Technical Bulletin 2021/4

Technical developments and emerging risks from October to December 2021

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

14 December 2021

Contents

1: Introduction 3

2: All sectors 5

3: Local government sector 8

4: Professional matters 16

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 from auditors for technical consultations with Professional Support.

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 generally to be aware of. It may still be necessary for auditors to read the source material if greater detail is required in the circumstances of a specific audited body. Source material can be accessed by using the hyperlinks. It is also accessible by auditors from the Technical Reference Library on SharePoint* maintained by Professional Support.

Any specific actions that Professional Support recommends that auditors take are highlighted in green.

Technical Bulletins are also published on the Audit Scotland website and therefore are available for audited bodies and other stakeholders to download. However, hyperlinks in this bulletin indicated with an asterisk (*) link to files on SharePoint and are only accessible by auditors.

Highlighted items

Professional Support highlights in the following table a selection of the items in this Technical Bulletin that are of particular importance:

Highlighted items		
Professional Support has published guidance on planning 2021/22 audits [see paragraph 1]	Professional Support has expressed views on some technical consultations with auditors [see paragraphs 4 and 37]	Professional Support has published guidance on risks of misstatement in 2021/22 local government annual accounts [see paragraph 5]

Highlighted items		
CIPFA has issued guidance notes on the 2021/22 accounting code [see paragraph 9]	CIPFA has issued a consultation on proposed changes to the prudential code [see paragraph 12] and treasury management code [see paragraph 28]	The FRC has issued a paper on what makes a good audit [see paragraph 38]
The FRC has issued a report on IAS 37 disclosures [see paragraph 44]	The FRC has issued a factsheet on climate related financial reporting [see paragraph 46]	The FRC has issued a report on Alternative Performance Measures [see paragraph 52]

Contact point

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

2: All sectors

Contact: Paul O'Brien, Pobrien@audit-scotland.gov.uk

Guidance on planning 2021/22 audits

1. Professional Support has issued guidance to assist all appointed auditors in planning their 2021/22 audits of public bodies. The guidance supplements the Code of Audit Practice, and auditors are therefore required to plan their 2021/22 audits in accordance with it. It is accessible by auditors with other supporting materials on SharePoint* but it is also freely available to download from the Audit Scotland website.

2. The guidance covers the main activities that comprise core audit work and the products associated with each activity. It recognises the impact of COVID-19 on completing the 2020/21 audits and the consequent late start to 2021/22 audits, the challenges in performing audits remotely, and the additional complexities and uncertainties involved.

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

Nature of change	Relevant chapter
Submission dates for Annual Audit Plans have reverted to pre-COVID dates	1
Rates for additional audit work have been revised	1
Guidance on assessing going concern has been added	2
Target submission dates for audited annual accounts have been moved forward one month from last year	2
Auditors are not asked to carry out any new specific work on the audit dimension areas in addition to their own local risk assessments (with the exception of procurement fraud brought forward from previous years' planning guidance)	3A
Submission date for Best Value Audit Plans has reverted to pre-COVID dates	3B
Councils where a Best Value Assurance Report is required have been updated	3B
Auditors are required to complete a return to demonstrate when they have reported their audit work on each of the Best Value themes	3B
The removal of the requirement for auditors in local government to consider Strategic Audit Priorities has been extended to 2021/22	3C

Nature of change	Relevant chapter
The removal of the requirement for auditors to contribute to performance audit reports or impact reports has been extended to 2021/22	4
The number of local government grant claims requiring certification has been reduced to two	5E
Guidance has been updated on involvement in the National Fraud Initiative	5K

Technical consultations with auditors

Professional Support responds to requests from auditors for technical consultations

4. The following tables summarise requests from auditors for technical consultations with Professional Support in respect of complex issues arising from the audit of the 2020/21 annual accounts which may apply to public bodies in all sectors, along with the view offered:

How should cloud computing arrangements be accounted for?
Under cloud computing arrangements, public bodies access and use a supplier's underlying software as needed (e.g. through the internet or via a dedicated line). International Financial Reporting Standards (IFRS) do not contain explicit guidance on how a customer should account for cloud computing arrangements and therefore a body needs to use judgement in determining which standard is the most appropriate to apply. In Professional Support's view, the standards most likely to be applicable are: • IAS 17 Leases and Similar Arrangements • IAS 38 Intangible Assets. In determining whether a cloud arrangement contains a lease, bodies should use IFRIC 4 and evaluate whether the arrangement conveys a right for them to control the use of the asset (e.g. underlying servers). The IFRS Interpretations Committee has decided that a right to receive future access to the supplier's infrastructure does not in itself give the customer any rights to control the use of the asset. An intangible asset should be recognised by the body under IAS 38 if: • it controls the software • future economic or service benefits are expected • the body can restrict others' access to those benefits. Where a contract conveys the right simply to access the supplier's software over the contract term, it would not give the body control of the software and therefore it would not create an intangible asset for the body. If the cloud arrangement does not fall within the scope of these standards, it is likely to be a service contract; expenditure would be recognised when the service is received.

The body has not included a senior employee in the Remuneration Report because the individual does not wish to be included. Is this acceptable?

Auditors should presume that information on named individuals will be given in all circumstances. However, the General Data Protection Regulation (Article 21) gives individuals the right to object to disclosure. The employee must give specific reasons, based upon their particular situation, for objecting to the disclosure. Bodies can still make the disclosure if they can demonstrate compelling legitimate grounds for disclosing the information which override the rights of the individual.

Professional Support expressed the following view to the auditor:

- The requirement for public accountability represents compelling legitimate grounds for the required disclosures to be made.
- The body may need to obtain legal advice, particularly if the objection is on the grounds that disclosure would cause the individual substantial damage or distress.
- Where non-disclosure is agreed, the body should instead disclose the fact that certain information has been omitted.

Bodies sometimes enter agreements with employees which attempt to restrict the disclosure of certain remuneration information (e.g. settlement agreements). For the avoidance of doubt, the requirement to disclose information on a relevant individual in the Remuneration Report is not affected by any 'settlement agreement'.

3: Local government sector

Contact: Paul O'Brien, Pobrien@audit-scotland.gov.uk

Technical Guidance Note on risks of misstatement in 2021/22

5. Professional Support has published Technical Guidance Note (TGN) 2021/8(LG) to provide auditors with guidance on risks of misstatement in the 2021/22 annual accounts of local government bodies. The TGN and supporting material is accessible by auditors on SharePoint* and is also freely available to download from the Audit Scotland website.

6. The TGN is intended to inform auditors' judgement when identifying and assessing the risks of material misstatement. 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 2021/22 audits. Auditors should advise Professional Support of any intended departures from the guidance.

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

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

8. The risks of misstatement for 2021/22 have been updated to reflect new requirements and risks which emerged during the 2020/21 audits that remain applicable. A separate note* summarises the main changes from 2020/21.

2021/22 guidance notes

9. The Chartered Institute of Public Finance and Accountancy (CIPFA) has issued guidance notes* on the 2021/22 Code of Practice on Local Authority Accounting in the UK (the accounting code).

10. The overall aim of the guidance notes is to explain and illustrate how to apply the accounting requirements of the accounting code, provide background to those requirements, and illustrate how they might be applied in practical situations. The guidance is not mandatory.

11. This edition of the guidance notes has been updated to reflect changes to the 2021/22 accounting code (see Technical Bulletin 2021/3 – paragraph 11).

Proposed revisions to prudential code

12. CIPFA has issued a consultation on proposed revisions to the Prudential Code for Capital Finance in Local Authorities. The proposed revisions follow the previous principles-based consultation earlier this year (see Technical Bulletin 2021/1 – paragraph 31).

13. The proposals are intended to strengthen the provisions of the prudential code, primarily in respect of commercial investments. They are briefly explained in the following paragraphs and, in summary, are in respect of:

- borrowing in advance of need
- defining commercial investments
- changes in prudential indicators.

Borrowing in advance of need

14. The current prudential code (paragraph 45) states that local authorities must not borrow more than or in advance of their needs purely in order to profit from the investment of the extra sums borrowed.

15. However, there has been an increasing trend in authorities purchasing property solely to make an investment return. CIPFA is proposing to provide more guidance to assist authorities with their decision making and to underline the importance of the code's provisions in this area.

16. There are therefore proposals to replace the existing paragraph 45 with new paragraphs 49 to 52. This includes:

- Paragraph 50 setting out examples of legitimate prudent borrowing, e.g. financing capital expenditure primarily related to the delivery of a local authority's functions.

- Paragraph 51 stating that an authority must not borrow to invest primarily for financial return.

