

Technical Guidance Note 2020/1 Module 14

Risks of misstatement in colleges in 2019/20



 AUDIT SCOTLAND

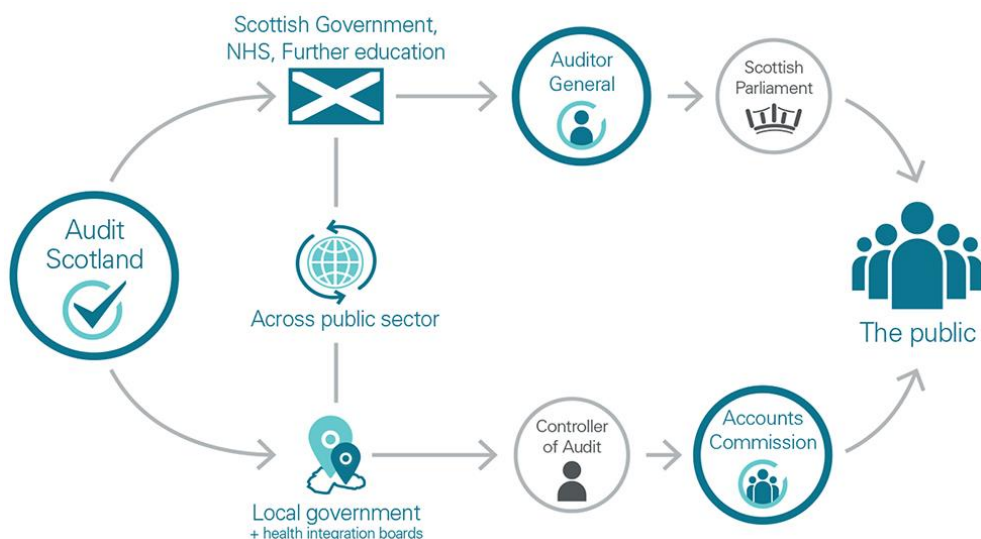
Prepared for appointed auditors in the college sector

20 August 2020

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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:

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- reporting our findings and conclusions in public
- identifying risks, making clear and relevant recommendations.

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Introduction

Purpose and use of this module

1. This module provides guidance on applying the other modules of [TGN 2020/1](#) to the audit of the annual report and accounts of colleges.
2. It also provides supplementary guidance on the risks of misstatements in the following areas:
 - The complete set of financial statements.
 - The going concern basis of accounting.
 - The accounting policy for measuring land and buildings, material uncertainties disclosed in valuers reports, impairment losses and disclosure of property, plant and equipment.
 - Significant matters affecting local government scheme pension liabilities, accounting policy for teachers' pension scheme, and calculation of early retirement provisions.
 - Transfers involving arms-length foundations (ALFs) and the treatment of ALFs in group financial statements.
 - Accrual method of grant recognition, and treatment of job retention scheme funding.
 - Disclosure of related parties, agency arrangements, and depreciation budget
 - Analysis of staff by band in the Remuneration and Staff Report.
 - Content of the Performance Report.
 - Compliance with good governance.
 - Accountable Officer arrangements.
3. The annual report and accounts of colleges are audited under schedule 2 of the [Further and Higher Education \(Scotland\) Act 1992](#) (the 1992 Act).
4. Colleges are required to prepare their annual report and accounts in accordance with a direction issued by the Scottish Funding Council (SFC) under the 1992 Act. The [2019/20 accounts direction](#) requires the financial statements to be prepared in accordance with the [Statement of Recommended Practice: Accounting for Further and Higher Education \(2019\)](#) (the 2019 SORP) with a 31 July year end.
5. 2019/20 is the first year that the 2019 SORP applies, but there are no significant changes from the 2015 SORP. The 2019 SORP requires colleges that follow it to apply all requirements of FRS 102. In certain areas, the SORP provides an interpretation to aid the practical implementation of FRS 102 (e.g. government grants). It also requires a small number of additional disclosures.

This module provides guidance on applying the other TGN modules to colleges along with some supplementary guidance

Enquiries

6. Auditors should contact Professional Support with any enquiries or requests for advice by sending an email to TechnicalQueries@audit-scotland.gov.uk.

Section 1

Application of other modules to colleges

7. The following tables summarise the application of the other modules of [TGN 2020/1](#) to colleges, and states the areas on which supplementary guidance is provided.

Overview Module

8. All sections of the Overview Module apply to colleges. Supplementary guidance on a complete set of financial statements and the going concern basis of accounting is provided at section 2.

