Technical Bulletin 2021/3

Technical developments and emerging risks from July to September 2021

Prepared by Audit Scotland for appointed auditors and audited bodies in all sectors

20 September 2021

Contents

1. Introduction

Purpose

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
- summaries of responses to requests for technical advice sought by auditors.

Appointed auditors are required by the Code of Audit Practice 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.

Any specific actions recommended by Professional Support to be taken by auditors are highlighted in green.

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 are only accessible by auditors.

Highlighted items

Professional Support highlights in the following table the items in this Technical Bulletin that may be of particular interest to auditors:

Highlighted items		
Professional Support has provided technical advice to auditors on emerging issues – paragraphs 1, 34 and 40	LASAAC has issued guidance on accounting for personal protective equipment provided free of charge – paragraph 2	The Scottish Government has issued draft statutory guidance on borrowing to fund a loan – paragraph 6

Highlighted items		
CIPFA/LASAAC has issued the accounting code for 2021/22 – paragraph 11	The Scottish Government has written to CoSLA on accounting for service concession arrangements – paragraph 16	CIPFA/LASAAC has issued the draft accounting code for 2022/23 – paragraph 20
Professional Support has published guidance on the risks of misstatements specific to colleges – paragraph 41	Professional Support has published model IARs for the college sector – paragraph 44	The FRC has issued new standards on audit quality management – paragraph 50
The FRC has issued a revised bulletin on auditor's reports in the private sector – paragraph 55	The FRC has issued guidance on data analytics – paragraph 59	The FRC has issued a statement on ESG challenges – paragraph 64

Contact point

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2. All sectors

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Technical advice to auditors

Professional Support responds to requests for technical advice sought by auditors

1. The following tables summarise requests for technical advice recently sought by auditors from Professional Support in respect of the audit of the 2020/21 annual accounts which may apply to public bodies in all sectors, along with the advice offered:

The valuer declared a Material Valuation Uncertainty in the valuation report at 31 March 2020, which the body properly disclosed in the 2019/20 financial statements. The body has not arranged for a revaluation at 31 March 2021 but is continuing to make the same disclosure in the 2020/21 financial statements. Is that appropriate?
The body should discuss with the valuer any continuing impact of the prior year Material Valuation Uncertainty on values at 31 March 2021. Given the additional uncertainty over the values at 31 March 2020, it would be sensible for the body to have arranged for another valuation exercise at 31 March 2021. This applies regardless of whether a valuation would otherwise be due; the five-yearly interval between valuations is a maximum where circumstances allow and may not always be appropriate. Bodies have a responsibility to demonstrate that the carrying amount at 31 March 2021 materially reflects current value. If the body cannot provide sufficient reliable evidence, auditors should expect the body to arrange for a valuation at that date. The wording of the disclosure made in the 2019/20 financial statements is unlikely to be appropriate for 2020/21, and will need to be updated. If a valuation exercise is not necessary, the body should as a minimum discuss with the valuer whether the prior year Material Valuation Uncertainty still applied. It would be helpful to users of the financial statements if the body made a disclosure in the 2020/21 financial statements explaining that the prior year Material Valuation Uncertainty no longer applied. That is preferable to simply removing any reference and leaving the user to wonder what had happened. The disclosure should also provide justification for not arranging for an uptodate valuation.

The body uses a 1 April valuation date rather than 31 March. The exercise for the 1 April 2020 valuation date was carried out in the period January to May 2021 and the valuer has declared a Material Valuation Uncertainty. Is this appropriate?
There is nothing to prevent a 1 April valuation date, but it creates unnecessary problems. A valuation at 1 April 2020 is one year out of date by 31 March 2021 and, in effect, needs to be treated in the same way as a valuation at 31 March 2020, i.e. the body should allow for changes during 2020/21. For that reason, Professional Support's advice is to discourage a 1 April valuation date.

The body uses a 1 April valuation date rather than 31 March. The exercise for the 1 April 2020 valuation date was carried out in the period January to May 2021 and the valuer has declared a Material Valuation Uncertainty. Is this appropriate?

