Audit of 2014/15 annual report and accounts (further education)

Technical guidance note 2015/6(FE) - all modules

AUDIT SCOTLAND

Prepared by the Technical Services Unit
17 August 2015

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.

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Technical guidance note 2015/6(FE) - overview module

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Foreword

Technical guidance notes are prepared by Audit Scotland's Technical Services Unit (TSU) to provide external auditors appointed by the Accounts Commission and Auditor General for Scotland with guidance on particular subjects or themes relevant to their audit appointment. They cover auditors' responsibilities to audit and report on the annual accounts, and review returns for whole of government accounts and local authority grant claims.

Technical guidance notes are available to external auditors from Audit Scotland's *Technical reference library,* and are also published on the Audit Scotland website so that audited bodies and other stakeholders can access them.

This particular type of technical guidance note is approved by the Assistant Auditor General and provides guidance on auditing the annual accounts.

While auditors act independently, and are responsible for their own conclusions and opinions, the TSU has a role in ensuring that those conclusions and opinions are reached on the basis of informed judgement. Consistency in similar circumstances is important and **the *Code of audit practice* therefore states that auditors should follow TSU guidance.** Auditors should advise the TSU promptly if they intend not to follow any guidance provided in this technical guidance note.

Audit Scotland makes no representation as to the completeness or accuracy of the contents of technical guidance notes or that legal or technical guidance is correct. Points of law, in particular, can ultimately be decided only by the Courts. Audit Scotland accepts no responsibility for any loss or damage caused as a result of any person relying upon anything contained in this note.

1 Introduction

Introduction

1. External auditors appointed by the Auditor General for Scotland are required under section 21(3) of the *Public Finance and Accountability (Scotland) Act 2000* (the 2000 Act) to audit the annual accounts prepared by the boards of management of colleges under schedule 2 of the *Further and Higher Education (Scotland) Act 1992* (the 1992 Act).

2. The accounts require to be prepared in such manner as the Scottish Ministers direct. Auditors' reports are required by section 22(1) of the 2000 Act to set out the audit findings as to whether the accounts comply with the direction.

3. The 2014/15 accounts direction issued by the Scottish Funding Council (SFC) requires the accounts to be prepared in accordance with the 2007 Statement of recommended practice: Accounting for further and higher education (the 2007 SORP). As colleges were reclassified as central government bodies from 1 April 2014, the direction also requires compliance with additional disclosures required by the 2014/15 Government financial reporting manual (FReM). In the event of any conflict, the SORP should take precedence over the FReM.

4. Colleges are registered charities and are therefore subject to The Charities Accounts (Scotland) Regulations 2006. However, regulation 14 requires compliance with the 2007 SORP rather than the charities SORP.

5. Section 22(1) of the 2000 Act also requires auditors' reports to set out their findings in respect of the regularity of expenditure and income.

Purpose of technical guidance note

6. The purpose of this technical guidance note from the TSU is to provide auditors with the guidance on meeting their statutory responsibilities to audit the 2014/15 annual accounts.

7. Auditors' responsibilities in respect of a college's annual accounts are to
   - audit and express an opinion on whether the financial statements, and those of the group where applicable, give a true and fair view and are properly prepared in accordance with the accounts direction
   - audit and express an opinion on the regularity of expenditure and income
   - audit and express an opinion on whether a specified part of the remuneration report has been properly prepared
   - read the operating and financial review (OFR) and express an opinion as to whether it is consistent with the financial statements
   - read the information in the governance statement and report by exception any non-compliance with relevant requirements

- read the other information that accompanies the financial statements to identify any material inconsistencies or misstatements of fact.

8. As part of the refresh of technical support provided by the TSU, technical guidance notes are replacing notes for guidance. This technical guidance note comprises this overview module and the following other modules which provide guidance on auditing financial statement areas
   - 1 Tangible fixed assets.
   - 2 Provisions and contingencies.
   - 3 Retirement benefits.
   - 4 Other financial statement areas, including accounting policies, intangible assets, leases, investments, government grants, and various disclosures.

9. Guidance on auditing the regularity of transactions is provided in module 5, and module 6 provides guidance on auditors' responsibilities in respect of the OFR, remuneration report and governance statement.

10. An audit of the financial statements involves auditors obtaining evidence about the amounts and disclosures sufficient to give reasonable assurance that they are free from material misstatement. *ISA 450 Evaluation of misstatements identified during the audit* defines a misstatement as a difference between the amount, classification, presentation, or disclosure of a reported financial statement item and that required for the item to be in accordance with the applicable financial reporting framework.

11. The modules on the financial statement areas highlight what the TSU considers to be the main risks of misstatement in each area, and sets out actions for auditors to consider. Although the modules provide a concise summary of the accounting treatment of risk areas, it may still be necessary for auditors to refer to the source material on which this note is based where issues of detail arise. The modules also
   - provide a summary of the financial reporting requirements
   - list available further guidance
   - highlight changes from the previous year.

12. There is also a module containing a summary of the risks of misstatement that auditors may use as a checklist.

13. Documents referred to in this technical guidance note may be obtained by using the hyperlinks or are available from the *Technical reference library*.

Purpose of overview module

14. The purpose of this overview module is to
   - provide information on the applicable financial reporting framework in 2014/15
   - provide information on, and guidance on the risks of misstatement in, the presentation of financial statements

- highlight some key requirements of auditing standards that are particularly relevant to this technical guidance note.

Other guidance and assistance

15. The following other guidance and assistance from the TSU in respect of 2014/15 will be provided in due course
    - guidance on emerging risks in future technical bulletins
    - technical guidance note 2015/7(FE) on the independent auditor's report.

16. Auditors are encouraged to contact the TSU 'helpdesk' with technical enquiries concerning colleges generally. Enquiries should be e-mailed to technicalqueries-furthereducation@audit-scotland.gov.uk.

Contact point

17. The contact point in the TSU for this module of the technical guidance note is Helen Cobb, Technical Adviser (Central Government, Health and Further Education) - 0131 625 1901 or HCobb@audit-scotland.gov.uk.

