARs) which should be used for the 2020/21 annual report and accounts. Auditors are required by the Code of Audit Practice to prepare their IARs in accordance with this TGN. 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 use this TGN when reporting the audit of the 2020/21 annual accounts and complete the checklist

46. The model IARs set out in Appendices 1 to 4 of the TGN have been tailored to reflect central government legislation and augmented by the reporting requirements of the Auditor General.

47. There are a number of changes to the model IARs as a result of revised versions of international standards on auditing (ISAs) applying in 2020/21 and other changes to the guidance. These are summarised in the following table:

Reason for change	Nature of change
Change to models arising from revised ISAs	• The assurance on the going concern basis of accounting is now in the form of a positive statement (rather than reported by exception). • The explanation of the extent to which the audit is considered capable of detecting irregularities has been revised to give greater focus to non-compliance with laws and regulations. • The opinions on the Remuneration and Staff Report and Statutory Other Information are now in separate parts of the model IARs, with the description of the auditor's responsibilities for Statutory Other information clarified and moved to the latter part. • There are some additional changes in the model for Scottish Water.
Other changes to models	• As Scottish Canals is classified as an NDPB for 2020/21, a separate model is no longer required.
Changes in guidance	• Additional emphasis has been added of the requirement to discuss any modifications or additions to the model IAR with Professional Support, including any Emphasis of Matter paragraph. • Wording has been specified for use where auditors judge an Emphasis of Matter paragraph is appropriate where the declaration of a 'material valuation uncertainty' has been disclosed'.

48. The TGN also provides guidance on the amendments that require to, or may, be made to the wording in the models in the form of auditor actions. Auditors should complete for each report the checklist at Appendix 6 which provides a list of those auditor actions.

49. Any proposed modifications to any audit opinion or conclusion, or the inclusion of Emphasis of Matter or Other Matter paragraphs, should be discussed with Professional Support in advance of finalising the report.

2020/21 GBS account information

50. Professional Support will obtain information on account balances at 31 March 2021 for central government bodies from the Government Banking Service (GBS) and distribute them to relevant auditors. The GBS has confirmed that the arrangements for obtaining 2020/21 account balances are unchanged.

Annual report and accounts developments

Revised 2020/21 FReM

51. HM Treasury has issued a revised version of the 2020/21 Government Financial Reporting Manual (the FReM). Changes from the original version referred to in Technical Bulletin 2020/1 (paragraph 43) are as follows:

- A new part E has been added to provide further guidance on pensions accounting and on whole of government accounts.
- Additional guidance has been included throughout chapter 2, particularly paragraphs 2.6.8 to 2.6.13 on the application of materiality to the performance and accountability reports, to help decide what to include in these reports and explain the importance of linkages.
- An adaptation to IFRS 9 has been added (table at paragraph 8.2.2.) to clarify that financial instrument balances within a group are not covered by the exception from recognising expected credit losses.

Addendum to 2020/21 FReM

52. Treasury has issued an Addendum to set out the minimum requirements of the 2020/21 FReM. In response to the continuing impact of COVID 19, the minimum requirements are largely the same as for 2019/20.

FReM addendum sets out minimum requirements for 2020/21

53. The addendum permits, but does not require, bodies to omit the performance analysis section from the Performance Report. Where relevant performance information has already been published elsewhere, bodies are encouraged to refer to the relevant publication.

54. Where unaudited information otherwise required to be included in the Accountability Report is already published elsewhere, bodies are permitted to refer to the relevant publication rather than including the information in their Accountability Report.

2021/22 FReM

55. Treasury has issued the 2021/22 FReM. This is the first edition of the FReM to apply UK (rather than EU) endorsed IFRS and interpretations. It applies those standards in effect for accounting periods commencing on or before 1 January 2021, except for IFRS 16 Leases which is deferred until 2022/23.

56. The main changes in the 2021/22 edition of the FReM apply to the Remuneration and Staff Report and relate to:

- additional guidance and reporting requirements for the single total figure of remuneration table (paragraphs 6.5.8 e) to 6.5.15)
- revised disclosures for fair pay (6.5.19 to 6.5.24).