Commercial investments

17. It is proposed that the prudential code (at paragraph 95) should set out the three categories of investments summarised in the following table:

Category	Definition
Treasury management	Investments that arise from cash flows or treasury risk management activity, and ultimately represent balances which need to be invested until the cash is required for use in the course of business. It may also include: • an allowance for a reasonable level of short-term treasury investments for liquidity purposes • the investment of borrowed cash where it has been prudent to borrow in advance of needing the cash, e.g. in order to reduce financing and interest rate risks.
Service	Investments held primarily and directly for the delivery of public services. There may be financial returns, but they are not the primary purpose of the investment.
Commercial	Investments held primarily for financial return and not linked to treasury management activity or directly part of delivering services. This includes commercial property which is defined at paragraph 91 as any property which the local authority purchases or holds primarily for financial return.

18. The objectives of the prudential code set out at paragraph 1 have been amended to reflect that the risks associated with investments for commercial purposes should be proportionate to the local authority's financial capacity, i.e. that plausible losses could be absorbed in budgets or reserves without unmanageable detriment to local services.

19. Paragraph 53 clarifies that authorities with existing commercial investments (including property) are not required to immediately sell these investments, and that they may invest in the repair, renewal and updating of their existing commercial properties. However, it advises that authorities:

- should review options for exiting their financial investments for commercial purposes in their annual treasury management or investment strategies

- should not take new borrowing if financial investments for commercial purposes can reasonably be realised instead.

20. Additional commentary on the assessment of affordability and the details of risks of undertaking commercial activity within the commercial activities section on determining the capital strategy is proposed to be added to paragraph 24.

Prudential indicators

21. There is a proposal to add new indicators at paragraphs 81 to 85 of the prudential code on the (estimated and actual) net income from commercial and service investments as a proportion of the net revenue stream. This is intended to assess the proportionality of such investments.

22. There is also the option to include a local indicator for net income from commercial and service investments as a proportion of useable revenue reserves.

23. The following changes are proposed to existing definitions:

- Interest and investment income should no longer be netted off finance costs (paragraph 94)

- Clarification is to be added that the net revenue stream should exclude capital grants, contributions and donated assets.

24. There is a proposal (at paragraph 43) that prudential indicators are reported quarterly rather than the current annual basis.

Proposals in earlier consultation not pursued

25. The earlier consultation proposed the addition of a new indicator comparing external debt with the net revenue stream. However, respondents did not agree with the proposal. CIPFA is therefore no longer proposing this indicator, but it will recommend in guidance that local authorities consider introducing this as a local indicator.

26. The earlier consultation also asked for views on the proposal to add an explicit reference to sustainability to the objectives of the prudential code. Respondents were mostly opposed to this on the grounds that:

- it mixed subjective, policy-related issues with the objectivity of the prudential code

- sustainability is a corporate issue which is the responsibility of the senior management team and elected members, rather than directly a finance function.

27. CIPFA is therefore not proposing to add a reference to sustainability to the objectives but instead will provide guidance to support sustainable behaviour (e.g. there is a proposal that paragraph 24 should recommend that the capital strategy explains how capital expenditure is prioritised in relation to the strategic priorities and policies of the authority, such as environmental sustainability).

Proposed revisions to the treasury management code

28. CIPFA has issued a consultation on proposed revisions to the Treasury Management in the Public Services Code of Practice. The proposed revisions follow the previous principles-based consultation earlier this year (see Technical Bulletin 2021/1 – paragraph 34).

29. The proposals are briefly explained in the following paragraphs and in summary are in respect of:

- categories of investments
- environmental, social and governance matters
- a knowledge and skills schedule
- a new liability benchmark.

Categories of investments

30. It is proposed that the treasury management code (at section 8) should set out three categories of investments in line with the proposed revisions to the prudential code (set out in the previous item). There is a proposal to require any service and commercial investments to be categorised into appropriate portfolios reflecting the different purposes, objectives and management arrangements of the investments. For each portfolio, a schedule would be required to set out the investment objectives, and risk management and reporting arrangements.

Environmental, social and governance

31. The earlier consultation proposed a new Treasury Management Practice (TMP 13) to require a body to establish, implement and monitor all arrangements for the identification, management and control of Environmental, Social and Governance (ESG) risks.

32. However, that proposal was not supported by respondents to the consultation. Instead, there is a revised proposal to add a reference that the formal counterparty policy required by TMP 1 should set out the body's policy and practices relating to ESG investment considerations.