2 Applicable financial reporting framework

Purpose of section

18. The purpose of this section is to provide information on the financial reporting framework that applies to colleges in 2014/15.

SORP requirements

19. The accounts direction requires colleges to comply with the 2007 SORP in preparing their financial statements. The SORP is based on UK GAAP. It requires colleges to prepare their accounts on an accruals basis to give a true and fair view of their financial activities. It also requires colleges to apply all extant accounting and financial reporting standards, Urgent Issues Task Force (UITF) Abstracts, and relevant legislation.

20. The SORP at paragraphs 15 and 24 requires the annual accounts to comprise
    - statement of principal accounting policies and estimation techniques (Module 4)
    - financial statements (section 3 of this overview module)
    - an OFR (Module 6)
    - a governance statement (Module 6)
    - a statement of responsibilities of the governing body.

Applicable FReM requirements

21. Colleges are required to provide additional disclosures where FReM requirements go beyond the SORP. This mainly relates to the requirement for a remuneration report (Module 6) and the inclusion of an estates strategy in the OFR. The SFC has advised that they consider that this includes the requirement to recognise as accrual for untaken annual leave (Module 4).

22. In addition, while the SORP allows tangible fixed assets to be carried at either historical cost or a current valuation, the FReM requires a current value (Module 1).

Financial year

23. The 1992 Act states that a college's year end is 31 March. The financial period for 2013/14 covered the eight months to 31 March 2014. *The Colleges of Further Education (Financial Year)(Scotland) Order 2015* amends this to 31 July from 2014/15 (which was also the case for years prior to 2013/14).

24. The 2014/15 accounting period for most colleges (other than those associated with the University of the Highlands and Islands - UHI) is therefore a 16 month period from 1 April 2014 to 31 July 2015.

Changes in 2014/15

25. The main changes in the financial reporting framework in 2014/15 are related to

- the additional disclosures and requirements of the FReM
- the change in year end for most colleges.

3 Financial statements

Purpose of section

26. This section provides information on, and guidance on the risks of misstatement in, the presentation of financial statements. Guidance on risks in respect of recognition and measurement of financial statement areas is provided in the relevant module.

Financial reporting requirements

27. The SORP at paragraph 15 specifies that colleges' financial statements should include
    - an income and expenditure account
    - a statement of historical cost surpluses and deficits. This is required where a college includes tangible fixed assets at valuation, and there is a material difference between the surplus or deficit reported in the income and expenditure account and that which would have been reported on an unmodified historical cost basis, (e.g. due to a different depreciation charge)
    - a balance sheet
    - a cash flow statement
    - a statement of total recognised gains and losses
    - notes to the accounts.

28. The SORP requires that the financial statements should contain a positive statement that they are prepared in accordance with applicable accounting standards and the SORP, and that any material departures are explained clearly.

29. The SFC requires a copy of the accounts direction to be reproduced as an appendix to the financial statements.

Further guidance

30. A format for each of the financial statements is provided at Appendix 2 of the SORP.

31. Appendix 3 to the SORP provides a guide to the items which may be expected to be included in a college's notes to the accounts.

32. Guidance notes from the SFC are intended to supplement the accounts direction.

Changes in 2014/15

33. The main changes in the requirements for the presentation of financial statements in 2014/15 are a consequence of the 16 months accounting period for most colleges.

Guidance on risks of misstatement

34. The following paragraphs highlight potential risks of misstatement in respect of the presentation of financial statements, explain the required treatment, and set out actions for auditors to consider.

Statement of total recognised gains and losses is not included

35. The statement of total recognised gains and losses should reflect
    - all gains and losses arising on revaluations (Module 1)
    - the recognition of actuarial gains and losses in relation to defined benefit schemes (Module 3).

36. In the unusual event that there have been no recognised gains or losses other than those included in the income and expenditure account, auditors should confirm that a statement to this effect has been made immediately below the income and expenditure account which replaces the primary statement.

Statement of historical cost surpluses and deficits is not included

37. The statement of historical cost surpluses and deficits should follow the income and expenditure account or the statement of total recognised gains and losses.

38. If there is no material difference between the surplus or deficit reported in the income and expenditure account and that which would have been reported on an unmodified historical cost basis, auditors should confirm that a statement to that effect has been disclosed instead below the income and expenditure account.

Donations to arms' length foundations not properly presented

39. Colleges generally donate their surpluses to arms' length charitable foundations to bring them outside Scottish Government budgeting limits. Paragraph 22 of the SFC guidance notes recommends that the donation should be included above the operating surplus line in the income and expenditure account and for this to be clearly disclosed.

Comparative amounts are not properly presented

40. Auditors should confirm that the comparative figures are for the 8 month period ending 31 March 2014 for non-UHI colleges as required by the accounts direction.

4 Summary of key auditing standards

Purpose of section

41. The *Code of audit practice* requires appointed external auditors to perform the audit of the financial statements in accordance with the Financial Reporting Council's international standards on auditing in the UK (ISAs).

42. The purpose of this section is to highlight some key requirements of ISAs that are particularly relevant to this technical guidance note.

Material misstatements

43. ISAs require auditors to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement

- *ISA 320 Materiality in planning and performing an audit* deals with the concept of materiality and requires judgments about materiality to be affected not only by the size of a misstatement, but also by its nature and the surrounding circumstances.
- *ISA 315 Identifying and assessing the risks of material misstatement through understanding the entity and its environment* requires auditors to identify and assess the risks of material misstatement in the financial statements.
- *ISA 450 Evaluation of misstatements identified during the audit* deals with evaluating the effect of identified misstatements. It defines a misstatement as a difference between the amount, classification, presentation, or disclosure of a reported financial statement item and that required for the item to be in accordance with the applicable financial reporting framework as set out in the Code. Auditors are required to request management and, if necessary those charged with governance, to correct all misstatements identified during the audit, other than those that are clearly trivial.