A valuation date of 1 April in 2020 is even more problematic than in other years. In effect, it artificially creates circumstances where a valuer may declare a Material Valuation Uncertainty, even though the work was carried out a year later. This additional complication strengthens the case for a valuation date of 31 March 2021. If the body declines to make that change, it will have to disclose the Material Valuation Uncertainty in the 2020/21 financial statements. However, it should disclose an explanation justifying that approach.

The body has changed valuer since the previous valuation 5 years ago. The property carrying amounts at 31 March 2021 have substantially increased in value compared with 31 March 2016, which is partially due to a change of valuation method. How should the increase in value be accounted for?

There are two main issues to consider here. First of all, a change in valuer does not necessarily lead to a change in the method adopted. It is for each body to determine the required approach and to instruct the valuer accordingly. It is important that bodies take responsibility for providing valuers with clear instructions. Auditors should:

- obtain the instructions and evaluate their clarity and appropriateness
- evaluate whether the body can demonstrate that the change in method is more appropriate and results in a more accurate estimate of property values. If the body cannot demonstrate this, the method should not be changed.

Aside from the change in method, if the increase in value is still substantial, unless there is evidence of a sudden increase in the last 12 months, it can reasonably be concluded that the increase in value has been accumulating evenly over the five years since the previous valuation. The increase may not have been material one year after the previous valuation, but the cumulative effect may have become material after say three years, and it should have been recognised in the carrying amount at that point. This would indicate that:

- the five year interval between formal valuations has been too long and should be reduced to three years going forward
- the carrying amounts at the end of years 3 and 4 (after the previous valuation exercise) were understated and an element of the increase should be treated as correcting a prior year error (i.e. by adjusting the value at 31 March 2020) rather than treating it all as an in-year increase.

A further consideration is whether a body revalues every asset in a class of property, plant and equipment simultaneously every five years or revalues a percentage of assets in that class every year. In Professional Support’s view, the latter approach is preferable as the movement in the value of those assets subject to the revaluation exercise can be used as a sense check of the carrying amounts of the remainder of the assets in that class.

3. Local government sector

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Guidance on accounting for PPE supplied free

2. The Local Authority (Scotland) Accounts Advisory Committee (LASAAC) has issued an addendum to their guidance on accounting for coronavirus grants referred to in Technical Bulletin 2021/2 (paragraph 17). The addendum sets out the accounting treatment for personal protective equipment supplied free of charge to local authority social care staff by National Services Scotland (NSS) during 2020/21.

3. Where the equipment is used by local authority staff, the guidance considers that the authority is likely to be acting as a principal in the transaction. The authority should therefore account for the equipment at fair value in accordance with Code of Practice for Local Authority Accounting in the UK (accounting code). The accounting entries are set out at paragraph 11 of the addendum and are summarised in the following table:

Action	Account debited	Account credited
Stock recognition (paragraphs 5.1.2.8 and 5.1.2.9 of the accounting code)	Stock	Donated Inventories Account
Stock consumption (paragraph 5.1.2.18 of the accounting code).	Expenditure	Stock
	Donated Inventories Account	Income

4. Where the local authority passes on the equipment to third party providers, it is likely to be acting as an agent for the Scottish Government. The equipment is therefore not recognised by the authority.

5. The equipment flows through the IJBs which are acting as an agent regarding the transaction. However, IJBs need to consider whether these transactions need to be reflected in increased funding from partners and related increased commissioning expenditure. As the net financial impact of the equipment transactions on the partners is nil, the guidance advises that it would be reasonable to conclude that no impact on the IJB financial statements is required.

Consultation draft of statutory guidance on borrowing to lend

6. The Scottish Government has issued a consultation draft* of statutory guidance on the accounting treatment when a local authority has funded a loan from borrowing.

7. The consent of the Scottish Ministers is required where a local authority wishes to borrow to lend to a third party. Consent will only be given where the lending is to support capital expenditure of the third party. Where a local authority is given consent to borrow to lend to a third party, the authority is required to:

- make a loans fund advance at the point of making the external loan
- repay the loans fund advance over time as a charge to the General Fund each year
- recognise any repayment of the external loan as a capital receipt. This could be applied to fund the annual repayment of the loans fund advance (to neutralise the impact on the General Fund).