Main changes are to Remuneration and Staff Report

57. The changes in respect of the single figure of remuneration disclosures are summarised in the following table:

Area	Disclosure
Additional columns	New option for the body to include additional columns setting out other items of remuneration.
Comparative amounts	New requirement to disclose equivalent amounts for the prior year.
Recovery or withholdings	New guidance on how to treat any remuneration in the prior year that is the subject of a recovery or withholding. A new requirement to disclose an explanation for the recovery or withholding and the basis of the calculation.
Prior year estimates	Guidance that any estimates in the prior year should be replaced with actual amounts and new requirements for related disclosures.
Non-cash benefits	New requirement to disclose types and value of benefits.
Performance pay and bonus	New requirement to disclose how the performance pay and bonus award was determined.

58. The previous fair pay disclosures have been revised. As the revisions are based on regulations issued under the Companies Act, the requirement for fair pay disclosures will apply to Scottish bodies from 2021/22. They are summarised in the following table:

Area	Requirement
Remuneration change from prior year	• The percentage change in respect of the highest paid director. • The average percentage change for all employees. • Comparative amounts for 2020/21 encouraged if available.
Pay ratio information for	• 25th, 50th and 75th percentile pay ratio. • Comparative information for 2020/21 for the 50th percentile and, where available for 25th and 75th. • Total pay and benefits, and salary separately, for the 25th, 50th and 75th percentile. • Salary component of total pay and benefits 75th percentile pay ratio.

Area	Requirement
Summary narrative	• An explanation of 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. • An explanation of whether the body believes that the median pay ratio reflects the pay, rewards and progression policy for employees as a whole.

Revised 2020/21 discount rate

59. Treasury has issued a revised PES(2020)12* on discount rates for general provisions, post-employment benefits liabilities, and financial instruments as at 31 March 2021. The revised paper replaces the original explained in Technical Bulletin 2020/4 (paragraph 56).

60. The revision updates the real post-employment discount rate from minus 1.03% to minus 0.95%.

Summary of auditor actions in this section

Paragraphs	Auditor actions
39-42	Pay due regard to TGN 2021/1 when performing the audit of 2020/21 annual report and accounts
43-47	Use TGN 2021/4(CG) when reporting the audit of the 2020/21 annual accounts and complete the checklist

Contact point for this section

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

Section 3

Health sector

Auditing developments

Technical Guidance Note on risks of misstatement in 2020/21

62. Professional Support has published Module 13 of TGN 2021/1 to provide:

- guidance on applying the other modules to the audit of the annual report and accounts of health boards
- supplementary guidance on the risks of misstatements in the areas specific to health boards.

63. 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 2021/1

2020/21 model IARs

64. Professional Support has published TGN 2021/2(H) to provide auditors with the model IARs which should be used for the 2020/21 annual report and accounts. The TGN is available with supporting material to auditors on SharePoint* and is also freely available from the Audit Scotland website.

65. The model Independent Auditor's Reports set out in Appendices 1 and 2 of the TGN have been tailored to reflect health sector legislation and augmented by the reporting requirements of the Auditor General.

66. The changes are the same as for the central government sector set out at section 2.

Auditor action
Auditors should use this TGN when reporting the audit of the 2020/21 annual accounts and complete the checklist

Review of central work on CNORIS

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

68. Professional Support will also evaluate the appropriateness of the methodology adopted by the Scottish Government to establish the total national liability for CNORIS. The review will focus on the estimation of the liability as at 31 March 2021 with a view to assessing the reliability of the methodology used for 2020/21.

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

- inform auditors' evaluation of the relevance and reliability of the information prepared by the CLO as audit evidence
- provide assurance on the methodology used in the preparation of the CNORIS figures as at 31 March 2021 which are provided to boards.

Annual report and accounts developments

Guidance on 2020/21 accounts

70. The Scottish Government has issued guidance on the process and timeframes for the 2020/21 annual report and accounts of health boards.

71. The Technical Accounting Group has agreed that boards should follow the 2019/20 Manual for the Annual Report and Accounts for NHS Boards and Capital Accounting Manual for preparing their 2020/21 annual report and accounts, rather than issue updated manuals.