Professional scepticism and judgment

44. *ISA 200 Overall objectives of the independent auditor* requires that auditors exercise professional judgment and maintain professional scepticism throughout the audit

- Professional scepticism is an attitude that includes a questioning mind, being alert to conditions which may indicate possible misstatement, and a critical assessment of audit evidence.
- Professional judgment is the application of relevant training, knowledge and experience in making informed decisions about the appropriate courses of action.

Audit evidence

45. *ISA 500 Audit evidence* explains what constitutes audit evidence, and deals with the auditor's responsibility to design and perform audit procedures to obtain sufficient appropriate audit evidence.

46. If information to be used as audit evidence has been prepared using the work of a management's expert (i.e. an individual with expertise in a field other than accounting or auditing, whose work is used by the entity in preparing the financial statements), auditors should
    - evaluate the competence, capabilities and objectivity of that expert
    - obtain an understanding of the work of that expert
    - evaluate the appropriateness of that expert's work as audit evidence.

Written representations

47. *ISA 580 Written representations* deals with the auditor's responsibility to obtain written representations from management. Although written representations provide necessary audit evidence, they do not provide sufficient appropriate audit evidence on their own.

Communication with those charged with governance

48. *ISA 260 Communication with those charged with governance* deals with the auditor's responsibility to communicate with those charged with governance.

49. Auditors should determine the appropriate persons within the authority's governance structure with whom to communicate, e.g. a committee whose remit includes audit or governance.

50. Auditors are required to communicate
    - the responsibilities of the auditor in relation to the financial statements audit, and an overview of the planned scope and timing of the audit
    - the auditor's views about significant qualitative aspects of the college's accounting policies, accounting estimates, and disclosures
    - any significant difficulties encountered during the audit
    - any significant matters arising from the audit that were discussed, or subject to correspondence, with management, and written representations the auditor is requesting
    - specific matters required by other ISAs, e.g. misstatements, fraud, external confirmations, related parties, deficiencies in internal control
    - any other matters arising from the audit that, in the auditor's professional judgment, are significant to the oversight of the financial reporting process
    - a statement that the audit team has complied with relevant ethical requirements regarding independence.

51. Communication by management of matters that the auditor is required to communicate does not relieve the auditor of the responsibility to also communicate them.

Group financial statements

52. *ISA 600 Special considerations - audits of group financial statements* deals with special considerations that apply to group audits, in particular those that involve component auditors. If a group auditor plans to request a component auditor to perform work on the financial information of a component, the group auditor is required to obtain an understanding of
    - whether the component auditor understands, and will comply with, the ethical requirements and is independent
    - the component auditor's professional competence. Group auditors should consider using the Audit Scotland annual quality report to document their assessment of component auditors' professional competence
    - whether the group audit team will be able to be involved in the work of the component auditor to the extent necessary
    - whether the component auditor operates in a regulatory environment that actively oversees auditors.

Other information

53. *ISA 720 Section A The auditor's responsibilities relating to other information in documents containing audited financial statements* deals with the auditor's responsibilities relating to other information that accompanies financial statements. Other information refers to the financial and non-financial information (other than the financial statements and the independent auditor's report) which is included in a document containing audited financial statements.

54. With the exception of part of the remuneration report and the OFR (both covered at module 6), auditors do not give an opinion on the other information. However, auditors should
    - read the other information to identify any material inconsistencies with the financial statements. An inconsistency is anything in the other information that contradicts information contained in the audited financial statements
    - identify any information that is apparently materially incorrect based on, or materially inconsistent with, the knowledge acquired by auditors in the course of performing the audit (i.e. misstatement of fact).

55. If auditors identify a material inconsistency or misstatement of fact, they should determine whether the financial statements or the other information requires to be revised
    - If revision of the audited financial statements is necessary, and the college refuses to make the revision, auditors should modify their audit opinion.

- If revision of the other information is necessary, and the college refuses to make the revision, auditors should include in the independent auditor’s report an 'other matter' paragraph under ISA 706 describing the material inconsistency.

Independent auditor's report

56. *ISA 700 The independent auditor's report on financial statements* establishes standards and provides guidance on the form and content of the independent auditor’s report.

57. Technical guidance note 2015/7(FE) from the TSU containing model independent auditor's reports based on the requirements of ISA 700 but adapted for the further education sector will be published shortly.

Audit of 2014/15 annual report and accounts (further education)

Technical guidance note 2015/6(FE) - module 1 tangible fixed assets

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Tangible fixed assets

Purpose of module

1. This module of technical guidance note 2015/6(FE) provides information on, and guidance on the risks of misstatements in, tangible fixed assets.

Definition

2. Tangible fixed assets are those held for use in the supply of services or for administrative purposes on a continuing basis.

Financial reporting requirements

3. Colleges are required to account for tangible fixed assets in accordance with FRS 15 Tangible fixed assets. Specific requirements are set out at SORP paragraphs 70 to 107.

4. While the SORP requires tangible fixed assets to be carried at either historical cost or a current valuation, the FReM requires a current value.

5. The SORP at paragraph 74 requires the following classes of tangible fixed assets to be presented in the balance sheet
   - land and buildings
   - plant and machinery
   - fixtures, fittings, tools and equipment
   - payments on account and assets in the course of construction.

6. A fifth class may also be required for heritage assets. FRS 30 Heritage assets applies to all colleges that hold heritage assets. They are discussed at SORP paragraphs 100 to 103.

7. SSAP 19 Investment properties applies to all colleges that hold investment properties.

Further guidance

8. Guidance on tangible fixed assets is provided at paragraphs 23 to 26 of the SFC guidance notes.

Changes in 2014/15

9. The main change in 2014/15 is colleges no longer have the option to value assets at historical cost as the FReM requires assets to be measured at current value.

Guidance on risks of misstatement

10. The following paragraphs highlight potential risks of misstatement in respect of tangible fixed assets, explain the required treatment, and set out actions for auditors to consider.