8. The proposal is to simplify the accounting by dealing with the loans fund repayment on a memorandum basis and for there to be no recognition (or application) of the capital receipt. There would therefore no longer be any impact on the General Fund.

9. However, charges will be required to the General Fund in the following circumstances:

- Any credit loss or other reduction in the debtor which is not matched with a repayment from the debtor would be a charge to the General Fund.
- A statutory charge to the General Fund will be required if the debtor does not repay a loan in the repayment period set by the Scottish Ministers. This will be equal to the outstanding loans fund advance. Any subsequent repayments will require the reversal of the statutory charge.
- If the debtor is written off, the outstanding amount would be a charge to the General Fund. In order to avoid the General Fund being charged twice for the same debtor, a reversal of the statutory charge would be necessary.

10. There is a similar proposal that loans fund repayments for loans to other statutory bodies or to common good funds should also be on a memorandum basis only.

2021/22 accounting code

11. The CIPFA/LASAAC Local Authority Code Board (CIPFA/LASAAC) has issued the accounting code* for 2021/22. The financial reporting framework is based on International Financial Reporting Standards (IFRS) and other pronouncements issued by the International Accounting Standards Board, adapted for the local government context where necessary. This is the first year that endorsement of IFRS is by the UK Endorsement Board rather than the EU.

12. The 2021/22 accounting code has been prepared on the basis of standards in effect for accounting periods commencing on or before 1 January 2021 (with the exception of IFRS 16 Leases).

13. The application of IFRS 16 has been deferred to 2022/23. Appendix F sets out the requirements agreed so far in respect of applying IFRS 16 in local government. Early adoption in 2021/22 is not permitted.

14. The changes in the 2021/22 accounting code are summarised in the Foreword. The changes are minor or simply provide clarification.

15. For example, paragraph 3.3.1.3 has been added to reflect that the accounting code adapts IAS 8 in respect of disclosing the impact of new accounting standards that have been issued but not yet adopted. The adaptation applies the disclosure requirement only to accounting standards that come into effect in the local government sector for financial years commencing on or before 1 January of the financial year in question (i.e. on or before 1 January 2022 for 2021/22). The addition is for clarification only as the requirement has been in effect for several years but was not previously explicitly described as an adaptation.

Proposed changes to statutory guidance on service concession arrangements

16. Technical Bulletin 2021/2 (paragraph 46) advised that the Scottish Government had issued draft revised statutory guidance on accounting for service concession arrangements. One proposal involved the short-term option to calculate the repayment of the service concession liability on an annuity basis in limited circumstances.

17. As a result of further discussions, the Scottish Government has written a letter* to COSLA to indicate that the statutory guidance will allow local authorities to repay a service concession arrangement liability on an annuity basis more generally. However, the authority will have to be able to demonstrate that it is both:

- prudent under the Prudential Code
- suitable, e.g. where the flow of benefits from an asset are expected to increase in later years, such as projects promoting regeneration or schemes where revenues will increase over time.

18. The decision to change to an annuity method of repayment must be taken by the full council. Any such change will be applied prospectively.

New flexibility to borrow to fund COVID-related costs

19. The Scottish Government has written a letter* to COSLA to advise of an additional financial flexibility that will enable local authorities to borrow to fund COVID-related revenue expenditure in 2021/22. A consent to borrow will be provided subject to the specified conditions being met, i.e. the local authority:

- could not balance its budget in 2020/21 and/or 2021/22
- must borrow from the Public Works Loan Board at a rate 1 percentage point higher than normal

- must undertake a review to identify any assets that could be sold to repay their borrowing; these assets must be sold in the next 3 to 5 years.

Consultation draft of 2022/23 accounting code

20. CIPFA/LASAAC has issued an invitation to comment (ITC) on the accounting code that will apply to 2022/23. The draft 2022/23 accounting code has been prepared on the basis of accounting standards and other pronouncements in effect for accounting periods commencing on or before 1 January 2022.