Modules 1 to 9

9. The risks of misstatement in modules 1 to 9 apply to colleges, although auditors should be alert to differences in terminology used by FRS 102. The following table refers to areas where supplementary guidance is provided at section 3:

Module	Supplementary guidance provided on
Module 1 Property, plant and equipment	Accounting policy for measurement basis , uncertainties in valuers reports, impairment losses, and disclosures.
Module 4 Employee benefits	An update on significant developments affecting liabilities in the Local Government Pension Scheme, early retirement provisions and the Teachers' Pension Scheme is provided.
Module 5 Group financial statements	Treatment of arm's-length foundations (ALFs).
Module 7 Grants and other income	Accrual model of grant recognition and disclosures, and treatment of job retention scheme funding IFRS 15 in respect of other income does not apply to colleges.
Module 8 Other financial statements areas	ALF transfers, and disclosures for agency arrangements, related parties and depreciation budget.

Module 10 Remuneration and Staff Report

10. Module 10 applies to colleges. Supplementary guidance is provided on the analysis of staff by band in section 4.

Module 11 Statutory Other Information

11. All sections of Module 11 apply to colleges. The following table sets out supplementary guidance on some areas provided in section 5:

Section	Supplementary guidance provided on
Section 1 Performance Report	Required content.
Section 2 Governance Statement	Compliance with good governance.
Section 3 Other statements	Accountable Officer arrangements.

Module 12 Charitable NDPBs

- 12.** The sections on fund accounting and donations and legacies in module 12 apply to colleges due to their charitable status

Section 2

Presentation of financial statements and going concern

A complete set of financial statements is not properly presented

13. **SORP** section 3.1 sets out what a complete set of financial statements should comprise for a college. The differences to the FREM requirements for 2019/20 are summarised in the following table:

FReM statements	SORP statements	FRA 102 requirements
Statement of Financial Position as at 31 March 2020	Balance Sheet as at 31 July 2020	FRS 102 section 4 sets out the requirements for a balance sheet as at the end of the period.
Statement of Comprehensive Net Expenditure	Statement of Comprehensive Income (SoCI)	FRS 102 section 5 sets out the requirements for a SoCI.
Statement of Changes in Tax-payers' Equity	Statement of Changes in Reserves	FRS 102 section 6 sets out the requirements for a statement of changes in reserves.
Statement of Cash Flows		FRS 102 section 7 sets out the requirements for a statement of cash flows
Notes to the financial statements		FRS 102 section 8 sets out requirements for the notes.

Going concern basis of accounting is not appropriate

14. Paragraph 3.27 of the SORP states that colleges normally prepare their financial statements on the basis of being a going concern. However, it requires the governing body to make its own assessment of the college's ability to continue as a going concern.
15. In Professional Support's view, the FREM's interpretation of going concern for non-trading entities applies to colleges, i.e. the anticipated continuation of the provision of further education, as evidenced by inclusion of financial provision in published documents, is normally sufficient evidence of going concern.
16. Professional Support therefore expects colleges to adopt a going concern basis of accounting in 2019/20, unless there is evidence that the SFC deems that inappropriate for a particular college.

Section 3

Financial statement areas

Property, plant and equipment

Accounting policy for measuring operational land and buildings is not appropriate

17. Colleges are required to account for property, plant and equipment in accordance with section 17 of FRS 102. Specific requirements are set out at [SORP](#) section 11.
18. The SORP allows property plant and equipment to be measured using either the cost model or the revaluation model. Although not specified in the accounts direction, the SFC expects colleges to adopt a revaluation model.

Material uncertainty over valuations

19. Under the Red Book, a valuer may declare a 'material uncertainty' in their valuation report. This indicates that circumstances at the time of the valuation mean that less certainty can be attached to the valuation than would normally be the case. RICS [guidance](#) is clear that a material uncertainty in a valuer's report does not mean that the valuation cannot be relied upon or that there is a misstatement.
20. It is important that bodies disclose in the notes an adequate explanation of the estimation uncertainty (as explained at section 7 of Module 8). The disclosure should help users understand the judgements that the body has made.

The accounting entries for impairment losses are not appropriate

21. Impairment losses should be recognised in the revaluation reserve to the extent that there is a credit balance relating to the impaired asset.
22. **Auditors should** evaluate whether impairment losses on revalued fixed assets during 2019/20 have been recognised in the Statement of Changes in Reserves and set against any revaluation surplus until the carrying amount of the fixed asset reaches depreciated historical cost and thereafter in the SoCI.

Information on property, plant and equipment is not properly disclosed

23. The disclosure requirements of FRS 102 include (at paragraph 17.31) a reconciliation of the carrying amount at 1 August 2019 and 31 July 2020. There is however no requirement in FRS 102 for a reconciliation in respect of prior periods to be disclosed.