Acquisition or construction costs are not properly recognised

11. The cost of an item should be recognised as a tangible fixed asset in the balance sheet (i.e. capitalised) if it is held for use in the supply of services or for administrative purposes on a continuing basis. A tangible fixed asset should be initially measured at its cost. Auditors should confirm that cost comprises
    - the purchase price
    - any costs directly attributable to bringing the asset into working condition for its intended use.
12. FRS 15 gives examples of directly attributable costs, which include
    - the labour costs of own employees that arise directly from the construction or acquisition of the asset
    - the costs of site preparation, initial delivery and handling costs, and installation and assembly costs
    - professional fees
    - the estimated costs of dismantling and removing the asset and restoring the site to the extent that it is recognised as a provision.
13. The cost of a self-constructed asset is determined using the same principles as for an acquired asset. Auditors should confirm that abortive costs relating to projects that are discontinued and abnormal costs that arise from inefficiencies (e.g. design faults, theft of materials, etc) have not been capitalised.
14. Auditors should confirm that capitalisation of directly attributable costs ceased when substantially all the activities necessary to get the tangible fixed asset ready for use were complete, even if the asset had not yet been brought into use.

Subsequent costs are not properly recognised

15. Auditors should confirm that colleges have assessed the standard of performance of their assets to determine their useful economic life and residual value.
16. Costs that can be capitalised include those incurred after initial recognition to the extent that they increase the expected future benefits of the asset beyond its previously assessed standard of performance (i.e. an enhancement). The cost of any such enhancements should be added to the gross carrying amount of the relevant asset. There is no requirement to revalue the asset at this point, unless the college has indications that the asset might be impaired.
17. Auditors should confirm that all subsequent expenditure to ensure that a tangible fixed asset maintains its previously assessed standard of performance (i.e. repairs and maintenance) has been recognised in the income and expenditure account in the period in which it is incurred, e.g. the cost of servicing plant and equipment, and repainting a building structure.

18. Land and buildings are not properly valuedLand and buildings should be carried at current value in 2014/15. This may require a prior year adjustment for some colleges. A professional valuation requires to be undertaken by a qualified valuer at least every five years, with an interim valuation in the third year. Revaluations should be applied to entire classes of tangible fixed assets, which means that where an individual asset is revalued, all other assets in the same class requires to be revalued. Auditors should confirm that colleges have ensured that the carrying value of assets in the accounting periods between valuations is materially accurate. When an asset under construction is first brought into use, auditors should confirm that colleges have considered whether a valuation is required at that point.

19. Under ISA 500, auditors are required to
    - evaluate the competence, capabilities and objectivity of the valuer
    - obtain an understanding of their work
    - evaluate the appropriateness of the valuer's work as audit evidence.

Specialised properties are not identified

20. Auditors should confirm that colleges have identified their properties that are considered specialised. Specialised properties are defined by the Royal Institution of Chartered Surveyors (RICs) as those which, due to their specialised nature, are rarely, if ever, sold on the open market for single occupation for a continuation of their existing use, except as part of a sale of the business in occupation.

21. Their specialised nature may arise from the construction, arrangement, size or location of the property, or a combination of these factors, or may be due to the nature of the plant and machinery and items of equipment which the buildings are designed to house, or the function, or the purpose for which the buildings are provided. Examples of specialised properties are
    - properties of such construction, arrangement, size or specification that there would be no market (for a sale to a single owner occupier for the continuation of existing use) for those buildings
    - standard properties in particular geographical areas and remote from main business centres, located there for operational or business reasons, which are of such an abnormal size for that district, that there would be no market for such buildings there;
    - college buildings where there is no competing market demand from other organisations using these types of property in the locality.

Specialised properties are not properly valued

22. If there is no market-based evidence because of the specialised nature of the asset and it is rarely sold, market value may be estimated using a DRC approach. DRC is a method of valuation which provides the current cost of replacing an asset with its modern equivalent asset. It is the aggregate amount of the
    - value of the land for the existing use or a notional replacement site in the same locality

- the gross replacement cost of the buildings and other site works, from which appropriate deductions may then be made to allow for the age, condition, economic or functional obsolescence, environmental and other relevant factors.

23. However, colleges should not automatically assume that market value evidence is not available simply because the property is specialised.

Equipment, vehicles, plant and equipment are not properly valued

24. Tangible fixed assets other than properties should be valued using market value where possible, or on the basis of depreciated replacement cost (DRC).

Surplus properties are not properly valued

25. Auditors should confirm that colleges have identified properties that are surplus to their requirements. Surplus properties should be measured at the lower of cost and net realisable value.

Revaluation increases are not properly accounted for

26. Auditors should confirm that increases in value have been taken to the revaluation reserve, except to the extent that they reverse revaluation losses on the same asset that were previously recognised in the income and expenditure account.

Revaluation decreases are not properly accounted for

27. Auditors should confirm that
    - all revaluation losses caused by a clear consumption of economic benefits have been recognised in the income and expenditure account
    - other decreases in valuation have first been set against any previous revaluation surplus for that asset, with only any remaining balance being recognised in the income and expenditure account.

Depreciation is not charged where it is required

28. Depreciation should be charged on tangible fixed assets with a finite useful life to reflect the consumption of economic benefits. The only justification for not charging depreciation is because the long remaining life or high residual value of an asset makes any such charge immaterial. However, where depreciation is not provided for, auditors should confirm that the asset has been reviewed for impairment at the end of the accounting period.

29. Some colleges may not be depreciating an asset when its value has increased over the year. Even where enhancement work or upward revaluation results in an increase in the value of an asset, the use of the asset will still result in the consumption of economic benefits. Auditors should confirm that these factors have been accounted for separately, i.e. assets should have been written up by the value of the enhancement or revaluation, and the depreciation charge based on the revised value and any revised useful life.

30. The following assets should not be depreciated
    - assets in the course of construction (i.e. depreciation on an asset should not commence until it is brought into use)
    - freehold land
    - heritage assets with an indefinite life
    - investment properties
    - assets held for resale.