21. The main issues in the ITC are in respect of:

- the implementation of specific aspects of IFRS 16 Leases
- minor changes to accounting standards
- clarifying the disclosure requirement for the Capital Finance Requirement.

22. Responses should be sent to cipfalasaac@cipfa.org by 11 October 2021.

Implementation of IFRS 16 Leases

Measurement of service concession arrangement liability

23. Section 1A of the ITC proposes that service concession arrangement liabilities should be measured in accordance with the lease liability requirements of IFRS 16.

24. The principal difference from the current treatment based on IAS 17 is that where payments depend on an index or rate, IFRS 16 requires lessees to remeasure the liability to reflect changes to payments arising from changes in the index or rate.

25. The ITC also asks for any comments on the practical impact of adopting this approach, including whether there are any particular matters on which guidance would be helpful.

HRA tenancies

26. The accounting code includes an interpretation to the effect that all Housing Revenue Account (HRA) tenancies are deemed to be operating leases.

27. However, paragraph 37 of the ITC proposes an amendment to confirm that the practical expedient in the accounting code on transitioning to IFRS 16 (i.e. that a local authority should not reassess whether a contract is a lease at 1 April 2022) does not apply to HRA tenancies. This is necessary as HRA tenancies were not leases under IAS 17.

Changes to accounting standards

28. Sections B1 to B3 of the ITC set out proposals to reflect changes in accounting standards, some of which are summarised in the following table:

Standard	Nature of change	Proposed impact on accounting code
IAS 37 – onerous contracts	The amendment clarifies which costs should be included when assessing whether a contract will be loss-making. It specifies that the cost of fulfilling a contract comprises the costs that relate directly to the contract.	While amendments may affect specific cases prospectively, paragraph 38 proposes no substantive amendments to the accounting code.
IAS 16 - proceeds before intended use	The amendments prohibit an entity from deducting from the cost of property, plant and equipment (PPE) amounts received from selling items produced while the entity is preparing the PPE asset for its intended use. Instead, an entity recognises such sales proceeds and related cost in profit or loss.	Paragraph 40 expresses the view that this amendment in practice does not affect PPE under the accounting code, as it is measured at current value. No substantive amendments are therefore proposed.
IPSAS 42 Social Benefits	IPSAS 42 provides guidance on the recognition, measurement and disclosures of social benefits. These are defined as cash transfers paid to specific individuals and/or households to mitigate the effect of social risk and address the needs of society as a whole. IPSAS 42 recognises liabilities in the same way as IAS 37.	Social benefits are currently scoped out of section 8.2 of the accounting code. As IPSAS 42 recognises liabilities in the same way as IAS 37, paragraph 48 proposes removing that scope exclusion.

29. In addition, section D1 of the ITC refers to IFRS 17 Insurance Contracts which has a revised effective date of 1 January 2023. Subject to UK adoption, the earliest year for local government adoption would be 2023/24.

30. A working group has been established by HM Treasury to consider early implementation issues of IFRS 17. This includes considering the extent to which the public sector may have contracts meeting the relevant criteria.

31. Paragraph 64 requests further information on the applicability of IFRS 17. Appendix 2 sets out some areas where potential issues for local authorities may exist, and provides guidance on matters which respondents might consider when making their response. The areas include: pension guarantees; mutual insurance and other transactions explicitly framed as insurance; economic development support; cases where local authorities are providing insurance while acting as an intermediary; and cases where local authorities are providing warranties.

Disclosure requirement for the Capital Finance Requirement

32. The consultation process on the 2021/22 accounting code indicated that some local authorities were having difficulty determining the appropriate amount for the Capital Finance Requirement (CFR) which is required by the accounting code to be disclosed. The components of the CFR are specified at paragraph 79 of the Prudential Code and should be extracted from information in the local authority's Balance Sheet.

33. Paragraph 69 of the ITC proposes amending the wording in the accounting code so it is clear that:

- it is the actual (as opposed to estimated) CFR that should be disclosed
- the CFR amount should be as specified by the Prudential Code.