Auditor action
Auditors should refer to the 2019/20 accounts manual when auditing the 2020/21 annual report and accounts

72. Boards are required to also follow the 2020/21 FReM. Annex A of the guidance provides a summary of relevant changes to the 2020/21 FReM, and other changes, and their impact on the accounts manual. The annex clarifies that:

- the flexibility to omit the performance analysis provided by the 2020/21 FReM Addendum applies to health boards
- the required disclosures on financial performance and payments to suppliers should be made in the performance overview if the performance analysis is omitted
- The Governance Statement should meet the requirements of both the FReM and the Scottish Public Finance Manual.

73. In addition, the guidance advises that the timetable for submitting the accounts has been extended to Tuesday 31 August 2021 for draft accounts and 30 September 2021 for audited accounts.

Summary of auditor actions in this section

Paragraphs	Auditor actions
60-61	Pay due regard to TGN 2021/1 when performing the audit of 2020/21 annual report and accounts
62-64	Use TGN 2021/2(H) when reporting the audit of the 2020/21 annual accounts and complete the checklist
68-71	Refer to the 2019/20 accounts manual when auditing the 2020/21 annual report and accounts

Contact point for this section

74. 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

Consultation on reviews of audit profession

75. The UK Government has issued a consultation paper that sets out a package of measures to take forward the recommendations made by the following independent reviews:

- Sir John Kingman's Independent Review of the Financial Reporting Council (FRC) - referred to in Technical Bulletin 2019/1 (paragraph 125).
- the Competition and Market Authority (CMA)'s Statutory Audit Services Market Study - referred to in Technical Bulletin 2019/2 (paragraph 145).
- Sir Donald Brydon's Independent Review of the Quality and Effectiveness of Audit - referred to in Technical Bulletin 2020/1 (paragraph 88).

76. Some of the key proposals related to each review that may have an impact on public audit or are of particular interest are summarised in the following tables. Comments on the proposals should be sent to audit.consultation@beis.gov.uk by 8 July 2021.

Kingman review of FRC

Review recommendation	Government proposal
The FRC should be replaced with a new independent regulator named the Audit, Reporting and Governance Authority (ARGA).	The Government will legislate to establish ARGA when Parliamentary time allows. Chapter 10 sets out the proposed objectives and governance arrangements for ARGA.
The Government should review the UK's definition of a Public Interest Entity (PIE).	Paragraph 1.3.17 sets out two options for expanding the PIE definition, both of which would include the largest private companies. Paragraph 1.3.29 seeks views on other types of entity that could be included in a new PIE definition, including third sector entities with a public benefit purpose.
The regulator should work towards a position where individual audit quality inspection reports, including gradings, are published in full upon completion of reviews (AQR reports). As an interim step, AQR reports should be published on an anonymised basis.	The Government intends to legislate to allow AQR reports on individual audits to be published by the regulator without the need for consent from the audit firm and the audited body. The regulator will be free to decide whether this is publication in full or in summary form. The Government will put in place safeguards to prohibit the publication of sensitive information about audited bodies (paragraph 9.2.8).
The regulator's corporate reporting review (CRR) process should be extended to cover the entire annual report.	The Government will legislate to bring the entire content of the annual report within the scope of the CRR including any voluntary elements (paragraph 4.2.6).

Brydon review into the quality and effectiveness of audit

Review recommendation	Government proposal
ARGA should be the supervisory body for a new profession of corporate auditing.	The Government believes that a new, distinct professional body for corporate auditors should be created. Paragraphs 9.6.11 to 6.9.16 consider the best way of establishing such a body.
The Companies Act should be amended to replace ‘true and fair’ with ‘present fairly, in all material respects’.	The Government considers that developing a new user guide to audit (which the FRC has agreed to take forward) is likely to be more effective in improving user understanding than replacing ‘true and fair’ (para 6.6.5).
There should be a mandatory Internal Controls Statement consisting of a signed attestation by the CEO and CFO to the Board on the effectiveness of the company’s internal controls over financial reporting.	Paragraphs 2.1.14 to 2.1.39 consider options for strengthening the UK’s internal controls framework. This includes an expanded role for external auditors in providing assurance that companies’ internal controls are effective. It would involve the auditor in undertaking additional work to be in a position to express a formal opinion on the directors’ assessment An initial preferred option is set out at paragraph 2.1.41. Under that option, decisions about whether the internal control effectiveness statement should be subject to external audit would usually be a matter for the audit committee.
Directors should report on the actions they have taken to prevent and detect material fraud. Auditors should state explicitly • the work performed to conclude whether the directors’ statement is appropriate • the steps they have taken to assess the effectiveness of the relevant controls and to detect any such fraud.	Para 6.4.2 advises that the Government proposes to legislate to require • directors of PIEs to report on the steps they have taken to prevent and detect material fraud • auditors of PIEs to report on the work they performed to conclude whether the proposed directors’ statement is factually accurate. The Government will discuss with the FRC the changes needed to require auditors to report on the steps they took to detect any material fraud and assess the effectiveness of relevant controls
Alternative Performance Measures (APMs) and KPIs linked to remuneration should be subject to audit.	The Government does not propose to introduce any further audit requirement for APMs or KPIs. It would welcome views, however, as to the effectiveness of the existing audit requirement for part of the Remuneration Report and whether this could be improved to promote better disclosure of financial metrics (para 6.7.7).