Depreciation is not properly calculated

31. Depreciation should be calculated on tangible fixed assets by allocating the cost (or revalued amount) less any estimated residual value as fairly as possible over the useful lives. Auditors should confirm that
    - the useful lives and residual values have been estimated on a realistic basis, and reviewed at 31 July 2015
    - a change in either has been accounted for prospectively over the asset's remaining useful economic life, except to the extent the asset has been impaired.

32. Where a decision is taken to dispose of an asset prior to the end of its estimated useful economic life, auditors should confirm that
    - the estimated life has been revised to reflect the remaining period of service
    - the residual value has been adjusted to the expected disposal proceeds
    - the depreciation charge has been adjusted accordingly.

Accumulated depreciation is not restated on revaluation

33. When a tangible fixed asset is revalued, the carrying amount of the asset is restated at its revalued amount. Auditors should confirm that
    - any accumulated depreciation at the date of revaluation has been eliminated and the asset restated at its revalued amount; or
    - where the valuation is on a DRC basis, both the asset value and the accumulated depreciation have been restated, so that the carrying amount of the asset after revaluation equals its revalued amount.

Major components are not separately depreciated

34. Where a tangible fixed asset comprises two or more major components with substantially different useful economic lives, auditors should confirm that each component has been accounted for separately for depreciation purposes and depreciated over its individual useful life. An example of separable components is the structure of a building and items within the structure such as general fittings.

35. Where each component is depreciated over its individual useful economic life, auditors should confirm that

- subsequent expenditure incurred in replacing the component has been recognised as an addition to the tangible fixed asset
- the carrying amount of the replaced component has been removed from the balance sheet.

36. Where an asset is not treated as several different components for depreciation purposes, auditors should confirm that the cost of replacing part of the asset has not been accounted for as an addition (i.e. it should be charged to the income and expenditure account).

Impairment reviews are not carried out

37. An impairment loss arises where the higher of the net recoverable amount or value in use of an asset is lower than its carrying amount in the balance sheet. Impairment reviews are therefore necessary if events or changes in circumstances indicate that the carrying amount may not be recoverable.

38. Auditors should confirm that colleges have

- established appropriate indicators of impairment, e.g. operating losses; evidence of physical damage or obsolescence; a significant adverse change in the business, regulatory or statutory environment; a commitment to undertake a significant reorganisation; or withdrawal from the provision of a course
- carried out an impairment review where such indications exist to determine whether there is an impairment and quantify the financial impact.

39. Assets should also be tested for impairment where

- no depreciation has been charged on the grounds that it would be immaterial
- assets are surplus to requirements in the long term.

Impairment losses are not properly accounted for

40. Auditors should confirm that

- an impairment loss caused by a clear consumption of economic benefit has been recognised in the income and expenditure account in the period to which it relates
- other impairment losses on revalued fixed assets have been recognised in the statement of total recognised gains and losses and set against any revaluation surplus until the carrying amount of the fixed asset reaches depreciated historical cost and thereafter in the income and expenditure account.

Heritage assets are not identified

41. Heritage assets are those that are intended to be preserved in trust for future generations and are held and maintained principally for their contribution to knowledge and culture. They include historical buildings, archaeological sites, scientific equipment of historical importance,

and works of art. Auditors should confirm that colleges have reviewed their tangible fixed assets to identify those that meet the definition of a heritage asset.

42. However, assets that are also used by a college to provide services are operational assets (even if they otherwise meet the definition for heritage assets) and should be accounted for in accordance with FRS 15.

Heritage assets are not properly valued

43. Valuations of heritage assets may be made by any method that is appropriate and relevant. Where it is not practicable to obtain a valuation, heritage assets should be measured at historical cost. Auditors should confirm that, where a college has information on the cost or value of a heritage asset or can obtain it at a cost commensurate with the benefits, the assets has been recognised in the balance sheet.

44. Depreciation is not required on heritage assets which have indefinite lives, but the carrying amount should be reviewed where there is evidence of impairment.

Heritage assets are not properly disclosed

45. FRS 30 sets out disclosure requirements for the reporting of heritage assets, which apply whether or not they are reported in the balance sheet. Auditors should confirm that the following disclosures have been made for all heritage assets
    - an indication of their nature and scale
    - the policy for their acquisition, preservation, management and disposal
    - the accounting policies adopted
    - a summary of transactions disclosing the cost of acquisitions, the value acquired by donation, the carrying value of disposals and proceeds, and any impairment.

46. Auditors should confirm that the following have been disclosed for heritage assets recognised in the balance sheet
    - a reconciliation of the carrying amount at the beginning and end of the financial period showing additions and disposals, revaluation changes, any impairment losses, and any depreciation
    - the date of the valuation, valuation methods used to produce the valuation, and details of valuer etc.

47. For heritage assets that are not reported in the balance sheet, auditors should confirm that the reasons for non-recognition have been disclosed.

Investment properties are not identified

48. Auditors should confirm that colleges have identified any investment properties they hold. An investment property is an interest in land and/or buildings which is held for its investment potential, with any rental income being negotiated at arm's length.

49. This definition does not include a property
    - which is owned and occupied by a college for its own purposes
    - let to, and occupied by, a subsidiary.

50. Auditors should confirm that investment properties have been included in the balance sheet at their market value without any depreciation.

Assets held for re-sale are not identified

51. Auditors should confirm that colleges have identified any assets held for re-sale. Where a college is committed to the disposal of a tangible fixed asset, such assets should be carried at cost or valuation, or written down to their net realisable value, whichever is lower.

52. Where all the following criteria are met, SORP paragraph 98 requires such assets to be transferred from fixed assets to current assets
    - The asset is no longer in use.
    - There is a commitment to sell the asset.
    - The asset is not being replaced.

53. Auditors should confirm that the assets have been transferred at their existing carrying value, subject to any impairment where the asset has been surplus to requirements in the long term.