Technical advice to auditors

Professional Support responds to requests for technical advice sought by auditors

34. The following tables summarise requests for technical advice recently sought by auditors from Professional Support in respect of the audit of the 2020/21 annual accounts of local government bodies, along with the advice offered:

Can a local authority continue to treat the full depreciation charge as a statutory adjustment in 2020/21?
In previous years, the full depreciation charge was transferred as a statutory adjustment from the General Fund (credit) to the Capital Adjustment Account (debit). In addition, there was a reserve transfer from the Revaluation Reserve (debit) to the Capital Adjustment Account (credit) for the revalued element of deprecation (i.e the additional depreciation charged as a result of the asset being carried at current value rather than historical cost). Although this treatment continues to be permitted by the 2020/21 accounting code, it is no longer permitted for Scottish authorities as a result of mandatory guidance from LASAAC. The LASAAC guidance restricts the statutory adjustment to depreciation on the asset's historical cost. Depreciation on the asset's revalued element should be the subject of reserve transfer from the Revaluation Reserve (debit) to the General Fund (credit).

The council has not included resources transferred from the health board for community care or additional Social Fund contributions via the NHS for social care COVID-19 pressures in its disclosure note for grant income. Do these items constitute a grant or are they revenue from a customer?
The main consideration is whether the transaction is: • an exchange transaction, i.e., the council provides services to the health board of an approximately equal value in exchange for the income (which would indicate it is revenue from a customer under IFRS 15); or • a non-exchange transaction, i.e. the council does not provide the health board with approximately equal value in exchange (which would indicate a grant under IAS 20).

The council has not included resources transferred from the health board for community care or additional Social Fund contributions via the NHS for social care COVID-19 pressures in its disclosure note for grant income. Do these items constitute a grant or are they revenue from a customer?

In the case of social care funding that flows through health boards to local government, health boards are required by Scottish Government to pass this funding to the council. The health board does not gain anything in exchange for providing the funding. Such funding should be recognised and disclosed as grant income.

A similar argument applies to resource transfer funding provided by the health board to the council. As the health board does not receive any distinct good or service in return for provision of the funding, it is appropriate to treat it as a grant.

Grant claims and returns

Housing benefit subsidy

35. The Department for Work and Pensions has issued the Module 5 Software Diagnostic Tool* component of the HBAP approach to the certification of the 2020/21 housing benefit subsidy claims for councils using Capita, Civica and Northgate benefit systems.

Non-domestic rates

36. The Scottish Government has issued Finance Circular 8/2021 Business Rates Incentivisation Scheme 2019 - 22 to:

- provide details of the outcome of the Business Rates Incentivisation Scheme (BRIS) for 2019/20
- confirm that BRIS has been suspended for both 2020/21 and 2021/22.

37. Annex A sets out the sums to be retained under the BRIS for 2019/20. For 2020/21 and 2021/22, some Non-Domestic Rates Income has been converted to General Revenue Grant for the cost of COVID-19 reliefs.

4. Central government sector

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Revised guidance on severance and settlement agreements

38. The Scottish Government has issued Finance Guidance Note 2021/3 to advise of amendments to the Scottish Public Finance Manual chapter on severance and settlement agreements.

39. The main amendments to the chapter clarify that:

- the severance policy applies to all bodies except where it is inconsistent with any statutory requirements
- the maximum payback period of 24 months for voluntary severance applies in all cases except where a body's own compensation scheme has a shorter payback period
- the purpose of the £95,000 cap is to restrain settlement payments from going excessively beyond what a body is legally obliged to pay
- notice periods for voluntary severance are expected to be worked and outstanding leave taken prior to termination of employment.

Technical advice to auditors

Professional Support responds to requests for technical advice sought by auditors

40. The following table summarises a request for technical advice recently sought by auditors from Professional Support in respect of the audit of the 2020/21 annual accounts of central government bodies, along with the advice offered:

The central government body presents a Foreword and other statements in its annual report and accounts separate from the Performance Report and Accountability Report, and there is no cross-reference. How should these statements be reflected in the Independent Auditor's Report?
The Government Financial Reporting Manual (FReM) requires the annual report and accounts to comprise the following three elements: financial statements, Performance Report and Accountability Report. The expectation is that all information in the annual report and accounts should fit into one of those elements, and therefore the model Independent Auditor's Reports are designed on that basis. If a body positions a foreword or other statement outside that specified structure, it may impact on the opinions expressed on, and the description provided for, Statutory Other Information in the Independent Auditor's Report.

