Audit of 2018/19 annual accounts (local government) - other financial statement areas

Technical guidance note 2018/10(LG) - module 9

AUDIT SCOTLAND

Prepared for appointed auditors in the local government sector
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Audit Scotland is a statutory body set up in April 2000 under the Public Finance and Accountability (Scotland) Act 2000. It provides services to the Auditor General for Scotland and the Accounts Commission. Together they ensure that the Scottish Government and public sector bodies in Scotland are held to account for the proper, efficient and effective use of public funds.

Contents

1 Introduction

Purpose of module

2. This module of technical guidance note 2018/10(LG) provides information on, and guidance on the risks of misstatements in, the following financial statement areas

- Expenditure and funding analysis note (section 2).
- Heritage assets (section 3).
- Fair value measurement (section 4).
- Investment property (section 5).
- Intangible assets (section 6).
- Assets held for sale (section 7).
- Cash, cash equivalents, and overdrafts (section 8).
- Statutory income statements, i.e. the HRA, council tax income account, and non-domestic rates income account (section 9).
- Significant trading operations (section 10).
- Disclosures (section 11) on
  - new accounting standards
  - key assumptions and judgements
  - related parties
  - pension fund information by administering authorities
  - agency arrangements
  - trust funds.

Contact point for this module

3. The main contact point for this module of the technical guidance note is Paul O'Brien, Senior Manager (Professional Support) - Pobrien@audit-scotland.gov.uk.

2 Expenditure and funding analysis note

Changes in 2018/19

4. The 2018/19 accounting code has been amended as follows:
   - There is a new requirement to disclose factors used in identifying the reportable service segments.
   - Service segments may be aggregated where they are similar.
   - Additional columns may be added to the expenditure and funding analysis.

Summary of proper accounting practices

5. Paragraphs 3.4.2.98 to 3.4.2.100 of the accounting code require local government bodies to disclose an expenditure and funding analysis note to reconcile statutory adjustments between their financial performance on a funding basis and the surplus or deficit on the provision of services in the CIES.

6. Paragraphs 3.4.2.92 to 3.4.2.97 and 3.4.2.102 of the accounting code set out related requirements for segmental reporting.

External guidance

7. External guidance referred to in this section is section I of module 3 of the 2018/19 accounting code guidance notes.

Risks of misstatement

8. The following paragraphs highlight potential risks of misstatement in respect of the expenditure and funding analysis, and set out actions for auditors to undertake to assess whether the body has followed the required treatment.

A description of the purpose is not provided

9. Paragraph 3.4.2.98 of the accounting code requires bodies to provide a description of the purpose of the expenditure and funding analysis, and suggests recommended wording. Although the code allows the description to be in the management commentary, guidance from the Scottish Government overrides this and requires it to be in the note.

10. **Auditors should:**
    - confirm that the body has provided a description of the purpose of the expenditure and funding analysis note in 2018/19
    - assess whether the description is clear, concise and free from misstatement.

Information in the expenditure and funding analysis is not properly disclosed

11. Paragraph 3.4.2.99 of the accounting code requires the expenditure and funding analysis note to include (at least) three columns and sets out what each column should present. The following table provides an indicative illustration of the code's requirements:

	(I) Net expenditure chargeable to general fund and HRA balances	(II) Adjustments between the funding and accounting basis	(III) Net expenditure in the CIES
Service segments			
Net cost of services			
Other income and expenditure			
Surplus (or deficit)			

12. **Auditors should** assess whether:

- Column I) shows the income and expenditure chargeable to the general fund for 2018/19 (and 2017/18 comparatives) and that there are lines for:
  - a) Net expenditure chargeable on a statutory funding basis analysed by service segments
  - b) Other income and expenditure not charged to services and chargeable to the general fund
  - c) Surplus or deficit for the general fund.
- Column II) shows adjustments that add expenditure or income not chargeable to council tax or rents and remove transactions which are only chargeable under statutory provisions. From 2018/19, it may also include other adjustments necessary to reconcile Column I with Column III.
- Column III) shows the amounts for each line in column I after the adjustments in Column II, which equal the net expenditure in the equivalent lines in the CIES (with lines b) to e) required by paragraph 3.4.2.38 of the accounting code aggregated into one line for comparison with the general fund position).

13. From 2018/19, paragraph 3.4.2.99 of the accounting code has been amended to allow additional columns to be added where necessary to demonstrate the relationship between the CIES and the general fund.

Service segments are not properly presented

14. The service segments in the expenditure and funding analysis should be based on the organisational structure used by the body for internal management reporting in respect of assessing the performance of services when considering the allocation of financial resources. From 2018/19, the factors used to identify the segments should be disclosed, including the basis of organisation.

15. Not all segments require to be reported. Information on a segment is required where:
    - its expenditure is 10% or more of the gross expenditure within the net cost of services; or
    - its income is 10% or more of the gross income.

16. A body is permitted to report segments that do not meet the above criteria.

17. Where the operating segments identified by applying the criteria do not include at least 75% of the expenditure within the net cost of services, additional segments require to be reported until that level is reached.

18. From 2018/19, paragraph 2.4.2.97 of the accounting code has been amended to allow segments to be aggregated where they are similar in terms of economic characteristics, nature and type of service recipient. The paragraph has also been amended to set a practical upper limit of ten segments.

19. **Auditors should:**
    - confirm that the service segments in 2018/19 have been based on the organisational structure used for internal management reporting
    - confirm that the factors used to identify the segments have been disclosed
    - confirm that segment information has been reported where the 10% limit is exceeded
    - confirm that the total expenditure on reportable segments meets the 75% level
    - assess whether segments have been aggregated where they are similar
    - encourage the body not to exceed the ten segments limit.

Movements on the general fund are not properly disclosed

20. Paragraph 3.4.2.99 of the accounting code also requires the movement (including opening and closing balances) on the general fund to be disclosed at the foot of the expenditure and funding analysis note.

21. **Auditors should** confirm that the body has disclosed:
    - the balance on the general fund and HRA at 1 April 2018
    - the surplus (or deficit) for 2018/19
    - any other transfers to or from the general fund/HRA during 2018/19
    - the balance on the general fund and HRA at 31 March 2019.

22. **Auditors should** confirm that the body has either:

- analysed the movements between the general fund and the HRA; or
- made an appropriate cross reference to those same balances in the MiRS.