54. Auditors should also confirm that any material gain or loss on the disposal of a tangible fixed asset that has been reclassified as current requires has been disclosed as an exceptional item.

Gains and losses on disposal are not properly accounted for

55. The gain or loss arising from the disposal of tangible fixed assets is the difference between the carrying amount of the fixed asset and the net sale proceeds. Gains or losses should be reported in the income and expenditure account.

56. Auditors should confirm that the net sale proceeds
    - exclude any proceeds required to be surrendered under the financial memorandum between the college and the SFC
    - have been included in the income and expenditure account and, if material, presented separately.

Property occupied rent-free is not disclosed

57. SORP paragraph 95 requires disclosure of any arrangement where a college occupies premises which are owned by other bodies and for which no market level rental is made.

58. Auditors should confirm that
    - colleges have identified relevant properties.

- a value has been attributed to this benefit, where practicable, which has been capitalised and is being depreciated over the period of use
- a corresponding credit has been made to deferred capital grants (which should subsequently be released to the income and expenditure account).

Contact point

59. The contact point in the TSU for this module of the technical guidance note is Helen Cobb, Technical Adviser (Central Government, Health and Further Education) - 0131 625 1901 or HCobb@audit-scotland.gov.uk.

Audit of 2014/15 annual report and accounts (further education)

Technical guidance note 2015/6(FE) - module 2 provisions and contingencies

AUDIT SCOTLAND

Prepared by the Technical Services Unit

17 August 2015

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.

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Provisions and contingencies

Purpose of module

1. This module of technical guidance note 2015/6(FE) provides information on, and guidance on the risks of misstatements in, provisions and contingencies.

Definition

2. Provisions are liabilities incurred of uncertain timing or amount.

Financial reporting requirements

3. Colleges are required to account for provisions in accordance with FRS 12 Provisions, contingent liabilities and contingent assets. Specific requirements are set out at paragraphs 167 to 176 of the SORP.

4. FRS 12 requires provisions to be recognised as a charge to the income and expenditure account when, and only when, the following three conditions are met
   - The college has a present obligation as a result of a past event.
   - It is probable that a transfer of benefits will be required to settle the obligation.
   - A reliable estimate can be made of the amount of the obligation.

5. A past event leads to a present obligation only where the settlement of the obligation can be enforced by law or where a college has indicated to other parties that it will accept certain responsibilities and has created valid expectations on the part of those other parties that it will discharge those responsibilities.

Further guidance

6. Guidance on the early retirement provision is provided at paragraphs 29 to 35 of the guidance notes. The SFC has also provided guidance on the interest rate to be used and an accompanying spreadsheet.

7. Annex H of the guidance notes sets out a model disclosure note.

Changes in 2014/15

8. There are no changes in accounting requirements for provisions and contingencies in 2014/15.

Guidance on risks of misstatement

9. The following paragraphs highlight potential risks of misstatement in respect of provisions and contingencies, explain the required treatment, and set out actions for auditors to consider.

Provisions are not recognised when there is a present obligation

10. A past event leads to a present obligation where the settlement of the obligation can be enforced by law or where a college has indicated to other parties that it will accept certain responsibilities and has created valid expectations on the part of those other parties that it will discharge those responsibilities.

Provision are not recognised because of affordability

11. The amount recognised as a provision should be the best estimate of the expenditure required to settle the present obligation at 31 July 2015. This is the case even where it is prohibitively expensive to settle the obligation at that date.

Provisions are not properly calculated

12. The estimates of outcome and financial effect should be determined by the judgement of the college's management, supplemented by experience of similar transactions and, in some cases, reports from independent experts. The evidence considered should include any additional evidence provided by events after the reporting period.

13. Auditors should confirm that colleges have reviewed provisions annually and adjusted them to reflect the current best estimate or to reflect material changes in the assumptions underlying the calculations of the cash flows.

14. Where the effect of the time value of money is material, the amount of a provision should be discounted to present value of the expected payments. The unwinding of the discount due to the passage of time requires to be recognised as an interest charge.

Provision are not recognised for restructuring costs

15. A provision for the costs of restructuring a college's operations should be recognised when the general recognition criteria for provisions are met. In this context, a constructive obligation to restructure arises when a college has
    - a detailed formal plan for the restructuring identifying the activities concerned, the principal locations, the number of employees who will be compensated for terminating their services, the cost and date
    - raised a valid expectation in those affected that it will carry out the restructuring by starting to implement that plan or announcing its main features to those affected by it.

16. A decision to restructure does not give rise to a constructive obligation at 31 July 2015 unless the college has, before that date
    - started to implement the restructuring plan; or

- communicated the restructuring plan to those affected by it in a sufficiently specific manner to raise a valid expectation in them that the college will carry out the restructuring.

17. Auditors should confirm that a restructuring provision includes only the direct expenditure arising from the restructuring. Direct expenditure are those that are both
    - necessarily entailed by the restructuring
    - not associated with the ongoing activities of the college.

Provision is not recognised for outstanding legal claims

18. Colleges may have legal claims in progress that have not been settled by the year end. In some cases, it may not be clear whether a college has a present obligation. In these cases, a past event is deemed to give rise to a present obligation if, taking account of all available evidence including the opinion of experts, it is more likely than not that a present obligation exists at the end of the reporting period. The evidence considered should include any additional evidence provided by events after the reporting period.

19. A college should recognise a provision for the present obligation if the other recognition criteria are also met. If it is more likely than not that no present obligation exists, the college should disclose a contingent liability.

Provision recognised for future repairs

20. A provision for future repairs and maintenance is not normally recognised (unless, for example, a council issues a statutory order). This is because these costs relate to the future operation of a college, rather than to a past event, and should be recognised only when incurred.