Knowledge and skills schedule

33. There is a proposal to add to TMP 10 on training a requirement for a knowledge and skills schedule.

New liability benchmark

34. There is a proposal for a new treasury management indicator for the liability benchmark for local authorities. The liability benchmark is a measure of how well the existing loans portfolio matches the authority's planned borrowing needs.

35. Local authorities would be required to produce the liability benchmark for at least the next three financial years, with a recommendation to do so for at least ten years.

36. The liability benchmark would not be a single measure but would be presented as a chart of the four balances summarised in the following table:

Balance	Explanation
Existing loan debt outstanding	The authority's existing loans which are still outstanding in future years.
Loans Capital Financing Requirement (CFR)	This would be calculated in accordance with the loans CFR definition in the prudential code, and projected into the future based on approved prudential borrowing and planned loan repayments.
Net loans requirement	The authority's gross loan debt, less treasury management investments, at the last financial year end, projected into the future based on its approved prudential borrowing, planned loan repayments and any other forecast major cash flows.
Gross Loans Requirement, i.e. Liability benchmark	This would be the net loans requirement as set out above plus a short-term liquidity allowance.

Technical consultations with auditors

Professional Support responds to requests from auditors for technical consultations

37. The following tables summarise requests from auditors for technical consultations with Professional Support in respect of complex issues arising from the audit of the 2020/21 annual accounts of local government bodies, along with the view offered:

A council has capitalised the salaries of employees working on capital projects. For budgetary reporting reasons, the council has charged the gross salary cost to the Comprehensive Income and Expenditure Statement (CIES) and has credited income equal to the capitalised element. Is this an appropriate treatment?
It is an established principle that internal budgetary reporting should not drive external financial reporting. The council's approach is basically an internal transaction. This is acceptable for internal reporting but not for external financial reporting as it results in an overstatement of both gross expenditure and income in the CIES (although net expenditure is unaffected). For external financial reporting, the charge to the CIES should be the gross salary cost less the capitalised element. The capitalised element should be added to the cost of the asset in the balance sheet. No income should be credited to the CIES. Professional Support advised the auditor that an appropriate resolution would be to make use of the Expenditure and Funding Analysis (EFA). The gross salary cost and internal income should be included in column 1 of the EFA as it is reported internally, but they should be removed in column 2 (as an adjustment) so that they are not included in column 3 (which shows the CIES figures). There is an alternative presentation as paragraph 3.4.2.100 of the accounting code allows additional columns to be added to the EFA so the council could add a column for these adjustments to keep columns 2 solely for statutory adjustments.

A council has capitalised the salaries of employees working on capital projects. For budgetary reporting reasons, the council has charged the gross salary cost to the Comprehensive Income and Expenditure Statement (CIES) and has credited income equal to the capitalised element. Is this an appropriate treatment?

If the council used the EFA, the budgets would have been unaffected and the misstatements in the CIES would have been corrected.

The council revalues its property on a rolling basis every five years. Is that frequency sufficient? What should the council do about assets not revalued at 31 March 2021?

The basic requirement of the accounting code and IAS 16 is that revaluations should be made with sufficient regularity to ensure that the carrying amount at the year-end does not differ materially from the current value.

IAS 16 explains that the frequency of revaluations depends on the significance and volatility of changes in current value:

- Where property experiences significant and volatile changes in current value, an annual revaluation is required.
- Where changes in current value are insignificant, it may be necessary to revalue the property only every three or five years.

IAS 16 allows a class of assets to be revalued on a rolling basis provided revaluation is completed within a short period. The accounting code interprets 'a short period' as meaning that assets are normally measured once every five years for each class of assets. However, this is subject to the condition that the carrying amount does not differ materially from that which would be determined using the current value as at 31 March.

Professional Support provided the auditor with the following view:

- The five-year frequency is a qualified rather than absolute option. It is only appropriate for property which have insignificant changes in current value.
- The council should have determined a valuation frequency based on the expected significance and volatility of changes in current value. This should be informed by the results of previous valuation exercises. However, the frequency should be flexible and respond to changes in circumstances.
- For property not subject to a revaluation exercise at 31 March 2021, the auditor should expect the council to provide evidence that the carrying amount does not differ materially from the current value. It is expected that the evidence would include, as a minimum, a consideration of relevant building indices and changes in the value of comparable assets.