Employee benefits

Significant events affecting the LGPS liability are not reflected

24. Since the publication of Module 4 of TGN 2020/1, the Scottish Public Pensions Agency has issued a [consultation paper](#) setting out a proposed remedy in respect of the McCloud judgement. Colleges will need to consider, in discussion with their actuaries, whether the impact of this information on existing estimates of pension liabilities is material and therefore whether an adjustment is required.
25. A further event since the publication of TGN 2020/1 is the recent employment tribunal (the Goodwin tribunal) that changes the pension entitlement of male survivors in opposite sex marriages to take into account the female member's service from 6 April 1978. Previously, the male spouse survivor's entitlement was based on service accrued from 6 April 1988. The change is backdated to 5 December 2005. The change therefore affects the pension of male spouse survivors where their entitlement arose (i.e. where the female member died) on or after 5 December 2005. Further information is provided in [SPPA Circular 2020/04](#).

The accounting policy for the Teachers' Pension Scheme is not appropriate

26. Most college employees are members of the Teachers' Pension Scheme, which both the SORP and section 6.2 of the FReM requires to be accounted for on a defined contribution basis.

- 27. Auditors should** evaluate whether the Teachers' Pension Scheme has been accounted for on a defined contribution basis in 2019/20.

Provision for early retirements is not properly measured

- 28.** Additional pension liabilities arising from early retirements are not funded by the Teachers' Pension Scheme except where the retirement is due to ill-health. Colleges are therefore required to recognise a provision for the actuarial cost of early retirements to the extent not met by the scheme
- 29.** The SFC have advised colleges that they will not provide an appropriate discount factor as at 31 July 2020 or issue an accompanying spreadsheet for the calculation of a provision for early retirement costs. Colleges are expected to obtain this information from their actuaries.
- 30. Auditors should** evaluate whether:
- a provision has been recognised at 31 July 2020 for the actuarial cost of early retirements
 - an appropriate discount rate has been used
 - the provision is free from misstatement.

Group financial statements

Subsidiaries are not complete or do not exist

- 31.** Paragraph 9.11 of FRS 102 states that consolidation as a subsidiary may be required where the objects of another entity are substantially or exclusively confined to the benefit of the college. This may be the case, for example, where the objects of an ALF are set so narrowly that the benefits cannot be applied to any party other than the college.
- 32.** When evaluating control, **auditors should** examine the documentation for their college's local ALF and evaluate whether the objects of the charitable foundation are substantially or exclusively confined to the benefit of the college.

Associates are not complete or do not exist

- 33.** Where a college does not control an ALF, it may exercise significant influence. Significant influence is defined in FRS 102 as follows:
- If a college holds 20% or more of the voting power of an entity, it is presumed that it has significant influence, unless it can be clearly demonstrated that this is not the case.
 - Conversely, if the college holds less than 20%, it is presumed that there is not significant influence, unless such influence can be clearly demonstrated.
- 34.** In addition to voting share, in order to conclude on whether there is significant influence, **auditors should** consider other issues around the operation of the ALF including whether there is evidence, for example, that:
- the ALF has approved applications from third parties
 - the ALF has rejected applications from the college
 - there is a clear applications process which has been applied consistently
 - the college's ability to exercise influence is included within the ALF governing documents.

Grants and other income

Accounting policy for grants is not appropriate

- 35.** Colleges are required to account for government grants in accordance with section 24 of FRS 102. Specific requirements are set out in the SORP at paragraphs 17.11 to 17.17.
- 36.** The SORP Section 17 allows revenue and capital (other than for land) government grants to be accounted for by applying the accrual model or performance model. Colleges must apply the chosen approach consistently for each class of grant (i.e. capital grant for land, other capital grant and revenue grant). The SORP requires capital grants for land to follow the performance model.
- 37.** Whichever policy is adopted, government grants are not recognised until there is reasonable assurance that the college will comply with the conditions attaching to them and that the grants will be received.

38. Guidance on SFC funding is provided at paragraphs 6 and 7 of [guidance notes](#) on the 2019/20 financial statements issued by the SFC. Annex A of the guidance notes provide a model disclosure note.

The accounting treatment of grants under the accrual model is not appropriate

39. Under the accrual method, revenue government grants should be recognised as income on a systematic basis over the periods in which the college recognises the related costs for which the grant is intended to compensate.
40. In normal circumstances, grant is returned if outcome agreement targets or other specified conditions are not met. Due to the impact of COVID-19, the SFC has indicated that this may not be the case for 2019/20. **Auditors should:**
- establish which conditions apply in practice to particular funding streams in 2019/20
 - evaluate whether grant has been properly recognised.