Provision not recognised for early retirement costs

21. When calculating a provision for early retirement costs, in the absence of an actuarial valuation, colleges may use pension tables. The SFC commissioned new pensions tables in August 2015 which are available on the SFC website. The notes state that the tables may meet the 'best estimate' and 'present value' requirements of FRS 12. The SFC has advised that an appropriate discount factor (net interest rate) as at 31 July 2015 is 1% (2013/14 - 2%), and has also issue an accompanying spreadsheet for the calculation of the provision. Where a different net interest rate has been used, auditors should confirm there is reasonable justification for doing so.

22. Where a college has recognised a pension liability under FRS 17 (explained at module 3), the liability will include early retirement costs. Colleges should therefore reduce the early retirement provision under FRS 12 for amounts recognised under FRS 17 to prevent double-counting.

Provision not recognised for overtime holiday pay

23. A ruling from the Employment Appeal Tribunal states that holiday pay should include overtime. Colleges however have not previously included overtime in their calculations of holiday pay owed to employees. Auditors should confirm that colleges have considered the need to recognise a provision for any claims received, including obtaining legal advice, where the recognition criteria are met.

Provision not recognised for termination benefits

24. Colleges may need to recognise a provision for termination benefits payable as a result of either an employer's decision to terminate an employee's employment before the normal retirement date, or an employee's decision to accept voluntary redundancy in exchange for those benefits.

25. The event which gives rise to the obligation for termination benefits is the termination of employment, rather than employee service. Termination benefits are often lump-sum payments, but may also include enhancement of retirement benefits and salary until the end of a specified notice period if the employee renders no further service to the college.

26. For termination benefits payable as a result of an employee's decision to accept an offer of redundancy, the time when a college can no longer withdraw the offer is the earlier of when
    - the employee accepts the offer; and
    - a legal, regulatory or contractual restriction on the authority's ability to withdraw the offer takes effect. This would be when the offer is made, if the restriction existed at the time of the offer.

27. When a college terminates an employee's employment, the college can no longer withdraw the offer when the college has communicated to the affected employees a plan of termination meeting all of the following criteria
    - Actions required to complete the plan indicate that it is unlikely that significant changes to the plan will be made.
    - The plan identifies the number of employees whose employment is to be terminated, their job classifications or functions and their locations and the expected completion date.
    - The plan establishes the termination benefits that employees will receive in sufficient detail that employees can determine the type and amount of benefits they will receive.

Contingent liabilities are not disclosed

28. Where there is a present obligation but it is not probable that an outflow of resources or service potential will be required or the amount cannot be reliably measured (and therefore a provision cannot be recognised) a contingent liability should be disclosed in the notes. A contingent liability is also required where there is a possible obligation arising from past events whose existence will be confirmed by uncertain future events not wholly within a college's control.

29. Auditors should confirm that colleges have disclosed a brief description of the nature of the contingent liability and, where practicable, an estimate of its financial effect, an indication of the uncertainties, and the possibility of any reimbursement.

Expected reimbursements are not recognised

30. Where some or all of the expenditure required to settle a provision is expected to be reimbursed by another party, the reimbursement should be recognised only when it is virtually certain that reimbursement will be received.

31. Auditors should confirm that the reimbursement has been treated as a separate asset, and the amount recognised does not exceed the amount of the provision.

Provisions are not properly disclosed

32. The model note for disclosing provisions at Annex H of the guidance notes requires provisions to be analysed between early retirement costs and other provisions.

Contact point

33. The contact point in the TSU for this module of the technical guidance note is Helen Cobb, Technical Adviser (Central Government, Health and Further Education) - 0131 625 1901 or HCobb@audit-scotland.gov.uk.

Audit of 2014/15 annual report and accounts (further education)

Technical guidance note 2015/6(FE) - module 3 retirement benefits

AUDIT SCOTLAND

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Retirement benefits

Purpose of module

1. This module of technical guidance note 2015/6(FE) provides information on, and guidance on the risks of misstatements in, retirement benefits.

Definition

2. Retirement benefits are all forms of consideration given by an employer in exchange for services rendered by employees that are payable after the completion of employment.

Financial reporting requirements

3. Colleges are required to account for retirement benefits in accordance with FRS 17 Retirement benefits *as* amended. Specific requirements are set out at paragraphs 178 to 204 of the SORP.

4. FRS 17 distinguishes between defined benefit schemes and defined contribution schemes, and prescribes different accounting and disclosure treatments for each scheme.

5. Colleges which have defined benefit schemes that are part of a multi-employer scheme, and which are unable to identify their share of the underlying assets and liabilities on a consistent and reasonable basis, should account for their participation on a defined contribution basis. FRS 17 states that an employer may be unable to identify its share of the underlying assets and liabilities on a consistent and reasonable basis if the scheme exposes the participating employers to actuarial risks associated with the current and former employees of other entities e.g. when the contributions from employers are set at a common level.

6. Colleges participate in two multi-employer defined benefit schemes, i.e. the *Scottish teachers superannuation scheme* (STSS) and the *Local government pension scheme* (LGPS).

Further guidance

7. Paragraphs 36 to 37 of the guidance notes provide guidance on FRS 17.

Changes in 2014/15

8. There are no changes in accounting requirements for retirement benefits in 2014/15.

Guidance on risks of misstatement

9. The following paragraphs highlight potential risks of misstatement in respect of retirement benefits, explain the required treatment, and set out actions for auditors to consider.

Schemes are not properly classified

10. The SORP states that it is normally possible for individual employers in the LGPS to identify their share of assets and liabilities. Therefore it considers that these schemes should be accounted for as defined benefit schemes, provided that the assets and liabilities can be measured on a reliable and consistent basis.
11. However, it acknowledges some LGPS administrators have indicated that they can only provide colleges with a 'pooled valuation' (i.e. assets and liabilities are only identified on an aggregate basis for a group of bodies that then share a common contribution rate).
12. The SORP states that the STSS should be treated as a defined contribution scheme, and all colleges account in this way.