CMA Audit Market Study

Review recommendation	Government proposal
Mandatory joint audit	The Government has identified significant barriers to implementing joint audits. Instead paragraph 8.1.12 sets out the Government’s proposal for a managed shared audit requirement for UK-registered FTSE 350 companies. This would involve an audit firm appointed to lead the group audit, with group entities being required to appoint a challenger audit firm to conduct a meaningful proportion of the audits.
An operational split between the audit and non-audit practices of the biggest firms	The Government has set out proposals at paragraphs 8.2.5 to 8.2.13 which share many of the key elements of the CMA’s recommendations.

Guide on the impact of COVID-19 on materiality

77. The Institute of Chartered Accountants in England and Wales has issued a guide on the impact of COVID-19 on determining materiality. The guide advises auditors to consider whether changes to organisations caused by COVID-19 impact on materiality determinations. It suggests that materiality may be set at a lower level than previously for some audits, which could increase the scope and extent of audit testing. It recommends that auditors consider:

- whether the benchmark remains appropriate
- what percentage to apply
- whether lower specific materiality for certain account balances, classes of transactions and disclosures is needed
- the impact on performance materiality.

78. Specific considerations are summarised in the following table:

Area	Questions	Matters to consider
Determining overall materiality	Has the underlying business remained the same Is the business a similar size to previous years?	Projects put on hold Significant restructuring Different delivery models Effect on supply chains Likelihood of assets being impaired New financial arrangements
	Have the users of the accounts changed, or has their focus changed? Which KPIs are users interested in?	Over-optimism in significant estimates Opportunity to conceal non-COVID issues
	What benchmark has previously been used and is it appropriate in the current circumstances? What alternative benchmarks might there be?	Volatility of benchmark and whether averaging techniques have been used Types of adjustments to benchmark appropriate in the circumstances
Performance materiality	Have the risks increased? Is there an increased risk of override of controls, fraud or error? Has the control environment changed?	Incentives for management bias and manipulation of the accounts New transaction streams Greater estimation uncertainty. Changes in the design and implementation of controls
Lower specific materiality	Have line items become more material? Are there areas where there are increased risks? What are the areas of focus of users of the accounts?	Balances, classes of transactions or disclosures qualitatively material

Area	Questions	Matters to consider
Evaluating misstatements	What are the implications for misstatements brought forward in opening balances? Are there misstatements that would be material because of their nature?	Concerns over how COVID-19 impact is presented or disclosed Unadjusted misstatements brought forward Broader ranges when evaluating estimates
Reassessing materiality	Why might auditors need to reassess materiality and what are the implications for the audit?	Actual amounts for benchmark significantly different to forecast Impact on benchmark of material audit adjustments
Group audits	Are there specific group audit implications?	Early planning of scope of group audit
Communication with those charged with governance	Has materiality changed? Will more audit work be required?	Communicate early in the audit process if materiality expected to change or a stricter approach to adjusting for misstatements Impact of more audit work on fees

Paper on using technology in audits

79. The Financial Reporting Council (FRC) has published a paper on the use of technological resources in audit. This is an umbrella term for technology that assists the auditor in performing risk assessment procedures, obtaining audit evidence, and managing the audit process. The paper sets out the views of stakeholders as well as planned future actions.