Professional Support advised the auditor to critically examine the evidence and, if judged to be inadequate, request that the council arrange for a valuation of the property be carried out as at 31 March 2021. If the council declined to arrange a valuation, the auditor was advised to consider whether this constituted a limitation of the scope of the audit.

Should Common Good accounts be disclosed as a note or presented as financial statements? Do statutory adjustments apply to Common Good accounts? Do Common Good accounts need specific reference in the Independent Auditor's Report?

The Common Good is an historic managed fund administered by councils in Scotland. Common Good funds fall within Section 106 of the Local Government (Scotland) Act 1973 and therefore are subject to the accounting and auditing requirements of that Act.

As a minimum, Common Good funds are 'other third-party funds administered by the authority' as referred to in paragraph 3.4.4.1 of the accounting code. This would require an indication of the overall nature and amounts to be disclosed in a note to the councils' financial statements. Where the Common Good is a registered charity, a separate statement of accounts is required. The information disclosed in the note to the council's financial statements should be consistent with the separate statement of accounts. It may also be helpful to users if a hyperlink to the statement of accounts is provided.

However, where the Common Good is not a registered charity, it may be appropriate for more information to be provided in the council's financial statements than simply an indication of the overall nature and amounts. LASAAC guidance on accounting for the Common Good recommends that such additional information should take the form of limited financial statements comprising the following:

- A Foreword briefly explaining the purpose and background of the Common Good fund.
- An Income and Expenditure Account and Balance Sheet. Where the council manages several funds, they may be aggregated for financial reporting purposes into the same statement.
- Notes providing information proportionate to the value of the fund.

Where the Common Good is not a registered charity, paragraph 1.3.8 of the accounting code requires it to follow the requirements of the accounting code.

The application of statutory adjustments is set out in the relevant statutory guidance. As the main reason behind statutory adjustments is to mitigate the impact of specified General Fund movements on council tax setting, statutory adjustments do not apply to the Common Good. For example, deprecation on assets is charged to the Common Good without reversal or replacement.

The Common Good accounts are audited by the auditor of the council. Where the information is provided in limited financial statements, an explicit reference to the Common Good accounts should be included in the Independent Auditor's Report in the list of financial statements that have been audited. There is no need for such a reference when the information is disclosed in a note as it will be implicitly included by the overall reference in the model wording to 'the notes to the financial statements'.

4: Professional matters

Contact: Paul O'Brien, Pobrien@audit-scotland.gov.uk

Paper on elements of good audit

38. The Financial Reporting Council (FRC) has issued a paper that sets out its views on the key elements of a high-quality audit. The elements are relevant to audit in any sector, including the public sector.

39. The paper recognises that auditing requires the application of judgement within a principles-based framework; it is not just a rules-based compliance exercise. As a result, it is vital for an audit team to not only have the necessary skills and experience, but also the right behaviours and mindset.

40. The FRC defines high-quality audits as those that:

- comply with the spirit and the letter of auditing standards
- are driven by a robust risk assessment
- are supported by rigorous due process and audit evidence
- involve the exercise of professional judgement and professional scepticism
- challenge management effectively
- report unambiguously the auditor's conclusion on the financial statements.

41. The paper discusses the following three key elements in conducting a good audit:

- Risk assessment and planning.
- Execution of the audit.
- Completion and reporting.

42. The following table summarises some key aspects of each element, and provides examples of associated attributes:

Risk assessment and planning

Key aspects	Examples of attributes
Robust risk assessment	Risk assessment procedures should be based on the inherent (i.e. gross) risk. Procedures must take account of the risk of management bias. Audit planning must be appropriately tailored to the risks identified.
Timely planning	Planning must be performed on a timely basis, well in advance of the financial year end. Planning must be led by the appointment lead and include the key members of the audit team. Planning for more complex areas of the audit may involve relevant specialists.
Knowledge and understanding	The audit team's knowledge and understanding of a business must be tailored to the sector and the specific entity. Knowledge needs to be distilled down to the actual audit risks.
Informed expectations	Audit teams must clearly record their informed expectations relating to key financial metrics and performance indicators. The basis for these auditor expectations must be explained and referenced to source material.
Appropriate resources	The audit team must be appropriately resourced at all levels. Auditors need to agree with the entity that sufficient time is provided to enable the audit to the completed to the appropriate standard. More complex risk areas should have responsibility allocated to experienced team members and, where necessary, specialists.
Planning analytical review	Effective planning analytical review blends the team's knowledge and expectations with management information to identify counter-intuitive trends and relationships. The nature of these potential anomalies must be resolved before the start of fieldwork.
Planning the group audit	Auditors must communicate the group audit approach to component auditors.
Communication to those charged with governance	The audit approach must be clearly communicated to those charged with governance. There should be clear documentation of the detailed correspondence and discussion between the audit team, management and those charged with governance.