Expenditure and funding analysis is not properly positioned

23. Paragraph 3.4.2.93 of the accounting code states that the expenditure and funding analysis should be given due prominence in accordance with the needs of users. Some bodies present the expenditure and funding analysis as a separate financial statement. However, paragraph 3.4.2.99 of the accounting code is clear that the expenditure and funding analysis is a note.

24. **Auditors should** encourage bodies to treat the expenditure and funding analysis as a note in line with the expectations of the accounting code. However, **auditors should** not consider it to be a misstatement if the analysis is treated as a financial statement. **Auditors should** however ensure they include the expenditure and funding analysis in the independent auditor's report in the list of financial statements that have been audited.

Description of the material adjustments is not properly disclosed

25. Paragraph 5.4.2.100 of the accounting code requires a note to the expenditure and funding analysis which describes the material adjustments in Column II. The following table provides an indicative illustration. The adjustments are allowed to be aggregated, and the illustration aggregates the adjustments under capital, pension and other which is in line with the accounting code guidance notes (other aggregations may be more appropriate):

Adjustments from general fund to arrive at CIES amounts	Adjustments for capital purposes	Net change for pension adjustments	Other adjustments	Total adjustments
Service segments				
Net cost of services				
Other income and expenditure				
Difference between general fund surplus and CIES surplus				

26. In order to meet the requirement to 'describe' the material adjustments, it is expected that some supporting narrative commentary will be required. The accounting code guidance notes set out some illustrative wording but bodies will need to tailor it to their circumstances.

27. **Auditors should:**

- confirm that the body has disclosed a note describing the material adjustments in 2018/19
- assess whether the main adjustments have been identified (auditors will find it helpful to refer to paragraph 3.4.2.56 of the accounting code and appendix 1 of this technical guidance note's overview module)
- confirm that the body has provided supporting narrative commentary
- assess whether the commentary is complete, clear, concise, relevant, and free from misstatement.

Other required segmental information is not disclosed

28. Paragraph 3.4.2.101 of the accounting code requires the disclosure of a segmental analysis of items listed at that paragraph that are included in Column Ia) of the expenditure and funding analysis. It is expected that the most likely item to be disclosed is income from services.

29. Paragraph 3.4.2.102 of the accounting code requires bodies to disclose an analysis of segment assets and/or liabilities only where they report these items internally. Where such an analysis is disclosed, bodies are also required to disclose a reconciliation of segment assets and/or liabilities to the total assets and/or liabilities included in the balance sheet.

30. **Auditors should:**
    - confirm that a segmental analysis has been disclosed for service income in 2018/19 and any other items of income or expenditure reported internally
    - confirm that a segmental analysis and related reconciliation have been disclosed for any assets and liabilities reported internally
    - assess whether the disclosures are complete, clear, concise, and free from misstatement.

Information on the nature of expenses is not properly disclosed

31. In addition, paragraph 3.4.2.45 of the accounting code requires bodies to disclose information on the nature of their expenses (i.e. subjective analysis), and sets out expense headings.

32. **Auditors should:**
    - confirm that the body has included a note for 2018/19 disclosing the nature of expenses using applicable headings
    - assess whether the disclosures are complete, clear, concise, and free from misstatement.

3 Heritage assets

Summary of proper accounting practices

33. The accounting code (section 4.10) requires local government bodies to account for tangible heritage assets in accordance with FRS 102.

Risks of misstatement

34. The following paragraphs highlight potential risks of misstatement in respect of heritage assets, and set out actions for auditors to undertake to assess whether the body has followed the required treatment.

Heritage assets are not identified

35. **Auditors should** assess whether the body has reviewed its property, plant and equipment to identify those that are held principally for their contribution to knowledge and culture. Heritage assets include historical buildings, archaeological sites, scientific equipment of historical importance, civic regalia, museum and gallery collections and works of art.

36. **Auditors should** assess whether assets which, in addition to being held for their heritage characteristics, are also used by the body for other activities or to provide other services have been classified as operational assets and accounted for as property, plant and equipment. However, an historic building held principally for its contribution to knowledge and culture within a park would be a heritage asset while the park would be classified as a community asset within property, plant and equipment.

Heritage assets are not properly valued

37. Heritage assets should be carried at valuation rather than a current value or fair value basis. Paragraph 4.10.1.4 of the accounting code contains an interpretation of FRS 102 to continue to permit the pre-existing valuation approach for heritage assets that was available under FRS 30. It specifies that:

- valuations may be made by any method that is appropriate and relevant, e.g. insurance valuations may be appropriate for museum collections
- valuations need not be carried out or verified by external valuers
- there is no prescribed minimum period between valuations.

38. However, the accounting code requires the carrying amounts of heritage assets carried at valuation to be reviewed with sufficient regularity to ensure they remain current. **Auditors should** assess whether the valuations at 31 March 2019 are free from misstatement. If a body uses insurance valuations, **auditors should** assess whether:

- there is evidence that demonstrates that they provide an appropriate valuation basis

- the valuation is current at 31 March 2019.

39. Where it is not practicable to obtain a valuation (e.g. where there is no market for the item and it is not possible to provide a reliable estimate of the replacement cost), they may be measured at historical cost (less accumulated depreciation and impairment).

Heritage assets are not properly accounted for

40. Heritage assets require to be recognised in the balance sheet where a body has information on the cost or value of a heritage asset (or can obtain it at a cost commensurate with the benefits). When assessing materiality, the nature of the item may be particularly relevant, and the assessment should not be restricted to solely the amount involved.

41. Depreciation is not required on heritage assets which have indefinite lives, but **auditors should** confirm that an impairment review has been carried out where an asset has suffered physical deterioration or breakage, or where new doubts arise as to its authenticity.

42. **Auditors should** assess whether:

    - heritage assets have been recognised in the balance sheet at 31 March 2019 where the body has information on the cost or value
    - depreciation has been charged unless the asset has an indefinite life
    - an impairment review has been carried out, where required.

Information on heritage assets is not properly disclosed

43. The disclosure requirements for heritage assets are detailed at section 4.10.4 of the accounting code. Some disclosures vary depending on whether the assets are recognised in the balance sheet (e.g. paragraph 4.10.4.2).

44. **Auditors should:**

    - confirm that the required disclosures have been made for heritage assets in 2018/19
    - assess whether the disclosures are complete, clear, concise, and free from misstatement.