80. The main findings are summarised in the following table:

Area	View
Impact on audit quality	The use of technology could significantly improve audit quality, when deployed at the right time in the audit process and by those with the right training.
Current standards	The current assurance model and ISAs do not represent a significant impediment to the development and deployment of technology in audit.
Application material	Additional application material and guidance would be beneficial.
Training and skillsets	Training and skillset are primary concerns. The recruitment of staff with the right skillsets alongside the development of appropriate training for current staff are priorities.
Data access	There are significant challenges in accessing high-quality data in a reliable and consistent format, meaning that the application of technological resources to improve audit quality can be practically challenging to deploy, requiring substantial work on the data itself before analysis can be conducted.

Proposals to revise quality management standards

81. The FRC has issued proposals to revise standards on audit quality which involves replacing the existing ISQC 1 and adopting:

- International Standard on Quality Management (UK) 1 Quality Management For Firms That Perform Audits Or Reviews Of Financial Statements, Or Other Assurance Or Related Services Engagements
- ISQM (UK) 2 Engagement Quality Reviews.

82. The proposed effective date of the new and revised standards is 15 December 2022. Comments were required by 18 March.

83. The proposed standards introduce a new quality management approach that is focused on proactively identifying and responding to risks to quality. Unlike extant ISQC 1, the new approach requires a firm to customise the design, implementation and operation of its system of quality management based on the nature and circumstances of the firm and the engagements it performs. The new approach also requires the firm to transition from policies and procedures that address standalone elements to an integrated approach that reflects the system as a whole.

A new approach that focusses on risk to quality

84. ISQM (UK) 1 introduces a new approach to quality management at the firm level that emphasises the responsibility of firm leadership for proactively managing quality, while at the same time being scalable to deal with differences in the size of firms and nature of the services they provide. ISQM (UK) 1 requires the firm to design and implement a risk assessment process to:

- establish quality objectives
- identify and assess quality risks
- implement responses to address those quality risks.

85. ISQM (UK) 1 focuses on those review findings that indicate that deficiencies may exist. Where positive outcomes or opportunities are identified as part of this process, the firm is encouraged to evaluate and respond to them. A consultation question explores making that a requirement.

86. More detailed requirements and related application material for engagement quality reviews are located in ISQM (UK) 2. It addresses the appointment and eligibility of an engagement quality reviewer and their responsibilities relating to that review. The revisions include:

- extending the requirement for an engagement quality review to engagements in addition to audits of financial statements
- enhancing the eligibility criteria for an individual to be appointed as an engagement quality reviewer
- enhancing the requirements and application material regarding the engagement quality reviewer's responsibilities, including the nature, timing and extent of the engagement quality review procedures performed
- consideration of the effect of engagement quality reviews, and other forms of engagement reviews, on the appropriate exercise of professional scepticism by engagement teams.

87. The proposals also include revising ISA (UK) 220 Quality Control For An Audit Of Financial Statements to reflect recent revisions to the international version of the standard. ISA 220 has been significantly revised resulting in a clear delineation of the responsibilities of the engagement partner and engagement team in relation to managing and achieving quality at the engagement level. There is also increased focus on taking into account the nature and circumstances of the audit engagement in managing quality at the engagement level.

Government response to Redmond Review

88. The UK Government has issued a response to the report from Sir Tony Redmond into the local audit of local authorities in England referred to in Technical Bulletin 2020/3 (paragraph 39). The response to each of the main recommendations are summarised in the following table:

Recommendation	Response
The creation of a new regulatory body called the Office of Local Audit and Regulation responsible for the procurement, contract management, regulation, and oversight of local audit.	The UK Government is not persuaded that a new body is required. It will explore other options for addressing the problems highlighted in the review including considering whether an existing body could take on the responsibilities.
Revising the current audit fee structure to ensure adequate resources are deployed.	Regulations are to be amended to allow the body that appoints auditors greater flexibility to ensure the costs of additional audit work are met.

Recommendation	Response
Deadline for published audited annual accounts to be extended from 31 July to 30 September.	Regulations are to be amended to extend the deadline to 30 September for 2020/21 and 2021/22 audits. The government will then review whether there is a continued need for an extended deadline.
An annual audit report to be submitted to the first full council meeting (rather than audit committee) after 30 September.	The government strongly agrees that submission should be to the full council and will explore but will consider whether the 30 September milestone is most appropriate.
Councils should appoint at least one independent member, suitably qualified, to the audit committee.	New guidance is to be issued which addresses these recommendations.
The facility for the Chief Executive, Monitoring Officer and Chief Financial Officer to meet with the Key Audit Partner at least annually should be formalised.	