Execution of the audit

Key aspects	Examples of attributes
Execution of the audit plan	The fieldwork must comprise execution of the agreed audit plan. Audit team should demonstrate how they have applied high-quality judgement to assess the (corroborative and contradictory) evidence they have obtained. The oversight and direction of the work of the audit team is critical. The level of participation of the appointment lead should be greater for more complex, higher risk audits. The audit documentation needs to provide an easy to follow narrative of the audit and the critical thinking of the team members.
Professional scepticism and challenge of management	Professional scepticism may be particularly apparent when assessing management's judgements and estimates. Auditors must consult appropriately when carrying out the audit of complex areas. Auditors should persist in challenging management if their concerns are not addressed. Auditors are expected to challenge management over whether their narrative reporting is fair, balanced and understandable (and not simply tick off a compliance report).
Specialists and experts	Relevant audit specialists or experts should be brought into the audit team to ensure it has sufficient expertise to assess the risks or to design and perform procedures responsive to the risks.
Group oversight	Better quality audits have particularly close contact with the component audit teams to deal with issues as they arise.
Consultation and oversight	Appropriate consultation with others on complex technical matters is a strength of an audit team. It is essential that those consulted are provided with sufficient information and time. There must be a clear record of the consultation showing how the audit team reached its initial conclusions, how the challenges were dealt with and how any matters arising were subsequently resolved.

Completion and reporting

Key aspects	Examples of attributes
Assess that sufficient, appropriate audit evidence has been obtained	Audit teams should stand-back and assess the level of work performed against the audit plan and ensure that sufficient, appropriate audit evidence has been obtained in support of the conclusions and judgements drawn.
Communicate matters of interest	Auditors must communicate matters of interest to those charged with governance in a timely way. Where teams find themselves in a very time-pressured environment, they must seek to obtain more resource, or delay completion of the audit. If an audit report is delayed, audit teams should record the reasoning.

43. Delivery of the various aspects within these elements depends on a high performing audit practice. The FRC consider that there are six elements to achieving this. These elements are summarised in the following table with examples of some attributes:

Key element	Examples of attributes
Assessing firm quality risks	Early adoption of ISQM (UK) 1 is strongly encouraged as this is expected to lead to improvements in audit quality.
Mindset, culture, governance and leadership	Senior leadership must live and drive the right values, ethics and behaviours that support high audit quality. There must be a clear link between remuneration/promotion and audit quality. Learning from audit inspections (internal and external), including good practice, must be shared across the audit practice and understood.
Performance monitoring and remediation	There needs to be an effective feedback loop to monitor performance of the audit practice; deficiencies identified should trigger decisive corrective action. It is important to create a culture of trust, whereby people are encouraged to openly talk about mistakes and learn from them.
Quality monitoring	Audit providers should re-evaluate the effectiveness of their quality monitoring approach, including hot reviews, and assess how it integrates with the other elements of the quality control system in order to effectively and sustainably remediate recurring deficiencies.

Key element	Examples of attributes
Resources (including recruitment and training)	It is essential that firms have sufficient, suitably trained and experienced staff to service their existing portfolio and support growth plans. Audit firms should align their reward and performance management framework to the delivery of high-quality audits. There should be a consistently applied audit methodology, understood and delivered by appropriately trained people.
Information and communications	Audit providers should regularly communicate with their audit teams and ensure that they have appropriate knowledge and skills. Audit teams should be supported by access to central teams with in-depth knowledge over auditing, accounting and other relevant matters.