4 Fair value measurement

Summary of proper accounting practices

45. The accounting code (section 2.10) requires local government bodies to measure their assets and liabilities in accordance with *IFRS 13 Fair value measurement* where another section of the code requires or permits fair value measurement.

46. Items which the accounting code requires or permits to be measured at fair value are listed at paragraph 2.1.2.50 of the accounting code and include surplus assets, financial instruments, investment property, intangible assets (where there is an active market), assets held for sale, debtors and creditors, revenue recognition, and pension scheme assets.

Risks of misstatement

47. The following paragraphs highlight potential risks of misstatement in respect of fair value measurement, and set out actions for auditors to undertake to assess whether the body has followed the required treatment.

Items at fair value are not properly measured

48. The measurement requirements for fair value are set out at paragraphs 2.10.2.18 to 2.10.2.29 of the accounting code. The code defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction in the principal (or most advantageous) market at the measurement date under current market conditions (i.e. an exit price) regardless of whether that price is available from a market or estimated using a valuation technique. This is a very technical definition and it is important that local government staff understand what the various terms mean. Some key terms are explained in the following table.

Term	Explanation
Orderly transaction	This assumes the body has access to the market before the measurement date (i.e. 31 March 2019) to allow for the usual marketing activities.
Principal market	The market with the greatest volume and activity for the asset or liability.
Most advantageous market	The market that maximises the amount that would be received to sell the asset or minimises the amount that would be paid to transfer the liability.
Exit price	The price that would be received to sell an asset or paid to transfer a liability. It takes into account the body's ability to generate economic benefits by either using the asset in its highest and best use or by selling it.

49. It is assumed that buyers and sellers in the principal (or most advantageous) market for the asset or liability are:

- independent of each other, i.e. they are not related parties
- knowledgeable, and have a reasonable understanding based on all available information
- willing and able to enter into a transaction for the asset or liability.

50. **Auditors should** assess whether the body has in 2018/19:
    - used the IFRS 13 definition of fair value for applicable assets and liabilities
    - not adjusted the price used to measure the fair value of the asset or liability for transaction costs (the treatment of transaction costs varies and should be in accordance with the relevant sections of the accounting code)
    - taken into account the characteristics of the asset or liability that market participants would take into account when measuring fair value, e.g. the condition and location of the asset, and any restrictions on its sale or use.

51. **Auditors should** assess whether the body has measured fair value for applicable assets and liabilities using valuation techniques that are consistent with the three main approaches summarised in the following table:

Approach	Explanation
Market	Prices and other relevant information generated by market transactions involving identical or comparable (i.e. similar) assets and liabilities.
Cost	The amount that would be required currently to replace the service capacity of an asset (often referred to as current replacement cost).
Income	Future cash flows converted to a discounted amount.

52. **Auditors should** assess whether the body has followed the fair value hierarchy prescribed by IFRS 13 which categorises into three levels the inputs to the above valuation techniques. Inputs are the assumptions that buyers and sellers would use when pricing the asset or liability. They are summarised in the following table:

Level	Inputs	Explanation
1	Quoted prices that are observable in active markets for identical assets or liabilities	This provides the most reliable evidence and **auditors should** confirm that it has been used without adjustment whenever the information is available. The emphasis is on determining: • the principal market for the asset or liability or, in the absence of a principal market, the most advantageous market; and • whether the body can enter into a transaction for the asset or liability at the price in that market at the measurement date. Fair value should be measured as the product of the quoted price for the individual asset or liability and the quantity held.

Level	Inputs	Explanation
2	Inputs other than quoted prices that are observable for the asset or liability, either directly or indirectly	Inputs include: • quoted prices for similar assets or liabilities in active markets • quoted prices for identical or similar assets or liabilities in markets that are not active • inputs other than quoted prices that are observable. Adjustments will vary depending on factors specific to the asset or liability. Those factors include the: • condition or location of the asset • extent to which inputs relate to items that are comparable • volume or level of activity in the markets.
3	Unobservable inputs	In the absence of observable inputs, unobservable inputs have to be used. These should reflect the assumptions that buyers and sellers would use when pricing the asset or liability. **Auditors should** assess whether the body (probably using a relevant expert) has developed unobservable inputs using the best information available in the circumstances.

Information on fair value measurement is not properly disclosed

53. The disclosures required are set out at section 2.10.4 of the code. **Auditors should:**

- confirm that the required disclosures have been made in 2018/19 for all relevant assets and liabilities measured at fair value
- assess whether information is disclosed to help users assess the valuation techniques and inputs used to develop the measurements for assets and liabilities that are measured at fair value after initial recognition
- assess whether information is disclosed to help users assess the effect of recurring fair value measurements using significant unobservable inputs (level 3) on the surplus or deficit on the provision of services or other comprehensive income and expenditure for the period
- assess whether the disclosures are complete, clear, concise, and free from misstatement.

5 Investment property

Summary of proper accounting practices

54. The accounting code (section 4.4) requires local government bodies to account for investment properties in accordance with *IAS 40 Investment properties* as adapted by paragraphs 4.4.1.2 and 4.4.1.3.

55. Authorities are also required to comply with statutory guidance issued with finance circular 7/2011.

Risks of misstatement

56. The following paragraphs highlight potential risks of misstatement in respect of investment properties, and set out actions for auditors to undertake to assess whether the body has followed the required treatment.

Investment properties are not identified

57. The accounting code restricts investment property to land or buildings. **Auditors should** assess whether the body has reviewed its land and buildings to identify those that are held solely to earn rentals and/or for capital appreciation.

58. However, a building held to earn rentals or for capital appreciation should be accounted for as property, plant and equipment (rather than investment property) where:
    - the body owns and occupies it for use in the delivery of services, or the production of goods, or for administrative purposes; or
    - the rentals arise from the authority's regeneration policy.

59. Where a body uses part of a building itself and leases the remainder, the building should be classified as follows:
    - Where the elements of the building could be disposed of individually, each element should be accounted for separately, i.e. as owner-occupied property or investment property.
    - Where the building cannot be split between the relevant elements, the whole building should be classified as owner-occupied unless that element is insignificant, in which case the whole building should have been classified as an investment property.