The central government body presents a Foreword and other statements in its annual report and accounts separate from the Performance Report and Accountability Report, and there is no cross-reference. How should these statements be reflected in the Independent Auditor's Report?

Auditors should request that the information contained in the separate foreword or other statement be brought within the Performance Report or Accountability Report. This can be done by either physically relocating the information or by simply adding a cross-reference to it. This is essential if the information is meeting a requirement of the FReM, but is recommended in any event. The outcomes are as follows:

- If the body accepts the request, no changes are required to the Independent Auditors Report.
- If the body declines to either relocate the information or even add a cross-reference, the relevant FReM requirement should be treated as not being met. Auditors should discuss with Professional Support a possible qualified opinion in respect of Statutory Other Information as a result of non-compliance with the FReM.
- If the information is not necessary to meet a requirement of the FReM, it does not impact on an opinion. However, auditors should consider whether it represents clutter and request it be removed from the annual report and accounts.

The model Independent Auditor's Reports describe Statutory Other Information as the Performance Report and the Accountability Report (except for the audited part of the Remuneration and Staff Report). Any foreword or any statement outside that specified structure (without a cross-reference) does not represent Statutory Other Information. It will be necessary to extend the wording of the description to encompass voluntary other information. Auditors should discuss with Professional Support the amendments required.

The same principle applies in local government for information outside the Management Commentary or Annual Governance Statement.

5. College sector

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Technical Guidance Note on risks of misstatement in 2020/21

41. Professional Support has published Module 14 of Technical Guidance Note (TGN) TGN 2021/1. The TGN is intended to inform auditors' judgement when identifying and assessing the risks of material misstatement in the 2020/21 annual report and accounts of central government bodies generally. Module 14 provides:

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

42. The TGN supplements the Code of Audit Practice and auditors are expected to pay the TGN due regard and use it as a primary reference source when performing 2020/21 audits.

43. The TGN along with Module 14 is available with supporting material to auditors on SharePoint* and is also freely available from the Audit Scotland website.

Technical Guidance Note on 2020/21 model IARs

44. Professional Support has published TGN 2021/6(C) to provide auditors with the model Independent Auditor's Reports (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.

45. The model IARs set out in Appendices 1 and 2 of the TGN have been tailored to reflect college sector legislation and augmented by the reporting requirements of the Auditor General.

46. 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).

Reason for change	Nature of change
	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.
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'.

47. 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 3 which provides a list of those auditor actions.

48. 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.

49. Auditors should use this TGN when reporting the audit of the 2020/21 annual report and accounts and complete the checklist.

6. Professional matters

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New audit quality management standards

50. The Financial Reporting Council (FRC has issued new standards on audit quality management in International Standards on Quality Management (ISQM) 1 and 2. These standards replace the extant standard that deals with a firm's responsibilities for its system of quality control (ISQC (UK) 1) for financial statement periods beginning on or after 22 December 2022.

51. The new standards introduce a quality management approach that is focused on proactively identifying and responding to risks to quality. Unlike extant ISQC (UK) 1, the new approach requires a firm (including public sector equivalents) 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, as required by extant ISQC (UK) 1, to an integrated approach that reflects upon the system as a whole.

52. 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. The new standard 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.

53. 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, but not required, to evaluate and respond to them.

54. ISQM (UK) 2 applies to all engagements for which an engagement quality review is required to be performed in accordance with ISQM (UK) 1. An engagement quality review is an objective evaluation of the significant judgments made by the audit team and the conclusions reached thereon, completed before the date of the auditor's report. An engagement quality reviewer may be a partner, other individual in the firm, or an external individual, appointed to perform the engagement quality review. ISQM(UK) 2 deals with the:

- appointment and eligibility of the engagement quality reviewer

- engagement quality reviewer's responsibilities relating to the performance and documentation of an engagement quality review.