Thematic review of IAS 37 disclosures

44. The FRC has issued a report summarising the findings from a thematic review of disclosures related to IAS 37 Provisions, Contingent Liabilities and Contingent Assets. The review considered how effectively a sample of UK companies met the disclosure requirements and provided other relevant information in their 2020/21 annual report and accounts

45. The report set out expected good disclosure for when a matter is material and relevant to the entity's financial reporting. Good practice in key areas is summarised in the following table:

Area	Explanation
Accounting policies	Concise and entity-specific descriptions of the significant accounting policies adopted in respect of provisions and contingencies
Basis for determining best estimate	Clear and specific descriptions of the nature of each material exposure, the timeframe over which it is expected to crystallise and the basis for determining the best estimate of the outflow
Contingent liabilities	Quantitative information about expected or maximum exposures to contingent liabilities, or a clear and justified statement that it is not practicable to provide an estimate of the financial effect; negative confirmation can be helpful where users may otherwise expect the entity to report an exposure
Indications of uncertainty	Indications of uncertainty in timing and/or amount that help users understand the potential financial effect (which may arise beyond the next financial year) of additional or reduced costs and/or earlier or later timing of outflows

Area	Explanation
Explanation of significant judgement	Explanation of significant judgement exercised by management in determining the recognition and measurement of provisions, setting out the rationale for management's conclusion and the effect on the financial statements of taking an alternative view
Information about critical estimation uncertainty	Quantitative and qualitative information about critical estimation uncertainty affecting the next financial year, including disclosure of key assumptions and sensitivities
Management commentary	Management commentary on significant year end balances and unrecognised exposures, and on significant movements recognised during the period

Factsheet on climate related reporting

46. The FRC has issued a factsheet on the financial reporting of climate-related matters. The factsheet informs preparers of annual accounts about climate-related matters that they may need to consider when preparing financial statements and associated narrative reporting.

47. Although, it is focussed on FRS 102, the principles in the factsheet apply equally to IFRS-based financial statements.

48. The first part of the factsheet outlines the ways in which climate-related matters may impact on a set of financial statements. Although there are no explicit references to climate-related matters in accounting standards, such matters should be considered in the same manner as any other matters which could have a material impact on the financial statements.

49. The guidance in the factsheet sets out the ways in which financial statements should take into account:

- the impact the entity has on climate change (such as investment in carbon-reducing technology)
- the impact climate change has on the entity (such as on the measurement of individual assets or on the long-term viability of the business).

50. Examples of areas where climate-related matters may impact on the financial statements are summarised in the following table:

Area	Examples of impact
Financial instruments	Measurement could be affected if the matters cause credit losses (e.g. through non-payment by borrowers) or impact an entity's ability to obtain finance. The fair value of financial instruments could be impacted.

Area	Examples of impact
Property, plant and equipment	An entity may require to incur expenditure in ways not previously expected or experienced, such as altering existing assets to make machinery 'greener' or to comply with new legislation. Changes in the residual value or useful life of an asset may result from matters such as: • a property being situated in a location expected to be negatively impacted by climate change, such as by rising sea levels • a machine being impacted by changes in legislation designed to reduce dependence on fossil fuels • vehicles becoming obsolete sooner than expected due to rapid technological change.
Provisions and contingencies	Climate-related risks and uncertainties may require the recognition of additional provisions or disclosure of contingent liabilities (e.g. litigation from an increased focus on climate change). A provision for decommissioning an asset may increase if more stringent environmental regulations are put in place, or if the useful life of the asset is reduced (reducing the discount for time value of money).

51. The second part of the factsheet considers narrative reporting. For example:

- Themes included by entities within the narrative reporting should be reflected in the financial statements.
- Entities need to consider the inclusion of climate-related risks in the reporting of their principal risks and uncertainties.

Thematic review of APMs

52. The FRC has issued a report following a thematic review which assesses the quality of the reporting of Alternative Performance Measures (APMs) in UK-listed companies. APMs are indicators of financial performance which involve adjustments to the amounts reported in the financial statements.

53. The review found that, while companies generally provided good quality APM disclosures, their context needs to be better explained, particularly as profit-based APMs tended to be more favourable than their results in the financial statements.

54. The report advises entities to:

- clearly define APMs and explain why they are needed
- ensure that APMs are not presented in ways that give them greater prominence than amounts stemming from the financial statements

- avoid comments that imply APMs have more authority than amounts stemming from the financial statements
- provide specific, tailored explanations for the inclusion of individual APMs
- explain terms such as ‘underlying profit' or 'core operations' and the basis for identifying adjustments as 'non-underlying' or non-core’
- reconcile APMs to the most directly reconcilable line items, subtotals or totals presented in the financial statements.

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

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