60. Finance circular 5/2010 includes investment properties in the definition of investments. **Auditors should** confirm that any investment properties at 31 March 2019 are included in the body's permitted investments and that the conditions in the finance circular are met.

Investment properties are not properly valued

61. The accounting code adapts IAS 40 and requires investment property, after initial recognition at cost, to be carried at fair value. Fair value should be in accordance with IFRS 13 (as explained at section 4 of this module). In order to reflect market conditions each year end, it is expected that an annual valuation will be required.

62. **Auditors should:**
    - confirm that the investment properties are carried at fair value
    - confirm that an annual revaluation has taken place
    - assess whether the valuation at 31 March 2019 is free from misstatement.

63. Exceptionally, where there is evidence when a property first becomes an investment property that the fair value is not reliably determinable, bodies are permitted to measure them at historical cost (less accumulated depreciation and impairment). For any new investment property during 2018/19 measured at historical cost, **auditors should** assess whether the fair value was reliably determinable.

Investment properties are not properly accounted for

64. Investment properties held at fair value should not be depreciated. However, **auditors should** confirm that investment property held at cost is being depreciated over its useful life, with the residual value assumed to be zero.

65. **Auditors should** assess whether changes in fair value during 2018/19 are free from misstatement and have been:
    - included in the surplus or deficit on the provision of services
    - transferred to the capital adjustment account in accordance with the statutory guidance
    - disclosed in the analysis of adjustments between the accounting basis and funding basis in the MiRS.

66. The accounting code permits investment property that meets the criteria to be classified as held for sale (as explained at section 7 of this module) to be reported separately as investment property held for sale.

6 Intangible assets

Summary of proper accounting practices

67. The accounting code (section 4.5) requires local government bodies to account for intangible assets in accordance with *IAS 38 Intangible assets*.

Risks of misstatement

68. The following paragraphs highlight potential risks of misstatement in respect of intangible assets, and set out actions for auditors to undertake to assess whether the body has followed the required treatment.

Intangible assets are not identified

69. An intangible asset is defined in the accounting code as an identifiable non-monetary asset without physical substance. An intangible asset requires to be recognised if (and only if) it is controlled by the body as a result of past events, and future economic or service benefits are expected to flow from the asset to the body. **Auditors should** assess whether:
    - the body has reviewed its expenditure during 2018/19 to identify amounts that meet the accounting code's definition of an intangible asset. For example, it is expected that in most cases purchased computer software will meet the definition
    - allowances purchased prospectively under the carbon reduction scheme have been classified as intangible assets (as explained in module 2)
    - expenditure to acquire or generate an item during 2018/19 that does not meet the definition of an intangible asset (e.g. research expenditure) has been recognised as an expense in the CIES when it is incurred
    - subsequent expenditure incurred on an intangible asset has been recognised as an expense unless exceptionally it meets the recognition criteria.

Internally generated intangible assets are not recognised

70. **Auditors should** assess whether development (but not research) expenditure has been recognised as an internally generated intangible asset when it meets the following criteria:
    - The technical feasibility of completing the intangible asset so that it will be available for use or sale must be demonstrated.
    - There must be an intention to complete the intangible asset and use or sell it.
    - The body must be able to use or sell the intangible asset.
    - The body must be able to demonstrate how the intangible asset will generate future economic benefits or future service potential, e.g. existence of a market for the output of the intangible or, if it is to be used internally, the usefulness of the intangible asset.

- Adequate resources must be available to complete the development of the asset and to use or sell it.
- The body must be able to reliably measure the expenditure incurred during the development of the intangible asset.

71. *SIC 32 Intangible assets – website costs* provides guidance on the types of expenditure to be considered for internally generated website projects. It states that expenditure on developing a website for promoting and advertising a body's own products and services should be recognised as an expense. As the primary purpose of a local government body's website is to provide information about services or objectives, **auditors should** confirm that an internally-generated website has not been recognised as an intangible asset.

Intangible assets are not properly valued

72. **Auditors should** assess whether an intangible asset is:
    - measured initially at cost
    - carried at its historical cost (less any accumulated amortisation and impairment) unless its fair value can be determined by reference to an active market in accordance with IFRS 13 as required by IAS 38.

Intangible assets are not properly accounted for

73. **Auditors should** confirm that an intangible asset recognised at 31 March 2019:
    - with a finite useful life has been amortised; or
    - with an indefinite life has been tested for impairment.
74. **Auditors should** assess whether amortisation and impairment has been:
    - charged to the surplus or deficit on the provision of services
    - transferred to the capital adjustment account
    - disclosed in the analysis of adjustments between the accounting basis and funding basis in the MiRS.

7 Assets held for sale

Summary of proper accounting practices

75. The accounting code (section 4.9) requires local government bodies to account for assets held for sale in accordance with *IFRS 5 Non-current assets held for sale and discontinued operations*.

76. Fair value should be measured in accordance with IFRS 13.

Risks of misstatement

77. The following paragraphs highlight potential risks of misstatement in respect of assets held for sale, and set out actions for auditors to undertake to assess whether the body has followed the required treatment.

Assets held for sale are not properly identified

78. **Auditors should** assess whether the body has reviewed its property, plant and equipment at 31 March 2019 to identify any assets where their carrying amount will be recovered principally through a sale rather than their continued use.

79. Where an asset is categorised as being held for sale at 31 March 2019, **auditors should** assess whether it is available for immediate sale in its present condition, and that the sale is highly probable. For the sale to be highly probable:

- the appropriate level of management must be committed to a plan of sale, and an active programme to locate a buyer and complete the plan must have been initiated
- the asset must be actively marketed at a reasonable price
- the sale should be expected to be completed within one year of the classification. Where a sale is not completed within one year due to circumstances beyond the body's control, the asset may remain categorised as being held for sale provided there is sufficient evidence that the body remains committed to the sale.

80. In the event that the criteria have not been met, **auditors should** consider whether the following circumstances apply:

- Assets which do not meet the criteria of an asset held for sale because the body is not actively marketing the asset may meet the criteria to be classified as investment property (explained at section 5).
- Assets which do not meet the criteria to be classified as either held for sale or as an investment property should be classified as a surplus asset (which is a sub-classification of property, plant and equipment explained in module 1).