Revised bulletin on auditor's reports in the private sector

55. The FRC has issued Bulletin - Illustrative Auditors Reports on Private Sector Financial Statements (August 2021). The auditor's reports set out in the Appendices to the bulletin illustrate:

- how the requirements of ISA (UK) 700 could be applied to private sector entities
- the requirements of the law and regulations applicable to the particular type of entity to which the illustration applies.

56. The reports are illustrative and other approaches may be adopted provided that the form and content of the auditor's report meets the requirements of ISA (UK) 700.

57. The bulletin has been updated to reflect legislative changes post the EU withdrawal transition period. It is applicable to financial statements for periods commencing after 1 February 2020 with filing after 31 December 2020.

58. Professional Support provides model auditor's report which are consistent with the illustrative examples contained in the bulletin but tailored to reflect Scottish public sector legislation and augmented by the reporting requirements of the Auditor General and the Accounts Commission.

New guidance on data analytics

59. The FRC has issued guidance on Addressing Exceptions in the use of Audit Data Analytics. For the purposes of the guidance, Audit Data Analytics (ADAs) are data analytic techniques that can be used to perform risk assessment, tests of controls, substantive procedures or concluding audit procedures.

60. The purpose of the guidance is to aid auditors in dealing with the large volume of outliers generated when using ADA. The guidance uses the following key terms:

- Outliers – means results generated by an ADA that do not match the auditor's initial expectation for the population.
- Exceptions – means the auditor has analysed the outliers and determined that they are truly exceptions and not generated as a result of inappropriate tool scoping, poorly defined initial parameters, or the use of poor-quality data.

61. A significant volume of outliers is a symptom of poorly defined parameters. Parameters may require re-calibration after initial analysis to ensure the tool is appropriately identifying outliers that merit further investigation as exceptions.

62. Page 4 of the guidance sets out some considerations for the auditor in determining whether the use of ADA is appropriate. For example, whether the data is of sufficient quality to support meaningful analysis, i.e. it is complete, accurate, valid, and accessible in a format which facilitates analysis.

63. The remainder of the guidance:

- sets out a general approach to addressing outliers generated when using ADA to test a single population (pages 5 and 6)
- covers refining the parameters of a tool after its initial application (page 7)
- provides an example of testing revenue (page 8).

Statement on ESG challenges

64. The FRC has issued a Statement of Intent on environmental, social and governance (ESG) challenges. The purpose of the statement is to set out the challenges to reporting on ESG issues in a way that meets the needs of stakeholders, some possible actions for addressing those challenges, and the FRC's planned activities in this area.

65. The FRC has grouped the challenges into six stages. Each stage along with the related challenges and examples of actions planned by the FRC are summarised in the following table:

Stage	Summary of challenges	Summary of FRC actions
Production – better internal information leads to better decisions and insight for stakeholders	Companies face challenges in how they measure, manage, control and assure ESG data. This situation is compounded by multiple thresholds, frameworks and guidance, as well as stakeholders having different information needs. Often reporting is aspirational and high level and does not provide users with information about progress, whether the entity's strategy will deliver the commitment, and whether financial statements are aligned with the commitment.	The FRC will: • ensure that the requirements for information are based on sound internal frameworks and methodologies, and that the system supports the standardisation and consistency of such methodologies • work with partners to improve the use of quality non-financial information • consider these issues within future revisions to the Guidance on the Strategic Report to strengthen the framework and deliver coherent and accessible information • develop guidance on the impact of climate-related issues on the financial statements, and consider whether changes need to be made to the accounting standards.