The accounting treatment of grants under the performance model is not appropriate

41. For grants accounted for under the performance model, **auditors should** evaluate whether grant is recognised when performance -related conditions are met.

The accounting treatment of job retention scheme funding is not appropriate

42. Colleges may receive funding in 2019/20 for staff on furlough under the Job Retention Scheme. Paragraph 18 7 of the SFC's [guidance notes](#) advise that such funding should be treated as government grant income and not netted off against staff costs.
43. Auditors should evaluate whether the college's treatment of job retention funding in 2019/20 is appropriate.

Information on grants is not properly disclosed

44. Annex A of the [guidance notes](#) contains a model note which colleges are required to adopt as far as possible. Any significant one-off or ring-fenced grants should be identified on a separate line. Smaller grants may be grouped together under the 'other' heading, but this should not represent a significant portion of the total grants received. **Auditors should** evaluate whether:
- the college has made the required disclosures
 - the disclosures are complete, clear, concise and free from misstatement.

Related parties disclosure

Disclosed related parties are not complete

45. In accordance with paragraph 33.2 of FRS 102, related parties for colleges include:
- those members of the governing body (and close members of their family) who hold influential posts in public bodies (e.g. local authorities, non-departmental public bodies, etc), private sector organisations with which the college has transactions, and ALFs
 - senior staff, including those who hold influential posts in other bodies with which the college has transactions, e.g. an NHS board
 - associates, collaborations and joint venture entities not fully eliminated on consolidation
 - pension schemes for the benefit of employees of either the college or an entity related to the college.
46. Colleges should have given due consideration as to whether bodies such as students' unions and separate development trusts are related parties in the context of FRS 102.

Agency arrangements disclosure

Disclosed agency arrangements are not complete

47. Colleges act as agents when they disburse funds on behalf of a funding body, and have no beneficial interest or risks related to the receipt and subsequent disbursement of the funds.
48. Paragraph 11 of the [guidance notes](#) lists the following as being agency arrangements:
- further education bursary funds

- discretionary funds
- educational maintenance allowances.

49. Agency arrangements do not include

- bursaries or scholarships made from a college's own funds
- childcare funds.

Depreciation budget disclosures

Information depreciation budget is not properly disclosed

50. Paragraph 10 of Appendix 2 to the [accounts direction](#) requires an explanation of the impact of the depreciation budget for government-funded assets to be disclosed in:

- a statement at the foot of the SoCI; and
- a note to the accounts.

51. An illustrative form of words for the disclosure is provided at Appendix 6 of the accounts direction. An explanation is required because the combination of the following factors leads to a deficit in the SoCI equivalent to net depreciation:

- The depreciation budget cannot be recognised as income in the SoCI.
- Colleges are required to spend the entire cash allocation.

52. Auditors should evaluate whether:

- the college has made the required disclosures in 2019/20
- the disclosures are complete, concise, clear and free from misstatement.

ALF donations and grants

Donations to/grants from arms' length foundations are not properly presented

53. Colleges have generally donated their surpluses to ALFs to bring them outside Scottish Government budgeting limits. Paragraph 21 of the SFC [guidance notes](#) recommends that the donation should be included above the operating surplus line in the SoCI and for this to be clearly disclosed.

54. Paragraph 9 of the guidance notes requires colleges to disclose separately any revenue or capital grants received from ALFs.

55. Auditors should evaluate whether:

- the college has clearly presented the donation/grant for 2019/20 in the SoCI
- the donation/grant is free from misstatement.

Section 4

Remuneration and Staff Report

Remuneration information is not properly disclosed

56. Paragraphs 31 to 36 of the [accounts direction's](#) Appendix 2 set out the requirements for the Remuneration and Staff Report (and an example is set out at Appendix 4).
57. However, paragraphs 41 and 43 of the direction's Appendix 2 allow the option of disclosing the remuneration of the Principal in a note to the financial statements, with only a cross reference in the Remuneration and Staff Report (or vice versa).
58. Professional Support recommends that the remuneration of the Principal should be included in the Remuneration and Staff Report with the other senior officers. In either case, it should be covered by the opinion on the Remuneration and Staff Report.

Audited information in the staff report is not properly disclosed

59. Paragraph 35 of Appendix 2 requires the number of senior staff by band to be disclosed in the staff report section. This disclosure should be audited.
60. However, paragraph 42 requires colleges to disclose in the notes:
 - the total number of higher paid staff in bands of £10,000 earning over £60,000
 - the number of senior post-holders within each band.
61. To avoid duplication, paragraph 43 of Appendix 2 allows the information to be disclosed in one place cross-referred to the other. Professional Support recommends that the information be disclosed in the staff report. In either case, it should be covered by the opinion on the Remuneration and Staff Report.