Assets held for sale are not properly valued

81. The accounting code requires an asset classified as held for sale to be measured at the lower of its carrying value and fair value less costs to sell. Fair value should be determined in accordance with IFRS 13 (as explained at section 4 of this module). **Auditors should** assess whether the valuation at 31 March 2019 is free from misstatement.

82. When the sale is expected to occur beyond one year, **auditors should** assess whether:

    - the body has measured the cost to sell at its present value
    - any increase in the present value of the costs to sell that arises from the passage of time has been treated as a financing cost
    - the fair value has been kept up to date.

83. For any assets reclassified as held for sale during 2018/19, **auditors should** assess whether:

    - immediately before the reclassification, the carrying amount had been measured in accordance with section 4.1 of the accounting code
    - following reclassification, the subsequent amount of revaluation gains recognised has been limited to the cumulative impairment loss that has been previously recognised.

Assets held for sale are not properly accounted for

84. **Auditors should** assess whether:

    - any impairment loss or revaluation decrease on assets held for sale has been recognised in the surplus or deficit on the provision of services, even where there is a balance on the revaluation reserve in respect of that asset
    - assets classified as held for sale have not been depreciated.

8 Cash, cash equivalents and bank overdraft

Proper accounting practices

85. The accounting code (section 3.4) requires local government bodies to comply with *IAS 7 Statement of cash flows*.

Risks of misstatement

86. The following paragraphs highlight potential risks of misstatement in respect of cash, cash equivalents and bank overdrafts, and set out actions for auditors to undertake to assess whether the body has followed the required treatment.

Cash equivalents are not properly identified

87. IAS 7 requires cash equivalents to be reported along with cash in the balance sheet and the cash flow statement. Cash includes cash in hand and in demand deposits, which are generally accepted to be deposits that are repayable on demand and available within 24 hours without penalty.

88. **Auditors should** assess whether the body has adopted a reasonable policy for determining cash equivalents and has disclosed it. The policy should cover short-term, highly liquid investments that are readily convertible to known amounts of cash and which are subject to an insignificant risk of changes in value. IAS 7 suggests that 'short term' this would be a period of no more than three months from the date of acquisition of the investment.

Overdrafts are not properly presented

89. Paragraph 3.4.2.14 of the accounting code requires cash and cash equivalents to include bank overdrafts where they are an integral part of the body's cash management. This would be where the balance often fluctuates from being in credit to being overdrawn. **Auditors should** confirm that an overdraft at 31 March 2019 is presented separately as a liability where the account is rarely if ever in credit and is in effect an arrangement for borrowing.

9 Statutory income statements

Summary of proper accounting practices

90. The HRA requires to be maintained in accordance with the schedule 15 of the *Housing (Scotland) Act 1987*. The requirements are set out at section 3.5 of the accounting code.

91. The council tax income account is required to show income raised from council taxes under part II of the *Local Government Finance Act 1992*. The requirements for the statement are set out at paragraph 3.6.3.2 of the accounting code.

92. The non-domestic rate income account is required to show income from the rates levied on non-domestic property under part 1 of the *Local Government (Scotland) Act 1975* (the 1975 Act) as amended by section 110 of the *Local Government Finance Act 1992.* The requirements for the statement are set out at paragraph 3.6.3.3 of the accounting code.

Risks of misstatement

93. The following paragraphs highlight potential risks of misstatement in respect of statutory income statements, and set out actions for auditors to undertake to assess whether the authority has followed the required treatment.

HRA statement is not properly presented

94. Section 3.5 of the accounting code sets out the requirements for the HRA which has the following two parts:

- HRA income and expenditure statement shows in more detail the income and expenditure on HRA services included in the whole-authority surplus or deficit on the provision of services.
- Movement on the HRA statement shows how the HRA income and expenditure account surplus/deficit for the year reconciles to the movement on the HRA balance for the year.

95. **Auditors should:**

- confirm that the HRA income and expenditure statement for 2018/19:
  - presents the income and expenditure items required by paragraph 3.5.3.1 of the accounting code
  - has been prepared on the same basis as the authority's surplus or deficit on the provision of services and has followed all the requirements of the accounting code.
- assess whether:
  - the statement comprises the HRA’s share of amounts included in the whole authority net service cost not allocated to individual services

– the HRA's share has been estimated on a fair and reasonable basis.

96. The accounting code sets out the required line items for the movement on the HRA statement at paragraph 3.5.3.2. These are summarised in the following table:

Item	Notes for auditors
Balance on the HRA as at the end of the previous reporting period	**Auditors should** confirm this agrees to the figure at 31 March 2018 in the balance sheet.
Surplus or (deficit) on the HRA income and expenditure statement	**Auditors should** confirm that the amount agrees to the HRA income and expenditure statement.
Adjustments between accounting basis and funding basis	This line relates to items charged or credited to the HRA income and expenditure statement that are not permitted debits or credits to the HRA balance. An analysis of the adjustments should be presented on the face of the statement or disclosed in the notes. Paragraph 3.5.3.3 of the accounting code sets out the items that should be included in the analysis. **Auditors should** confirm that the analysis of adjustments is complete, clear, concise, relevant, and free from misstatement.
Increase or (decrease) in year on the HRA	This is the net movement in the HRA balance during 2018/19.
Balance on the HRA as at the end of the current reporting period	**Auditors should** confirm this agrees to the figure at 31 March 2019 in the balance sheet.

97. **Auditors should:**

- confirm that the authority has complied in 2018/19 with the disclosure requirements set out at paragraph 3.5.4.2 of the accounting code
- assess whether the disclosures are clear, concise, and free from misstatement.

Council tax income account is not properly presented

98. The council tax income account should show in accordance with paragraph 3.6.3.2 of the accounting code:

- the gross income raised from council tax levied under part II of the *Local Government Finance Act 1992*; less
- discounts and reductions
- write-off of uncollectable debts and an allowance for impairment
- the amount transferred to the general fund.

99. **Auditors should:**

- confirm that the net income presented in the council tax income account agrees to the amount in the 2018/19 CIES
- confirm that the 2018/19 income statement complies with paragraph 3.6.3.2 of the accounting code
- assess whether the items in the income statement are free from misstatement
- confirm that the authority has complied with the disclosure requirements set out at paragraph 3.6.4.1 of the accounting code
- assess whether the disclosures are clear, concise, and free from misstatement.