89. In addition to the audit recommendations, the UK Government agrees with the recommendation related to the preparation of an audited simplified statement of service information and costs to enable comparison with the annual budget and council tax set for the year. The intention is for standardised statements to be communicated to all taxpayers and service users in England from 2021/22. The UK Government will explore how this can be done, for example alongside council tax bills.

90. The UK Government also agrees that the annual accounts should be reviewed to determine whether there is scope to remove disclosures that may no longer be considered to be necessary. The earliest this can be done is from 2022/23.

Contact point for this section

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

Section 5

Fraud and irregularities

Auditor action

Auditors should consider whether weaknesses in internal control which facilitated each fraud may exist in their bodies and take the appropriate action

92. This chapter contains a summary of fraud cases and other irregularities facilitated by weaknesses in internal control at audited bodies that have recently been reported by auditors to Professional Support.

Theft

Theft of assets and cash

93. An employee misappropriated cash and other assets valued at £237,000 from a public body over a period of eight years.

Key features

The theft was possible due to inadequacies in the reconciliation of a manual card recording system and management oversight.

The theft was identified when a new process for recording the cash and other assets was introduced and the perpetrator was moved to a new department. A subsequent internal audit identified the cash and assets were missing.

Police Scotland were informed. The employee admitted the theft, was prosecuted and imprisoned for over 3 years.

Procedures have been reviewed and improvements made.

Third party funds

94. A clerical assistant misappropriated over £7,000 from the accounts of vulnerable social care clients.

Key features

The clerical assistant committed the fraud by forging the signature of another staff member. The fraud was identified when another member of staff examined records of client funds and identified an entry that they had apparently authorised but had no knowledge of.

When interviewed, the clerical assistant admitted forging the signature of a colleague. An internal audit identified the full extent of the fraud.

The fraud was possible due to weakness in record keeping and in the oversight by management and the Corporate Appointee. Improvements have been introduced in relation to reconciliation processes and reviews of client accounts.

The matter was reported to Police Scotland and disciplinary processes were instigated. The clerical assistant has repaid the full amount.

Expenditure

Invalid supplier

95. A third party defrauded over £46,000 from a council by purporting first to be a council officer and then a supplier to the council.

Key features

One of the council's suppliers received an email purporting to be from the council asking if there were any outstanding invoices. The supplier replied attaching an invoice. The council then received an email purporting to be from the supplier with the invoice attached asking for it to be paid to a new bank account. The bank records were amended, and the invoice paid.

The fraud was identified when the genuine supplier contacted the council looking for payment of the invoice.

The fraud was possible as:

- the accounts payable department did not confirm that the change of bank details had been verified by the contracting service
- the officer within the contracting service had not received training on how to verify new bank details
- Indications within the e-mail that it was not genuine were missed
- learning from a previous unsuccessful similar attempted fraud involving the same supplier had not been shared with staff.

The council is introducing robust verification processes for change of bank details.

Grant payment

96. A third party defrauded £10,000 from a council by making a false claim for a business grant.

Key features

The perpetrator claimed a business grant for premises they had previously occupied. The fraud was identified when the legitimate business proprietor applied for a grant.

The fraudulent payment was possible as the council failed to identify that:

- the name on the business grant application was not the name of the business on the business rates system
- the bank statement used in support of the application was for a personal bank account rather than a business bank account.

More stringent checks are now carried out on grant applications and grants are now only processed by experienced staff.

The council are recovering the funds from the perpetrator.

Payroll

97. Third parties defrauded over £19,000 from three public bodies by re-directing salary payments.

Key features

In all cases, the payroll team received emails purporting to be from genuine members of staff, advising of a change to be made to bank account details. The payroll records were amended, and salary payments were made.

The frauds were identified when employees contacted the payroll team to query why they had not been paid.

The fraud was possible as the procedures in place to check the validity of bank detail changes had not been followed.

Payroll staff have been reminded of the proper procedures, including verification procedures for changes to employee bank account details. The cases have been referred to Police Scotland for investigation.

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