Stage	Summary of challenges	Summary of FRC actions
Audit and assurance – reported information is robust and reliable	The current level of data maturity is unlikely to be sufficient to enable a reasonable assurance opinion to be provided. However, a limited assurance opinion may be insufficient to meet expectations. Financial statements may not take proper account of material ESG issues.	The FRC will: • encourage the development of internal methodologies to ensure information is robust and aligns with the external reporting framework. • ensure that information is capable of being subject to assurance and provides high quality, consistent and comparable reporting • consider ESG-related amendments within future revisions of the auditing and assurance standards. • issue ESG-related audit and assurance guidance.
Distribution – information is made accessible to interested parties	ESG information is often located in separate places, reports and media at different dates and often not in an accessible or reusable format.	The FRC will: • ensure that there is an appropriate framework for information to be made publicly available on a more consistent basis • encourage the electronic distribution of ESG data and a digital tagging system.
Consumption – information leads to better decision making by stakeholders	Users have difficulty obtaining ESG data and it is often based on incomplete frameworks and differing methodologies, has limited comparability, or is not timely. The lack of useful and useable information results in stakeholders finding it difficult to make effective decisions.	The FRC will ensure that the reporting framework delivers information that is fair, balanced, and understandable, transparent, consistent, and comparable.
Supervision – information and activity is appropriately monitored and requirements are enforced	There is a need to supervise whether companies, auditors and assurance providers meet relevant existing and future requirements.	The FRC will: • assess the degree to which auditors ensure that companies take appropriate account of ESG issues in their annual report and accounts. • hold to account those who do not meet requirements.

Stage	Summary of challenges	Summary of FRC actions
Regulation – coordinated and coherent regulation leads to efficiency	There is a need to ensure that international ESG standards work effectively alongside a domestic framework. Greater coordination is needed to ensure there is an effective reporting ecosystem.	The FRC will: • develop a vision for what ESG reporting can deliver in the longer term, and how this can best be achieved • seek better regulatory coherence and the reduction of unnecessary overlap and confusion in requirements • support the movement towards global sustainability reporting standards • influence the development of IFRS where there are specific issues relating to ESG.

Feedback on future of corporate reporting discussion paper

66. The FRC has issued a Feedback Statement following their discussion paper on the future of corporate reporting (referred to in Technical Bulletin 2020/4 – paragraph 94).

67. The discussion paper set out a new, principles-based framework for corporate reporting. The central idea was a network of interconnected reports; with the full financial statements, a Business Report and a Public Interest Report at the core; and a series of network reports providing more tailored information across a range of topics.

68. Pages 5 to 15 of the statement set out the feedback provided by respondents. In summary, respondents were supportive of some aspects of the proposals. For example, they:

- broadly supported a reporting model that accommodates the information needs of investors and wider stakeholders; the development of guiding principles; the concept of the reporting network; and the development of standards for non-financial reporting

- supported the importance of firms providing information about how they view their obligations in respect of the public interest, although support was more muted for a standalone Public Interest Report

- strongly supported the role of technology and the importance of non-financial reporting in any future corporate reporting model.

69. However, respondents called for the FRC to consider the practical challenges of implementing the proposals, including the level of audit and assurance over the different reports within the network.

70. There were mixed views on whether an objective-driven model (that was neutral regarding the audience) should replace the current model where the content of the report is determined by reference to the information needs of the primary users. One of the challenges identified with the objective-driven approach was determining materiality.

Proposed auditing standard on less complex bodies

71. The International Auditing and Assurance Standards Board (IAASB) has issued an exposure draft of a proposed international standard on auditing the financial statements of less complex bodies.

72. The proposals recognise that the complexity in the ISAs poses challenges for audits of less complex entities. This stand-alone standard has been designed to be proportionate to the typical nature and circumstance of an audit of these entities.

73. Comments should be submitted via the IAASB website by 31 January 2022.

7. Fraud and irregularities

Contact: Anne Cairns, Acairns@audit-scotland.gov.uk

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.

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

Auditors should also refer to the annual Fraud and Irregularity Report.

Pension payments

74. A family member of a deceased pensioner continued to collect £300,000 of pension payments over a 21-year period from a public sector pension fund.

Key features
The pension fund was not notified of the death of the pensioner and the pension payments continued to be paid.
The fraud was discovered by the pension fund after mail sent to the deceased pensioner was returned.
The fraud was possible as the pensioner's death pre-dated data matching controls which are now in place to automatically highlight when a pensioner has died.
The pension payments have been stopped and the matter reported to Police Scotland.

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Technical Bulletin 2021/3

Technical developments and emerging risks from July to September 2021

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