Non-domestic rate income account is not properly presented

100. The non-domestic rate income account should show in accordance with paragraph 3.6.3.3 of the accounting code:

- gross income from the rates on non-domestic property; less
- reliefs and other deductions
- write-offs of uncollectable debts and an allowance for impairment
- adjustment to previous years' national non-domestic rates
- contribution to national non-domestic rate pool.

101. In general, authorities collect non-domestic rates under an agency agreement on behalf of the Scottish Government. The net income is due to the Scottish Government as a contribution to the national non-domestic rate pool. The pool is then distributed to local authorities based on estimated collection levels.

102. **Auditors should:**

- confirm that the 2018/19 income statement complies with paragraph 3.6.3.3 of the accounting code
- assess whether the items in the income statement are free from misstatement
- confirm that the authority has complied with the disclosure requirements set out at paragraph 3.6.4.1 of the accounting code
- assess whether the disclosures are clear, concise, and free from misstatement.

103. In addition to the agency arrangement, local authorities act as principal under the *Tax incremental financing scheme* (TIF) and the *Business rates incentive scheme* (BRIS), and should recognise an element of income in the CIES. There is also a line in the non-domestic rate income account for income retained by authorities, with a requirement for separate reporting for each scheme.

104. **Auditors should:**

- confirm that the income under these schemes presented in the income account agrees to the amount in the CIES

- assess whether the income is complete and free from misstatement.

Impairment on taxation debtors is not properly calculated

105. Council tax and NDR debtors are excluded from the scope of IFRS 9 and therefore are not subject to the new 'incurred loss' model. Impairment losses are incurred if there is objective evidence of impairment as a result of a past event that occurred subsequent to the initial recognition of the debtor.

106. **Auditors should**:

- confirm that the authority has assessed whether there is objective evidence at 31 March 2019 that taxation debtor balances may be impaired
- assess whether the impairment loss is complete and free from misstatement.

10 Significant trading operations

Summary of proper accounting practices

107. Paragraph 3.4.4.1 of the accounting code requires information on any significant trading operations to be disclosed in a note. This is based on section 10 of the *Local Government (Scotland) Act 2003* which requires local government bodies to maintain and disclose trading accounts for significant trading operations.

External guidance

108. Guidance referred to in this section is Significant trading operations - consolidated guidance.

Risks of misstatement

109. The following paragraphs highlight potential risks of misstatement in respect of significant trading operations, and set out actions for auditors to undertake to assess whether the authority has followed the required treatment.

Statutory trading operations are not identified

110. The LASAAC guidance sets out the criteria whereby a service or activity should be considered a trading operation for the purposes of the 2003 Act. These are principally where the service or activity is provided externally in a competitive environment and charged for on a basis other than the straight recharge of cost. The criteria is applied to some services/activities in the following table:

Service/activity	Statutory trading operation
Internal trading between departments	No - the LASAAC guidance was amended in 2013/14 to reflect that the requirements apply only to external trading. This is defined as those services or activities which are provided externally by the body.
Discretionary services provided externally at a market rate	Yes - The service is provided externally in a competitive environment and charged for on a basis other than the straight recharge of cost.
Discretionary services provided externally where costs are simply recharged	No - Although the service is provided externally, the charges levied to customers are the straight recharge of cost.
Care home services	No - The requirements do not apply to services which are statutory.

111. **Auditors should** assess whether the body has identified all its services or activities:

- provided in a competitive environment
- charged for on a basis other than the straight recharge of cost
- provided externally on a non-statutory basis.

Significance of statutory trading operations is not determined

112. **Auditors should** confirm that the body has set criteria for determining the significance of each statutory trading operation, and assess whether the significance criteria:

- includes financial and non-financial factors
- are a reasonable basis for identifying significance
- are consistently applied to all identified statutory trading operations.

Significant trading operations are not charged with relevant costs

113. The trading accounts for each significant statutory trading operation should be charged with:

- all relevant costs attributable to the external delivery of the service including depreciation, impairment losses, provisions, and current service pension costs
- a cost of capital charge. This is for the purposes of demonstrating that the statutory requirement to break even over three years has been met.

114. **Auditors should** assess whether:

- a trading account has been maintained for each significant trading operation
- the trading accounts have been charged with all relevant costs attributable to the external delivery of the service
- the trading accounts has been debited with a reasonable cost of capital charge
- the costs associated with any internal trading have been recorded separately from the external trading.

Significant trading operations are credited with inappropriate income

115. The trading accounts of significant statutory trading operations should be credited with the trading income received from service recipients. There should not be any income credited in respect of any internal trading.

116. **Auditors should** assess whether the trading accounts for significant statutory trading operations have been credited with the appropriate amount of external trading income.

Information on significant trading operations is not properly disclosed

117. **Auditors should** assess whether the following has been disclosed for each significant statutory trading operation:

- the nature, turnover and surplus/deficits

- the cumulative surplus or deficit for the three years from 2016/17 to 2018/19.

118. Bodies may choose to also disclose trading accounts for internal trading. However, **auditors should** confirm that these are disclosed separately from the disclosures for significant statutory trading operations.

Prescribed financial objective has not been met

119. The trading accounts of statutory significant trading operations have a prescribed objective to break even over three years. Break even means that over a rolling three year period, the external trading income of each significant trading operation should be not less than the expenditure (including the cost of capital) charged to its trading account.

120. Auditors are required to report any failure of a relevant statutory significant trading operation to break even over the three year period 2016/17 to 2018/19 in their independent auditor's report as a failure to achieve a prescribed financial objective. Guidance on this will be provided in the separate technical guidance note on the 2018/19 independent auditor's report.

Trading account income and expenditure is not properly presented

121. The trading accounts are essentially memorandum accounts that exist to demonstrate that a significant trading operation has met its statutory objective to break even. The income and expenditure of significant trading operations (other than the cost of capital charge) and other trading operations still require to be included in the CIES. The required treatment for trading accounts is summarised in the following table:

Type of activity	Treatment
Integral part of local government services	Include in the cost of that service
Not part of local government services	Include in the financing and investment income and expenditure line rather than the cost of services section

122. **Auditors should** assess whether the income and expenditure of trading operations have been properly included in the CIES in 2018/19.

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11 Miscellaneous disclosures

New accounting standards

Summary of proper accounting practices

123. The accounting code (at paragraph 3.3.4.3) requires a local government body to disclose information relating to the impact of an accounting change that will be required by a new standard that has been issued but not yet adopted.