Section 5

Statutory Other Information

Performance Report

Performance Report is not in accordance with the accounts direction

62. The [accounts direction](#) sets out requirements for the Performance Report at paragraphs 3 to 19 of Appendix 2. The accounts direction requires compliance with the disclosure requirements of the FReM including the [addendum](#). Colleges are therefore permitted to omit the performance analysis section in 2019/20. In addition to the applicable requirements of the FReM explained in module 11 of [TGN 2020/1](#), the accounts direction also requires colleges to include the following in the Performance Report:
- A statement from the Chief Executive providing their perspective on performance
 - A short summary explaining the purpose of the overview section.
63. In addition to FReM requirements, the accounts direction requires:
- a statement describing the payment practice code or policy adopted regarding the payment of suppliers and the performance achieved, together with disclosure of any interest paid under the Late Payment of Commercial Debts (Interest) Act 1998, or a statement that there were no matters to disclose
 - an analysis of how the cash budget allocation previously earmarked for depreciation was spent. This is referred to as the 'cash budget for priorities' in the direction and the analysis should take the form of a table showing the expenditure under each heading and the impact on the operating position. An illustrative form of wording is provided at Appendix 5 of the accounts direction
 - details of the adjusted operating position. The adjusted operating position reflects the financial performance of a college after allowing for non-cash adjustments and other one-off or distorting items. A template for calculating the underlying operating position is provided at Appendix 7 of the accounts direction. Paragraph 18 of Appendix 2 requires colleges to submit their annual operating position calculation to the SFC prior to being signed off.
64. As a result of the different requirements, a checklist specific for colleges is provided at appendix 1 to this module which auditors should use when carrying out test procedure 2 set out in Module 11.

Governance statement

Governance statement is not in accordance with the accounts direction

65. The accounts direction requires colleges to include with their financial statements a statement covering the responsibilities of their board of management in relation to corporate governance. Paragraph 4 of the direction's Appendix 3 requires colleges to refer to the [Good Practice Note on Governance Statements](#) published by Professional Support.
66. The SFC requires the governance statement to indicate how the college has complied with good practice in this area, including the [Code of Good Governance for Scottish Colleges](#), which colleges are required to comply with as a condition of grant. Colleges are required to include either a statement confirming compliance with the code or explanations for any non-compliance. The template to be used for the compliance statement is provided at Appendix 3(a) of the direction.

Statement of responsibilities

Statement of responsibilities is not in accordance with accounts direction

67. Paragraph 24 of the accounts direction's Appendix 2 explains that, due to governance arrangements in the sector, colleges are required to provide a statement of responsibilities of the board of management rather than the Accountable Officer.

Appendix 1

Checklist – required content of Performance Report

Required item	Yes/No/N/A
Performance Overview	
1 A short summary explaining the purpose of the overview section	
2 A statement from the college Principal providing their perspective on the performance of the college for 2019/20.	
3 A statement of purpose and activities of the college including a brief description of the business model and environment, organisational structure, objectives and strategies	
4 Key issues and risks that could affect the college in delivering its objectives	
5 And explanation of the adoption of the going concern basis where this might be called into doubt	
6 A performance summary	
7 Where the Performance Analysis section is omitted:	
7a A summary of where money has been spent, and a short commentary on any major developments in the year such as new projects, programmes or liabilities, as well as significant financial issues	
7b Confirmation of compliance with Scottish Government sustainability reporting requirements	
7c A statement describing performance against the prompt payment code	
7d A breakdown of the spend on the cash budget for priorities	
7e Details of the adjusted operating position	
Performance Analysis	
8 Information on how the college measures performance i.e. what the college sees as its key performance measures, how it checks performance against those measures and narrative to explain the link between the measures, risk and uncertainty	
9 Detailed analysis and explanation of the development and performance of the board during 2019/20 and an explanation of the relationships and linkages between different pieces of information	
10 Information on social matters, respect for human rights anti-corruption and anti-bribery matters	

Required item	Yes/No/N/A
11 Information on environmental matters including the impact of the college's business on the environment	
12 Confirmation of compliance with Scottish Government sustainability reporting requirements.	
13 A statement describing performance against the prompt payment code.	
14 A breakdown of the spend on the cash budget for priorities.	
15 Details of the adjusted operating position	

Technical Guidance Note 2020/1 – Module 14 Colleges

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