Risks of misstatement

124. The following paragraphs highlight potential risks of misstatement in respect of disclosure of new accounting standards, and set out actions for auditors to undertake to assess whether the body has followed the required treatment.

Information on new accounting standards is not disclosed

125. The new standards will be set out in Appendix C to the 2019/20 accounting code and are expected to include, for example, *IFRS 16 Leases*.

126. **Auditors should** confirm that the body has considered whether the impact of the new standards will be material and, if so, has disclosed:
    - the title of the new standard, indicating that it is expected to be adopted by the 2019/20 accounting code
    - the nature of the impending changes in accounting policy
    - the date by which application of the standard, as adopted by the code is required
    - the date at which the body will adopt the standard initially, e.g. 1 April 2019
    - a clear and concise discussion of the impact that initial application of the standard as adopted by the code is expected to have on the body's financial statements (or, if that impact is not known or reasonably estimable, a statement to that effect).

Key assumptions and judgements

Summary of proper accounting practices

127. Paragraph 3.4.2.88 of the accounting code requires disclosure of the most significant judgements.

128. Paragraph 3.4.2.90 of the accounting code disclosure of assumptions that have a significant risk of resulting in a material adjustment within the next financial year.

Risks of misstatement

129. The following paragraphs highlight potential risks of misstatement in respect of disclosure of key assumptions and judgements, and set out actions for auditors to undertake to assess whether the body has followed the required treatment.

Judgements are not identified

130. **Auditors should** assess whether the body has considered the judgements made in applying the accounting policies that have the most significant effect on the amounts recognised in the financial statements. Examples of such judgements are whether:

- a lease agreement is a finance or operating lease
- land and buildings are investment properties
- an item should be recognised as a provision or disclosed as a contingent liability
- valuation techniques are appropriate.

Information on judgements is not properly disclosed

131. The relevant judgements should be disclosed along with the significant accounting policies or other notes. The aim of the disclosure is to highlight significant areas where others may have formed different judgements and provide justification for the view taken.

132. **Auditors should** assess whether a clear and concise explanation has been disclosed in 2018/19 which refers to the determining factors that were taken into account in making the judgements.

Key assumptions are not identified

133. **Auditors should** assess whether the body has considered the assumptions it has made about the future, and other major sources of estimation uncertainty, at 31 March 2019 that have a significant risk of resulting in a material adjustment to carrying amounts of assets and liabilities by 31 March 2020.

134. The disclosure requirement focusses on assets and liabilities whose carrying amount relies on estimates which are dependent on complex judgements for which there is a risk that correction or re-estimation with material effect during 2019/20 may be required.

135. Estimation uncertainty disclosures deal with situations where a body has incomplete or imperfect information which will only be enhanced as a result of future events. Examples of estimates that the body should be considering for inclusion in the note include:

- assumptions used in the calculation of depreciation
- assumptions about future events affecting provisions and retirement benefits
- assessments of the recoverable amounts of arrears and other debtors
- fair values that are not based on recently observed market prices.

Information on key assumptions is not properly disclosed

136. **Auditors should** assess whether the body, after considering the assumptions and other major sources of estimation uncertainty, has disclosed for the assets and liabilities affected:

- their nature
- their carrying amount as at 31 March 2019.

Related parties disclosure

Summary of proper accounting practices

137. The accounting code (at section 3.9) requires local government bodies to make related party disclosures in accordance with *IAS 24 Related party disclosures.*

Risks of misstatement

138. The following paragraphs highlight potential risks of misstatement in respect of disclosure of related parties, and set out actions for auditors to undertake to assess whether the body has followed the required treatment.

Related parties are not identified

139. **Auditors should** assess whether the body has identified its related parties in 2018/19 in accordance with ISA (UK) 550. A related party is defined at paragraph 3.9.2.7 of the code and includes:

- a person (or close family member of that person) who has control or significant influence over the local government body, or is a member of the key management personnel
- an entity controlled by a person identified above
- an entity which is significantly influenced by a person who controls the body
- subsidiaries, associates and joint ventures
- pension funds for the employees of the body, or of any entity that is a related party
- an entity, or any member of a group of which it is a part, that provides key management personnel services to the body.

140. Where a body shares key management personnel with another entity, the accounting code confirms that this does not automatically mean that there is a related party relationship. **Auditors should** assess whether it is likely that the person would be able to affect the policies of both entities in their mutual dealings.

141. The accounting code deems that the following are **not** related parties:

- providers of finance in the course of their business
- trade unions in the course of their normal dealings
- public utilities

- departments and agencies of a government that does not control, jointly control, or significantly influence the body
- an entity with which the relationship is solely that of an agency.

142. Possible related parties of local government bodies therefore include:

- the Scottish Government
- other public bodies subject to common control by the Scottish Government, e.g. non-departmental public bodies (NDPBs), health boards and other local government bodies
- elected members
- certain officers who are in a position to influence significantly the policies of the body, e.g. members of the corporate management team and other officers with independent statutory powers, i.e. the proper officer and the monitoring officer
- close family members with the ability to influence members or officers
- partnerships, companies, trusts or any entities in which members/officers or a member of their close family or the same household has a controlling interest
- subsidiaries, associates and joint ventures
- the relevant pension fund.

Related party transactions are not identified

143. A related party transaction is a transfer of resources or obligations between related parties, regardless of whether a price is charged. This includes sales, transfers and exchanges of non-current assets, leases, guarantees, the provision of goods and services, secondment of staff and the making of loans and investments.

144. **Auditors should** assess whether the body has identified all of its transactions with related parties during 2018/19.

Information on related parties is not properly disclosed

145. In the case of central government departments, NDPBs, health boards, and other local government bodies, a body is required to disclose:

- the name of the government (i.e. Scottish Government) and the fact that it exerts significant influence through legislation and grant funding
- the nature and amount of each individually significant transaction, and an indication of the extent of other transactions that are collectively, but not individually, significant.

146. For other related parties, a body is required to disclose

- a description of the nature of the related party relationships
- the amount of transactions that have occurred
- the amount of outstanding balances

- amounts incurred by the body for the provision of key management personnel services that are provided by a separate management entity.

147. Transactions and balances only need to be disclosed in the related parties note if they are not disclosed elsewhere in the annual accounts. However, good practice would be to make cross-reference in the related parties note to where the relevant disclosures can be found, rather than simply to omit the information.

148. **Auditors should:**

- confirm that the body has met the disclosure requirements of the accounting code in 2018/19
- assess whether
  - related party relationships where control exists have been disclosed irrespective of whether there have been transactions between the related parties
  - transactions have not been disclosed on an aggregated basis where disclosure of an individual transaction is necessary for an understanding of its impact
  - the body has judged materiality from the perspective of the related party as well as from its own perspective
  - the disclosures are complete, clear, concise, and free from misstatement.

Pension fund disclosure by administering authorities

Summary of proper accounting practices

149. Statutory guidance issued with finance circular 1/2011 sets out the required disclosures for LGPS-administering authorities.

Risks of misstatement

150. The following paragraphs highlight potential risks of misstatement in respect of disclosure of pension fund information, and set out actions for auditors to undertake to assess whether the administering authority has followed the required treatment.

Information on pension funds is not properly disclosed

151. Administering authorities are required to publish a pension fund annual report containing the pension funds financial statements (guidance on this is provided in module 12). Statutory guidance requires authorities to disclose in their own accounts information about the pension fund annual report. **Auditors should** confirm that the authority has disclosed the following in 2018/19:

- A note that the authority is an administering authority for the LGPS.
- The pension funds it is responsible for, including a general description of each fund and its membership.

- The statutory requirements for the publication of a separate pension fund annual report, and the contents of that report.
- How the pension fund annual report can be accessed or obtained.

Agency arrangements disclosure

Summary of proper accounting practices

152. The accounting code (at section 2.6) requires the accounting treatment of transactions to reflect whether a local government body is acting as an agent or principal.

Risks of misstatement

153. The following paragraphs highlight potential risks of misstatement in respect of disclosure of agency arrangements, and set out actions for auditors to undertake to assess whether the body has followed the required treatment.

Agency arrangements are not identified

154. A body is an agent when it is acting as an intermediary, and is a principal when it is acting on its own behalf. **Auditors should** assess whether the body has identified the transactions when it acted as an agent during 2018/19. A body may be acting as an agent where:

    - it does not have exposure to the significant risks and rewards associated with the sale of goods or the rendering of services
    - the amount the body earns is predetermined.

155. The accounting code gives the example of the collection of non-domestic rates, and bodies also collect water rates on an agency basis. There may be other cases, such as where a body is acting as a distribution point for grant monies to other entities and bears no significant risk.

156. Indications that the body is acting as a principal are where it:

    - has the primary responsibility for providing the goods or services to the service recipient or for fulfilling the order, e.g. by being responsible for the acceptability of the products
    - has inventory risk before or after the customer order, during shipping or on return
    - has latitude in establishing prices, e.g. by providing additional goods or services
    - bears the service recipient's credit risk for the amount receivable.

157. In applying these indicators to local government, an authority administering housing benefit payments would probably be able to conclude that it was a principal on the basis that:

    - the authority has some discretion in the award of benefits and their amount
    - when overpayments are made, the authority bears the risk of potential non-recovery
    - subsidy for the housing benefits paid is not fixed but has incentive elements based on the authority’s effectiveness in administering the system.

Agency arrangements are not properly accounted for

158. Where a body has acted as an agent in a transaction during 2018/19, **auditors should** assess whether:

- the transactions have been excluded from the 2018/19 CIES
- the balance sheet reflects the debtor or creditor position at 31 March 2019 in respect of cash collected or expenditure incurred on behalf of the principal
- the net cash position at 31 March 2019 is included in the financing activities in the cash flow statement
- any commission received for acting as an agent during 2018/19 has been recognised as income in the CIES.

Information on agency arrangements is not properly disclosed

159. **Auditors should:**

- confirm that the nature and amount of any significant agency income and expenditure has been disclosed in the notes to the financial statements
- assess whether the disclosures are complete, clear, concise, and free from misstatement.

Trust funds

Summary of proper accounting practices

160. The accounting code (paragraph 3.4.4.1) contains a requirement for local authorities to disclose information on trusts funds they administer in a note to their financial statements.

Risks of misstatement

161. The following paragraphs highlight potential risks of misstatement in respect of disclosure of trust funds, and set out actions for auditors to undertake to assess whether the authority has followed the required treatment.

Trust funds are not identified

162. **Auditors should** assess whether the authority has identified all the trust funds it administers. This includes trust funds and common good funds administered by an authority, regardless of whether they are registered charities or whether there are external trustees.

Information on trust funds is not properly disclosed

163. The accounting code requires an authority to disclose information on trusts funds where the authority acts as the sole trustee. **Auditors should** for any trust fund (or common good fund) where the authority is the sole trustee in 2018/19:

- confirm that the authority has disclosed details of the nature and amounts involved
- assess whether the disclosures are complete, clear, concise, and free from misstatement.

164. Although the accounting code requires a disclosure note, most authorities have historically treated the information as additional financial statements (within their own annual accounts). **Auditors should** encourage their authorities to treat the information as a note in 2018/19 in line with the expectations of the accounting code. However, **auditors should** not consider it to be a misstatement if the information is treated as a financial statement. **Auditors should** however ensure they include the trust funds in the independent auditor's report in the list of financial statements that have been audited.

165. For the avoidance of doubt, the disclosure requirement applies even where there is a separate statement of accounts for the trust fund (required where it is a registered charity). Module 13 of this technical guidance note provides guidance on the audit of the separate accounts.

166. For other trust funds administered by the authority (e.g. where there is an external trustee, **auditors should:**

- confirm that the authority has, in accordance with the code, disclosed in its own accounts in 2018/19 an indication of the overall nature and amounts administered by the authority
- assess whether the disclosures are complete, clear, concise, and free from misstatement.

Trust funds are not properly accounted for

167. The applicable accounting basis for the information disclosed in the local authority's own accounts depends on the size of the trust fund and whether it is a registered charity. This is summarised in the following table:

Registered charity		Non-registered charity
Income > £250,000	**Income < £250,000**	
Accrued basis based on Charities SORP	Receipts and payments basis	Accrued basis based on accounting code

168. Further information and guidance on accounting bases is provided in module 13.

169. Auditors should confirm that the information on trust funds disclosed in the authority's own 2018/19 accounts has been prepared on the appropriate accounting basis.