LGPS is not properly accounted for

13. FRS 17 requires assets in schemes accounted for on a defined benefit basis to be measured at their fair value at the balance sheet date, and liabilities to be measured on an actuarial basis. The objective of the valuation is to make the best estimate of the future cash outflows that will arise in respect of the benefits earned by employees at the valuation date.
14. Auditors should confirm that the estimated accrued liabilities have been discounted to their present value at the current rate of return on a high quality corporate bond of a currency and term that matches the scheme liabilities.
15. The valuation normally requires the expertise of an actuary. Under ISA 500, auditors are required to
    - evaluate the competence, capabilities and objectivity of the actuary
    - obtain an understanding of their work
    - evaluate the appropriateness of the actuary's work as audit evidence.
16. The surplus/deficit in a defined benefit scheme is the excess/shortfall of the value of the assets in the scheme over/below the present value of the scheme liabilities.

STSS is not properly accounted for

17. The cost of a defined contribution scheme is equal to the contributions payable to the scheme for the accounting period.

Pension items are not properly presented on the balance sheet

18. Auditors should confirm that
    - an asset has been recognised to the extent that the college is able to recover a surplus either through reduced contributions in the future or through refunds from the scheme
    - liabilities have been recognised in the balance sheet to the extent that they reflect a legal or constructive obligation

- the total of any defined benefit pension assets or liabilities have been presented separately on the face of the balance sheet following other net assets
- the net pension reserve arising as a result of the recognition of pension assets and liabilities has been presented on the face of the balance sheet.

Pension items are not properly disclosed in the notes

19. Auditors should confirm that the disclosures for defined benefit schemes set out the nature of the scheme and follow the disclosure requirements set out in paragraphs 76 to 82 of FRS 17.

20. Auditors of colleges which account for defined benefit schemes on a defined contribution basis should confirm that the college has disclosed
    - the cost for the period
    - any outstanding or prepaid contributions at 31 July 2015
    - the reason why sufficient information is not available to account for the scheme as a defined benefit scheme
    - the fact that the scheme is a defined benefit scheme but that the college is unable to identify its share of the underlying assets and liabilities
    - any available information about the existence of the surplus or deficit in the scheme and the implications of that surplus or deficit for the college.

Contact point

21. The contact point in the TSU for this module of the technical guidance note is Helen Cobb, Technical Adviser (Central Government, Health and Further Education) - 0131 625 1901 or HCobb@audit-scotland.gov.uk.

Audit of 2014/15 annual report and accounts (further education)

Technical guidance note 2015/6(FE) - module 4 other financial statement areas

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1 Introduction

Purpose of module

1. This module of technical guidance note 2015/6(FE) provides information on, and guidance on the risks of misstatements in, the following financial statement areas
   - Accounting policies and estimation techniques
   - Intangible assets
   - Investments
   - Leases
   - Government grants
   - Charitable funds
   - Untaken annual leave accrual
   - Group financial statements
   - Events after the balance sheet
   - Disclosures on agency arrangements, related parties, and other matters required by the accounts direction.

Contact point

2. The contact point in the TSU for this module of the technical guidance note is Helen Cobb, Technical Adviser (Central Government, Health and Further Education) - 0131 625 1901 or HCobb@audit-scotland.gov.uk.

2 Accounting policies and estimates

Purpose of section

3. This section of the module provides information on, and guidance on the risks of misstatements in, accounting policies and estimation techniques.

Definition

4. Accounting policies are the principles, bases, conventions, rules and practices by which transactions and other events are recognised, measured and presented in the financial statements.

Financial reporting requirements

5. The SORP requires that colleges comply with the requirements of FRS 18 Accounting policies. FRS 18 sets out the principles to be followed in selecting accounting policies and the disclosures needed to help users to understand the accounting policies adopted and how they have been applied.

6. Chapter 4 of the SORP provides guidance on the application of the accounting policies.

7. Where there is uncertainty, the monetary amount will be arrived at by using an estimation technique. Accounting policies are supplemented by estimation techniques where judgement is required in recording the value.

Further guidance

8. There is no further guidance in respect of accounting policies and estimation techniques.

Changes in 2014/15

9. There are no changes in the requirements for accounting in 2014/15.

Guidance on risks of misstatement

10. The following paragraphs highlight potential risks of misstatement in respect of accounting policies and estimation techniques, explain the required treatment, and set out actions for auditors to consider.

Accounting policies are not appropriate

11. Colleges are required to select those accounting policies that are most appropriate to their circumstances.

12. Auditors should confirm that the accounting policies have been regularly reviewed to ensure they remain the most appropriate to a college's circumstances. Colleges should, however, give due weight to the impact on comparability.

Changes to accounting policies are not properly accounted for

13. Auditors should confirm that any material adjustment applicable to prior periods arising from a change in accounting policy has been accounted for as a prior year adjustment in accordance with *FRS 3 Reporting financial performance*, unless the relevant accounting standard requires otherwise. This may apply to moving to a current value basis for assets and recognising an accrual for untaken annual leave at the year end.

Accounting estimates are not reasonable

14. Auditors are required to judge whether the accounting estimates are reasonable and the related disclosures in the financial statements are adequate. As part of the judgement of reasonableness, auditors should establish

- the method used in making the accounting estimate and determine whether it is appropriate
- the underlying assumptions and whether they are reasonable
- whether the body has assessed the effect of estimation uncertainty and how it has addressed it.

Changes to estimation techniques are not properly accounted for

15. Auditors should confirm that a change to an estimation technique has been accounted for as a prior period adjustment only where it represents the correction of a fundamental error.

Accounting policies and estimation techniques are not properly distinguished

16. Auditors should confirm that colleges have properly distinguished between accounting policies and estimation techniques.

- Measurement bases are a matter of accounting policy, e.g. moving from a historical cost basis to a current value basis.
- The method used to arrive at the monetary amount corresponding to a measurement basis is an estimation technique.

Disclosures have not been made

17. FRS 18 requires disclosure of the extent to which financial statements comply with any relevant SORP. Auditors should confirm that

- colleges have stated the title of the SORP
- the notes regarding the basis of preparation of the financial statements state that they have been prepared in accordance with and the provisions of the SORP and applicable accounting standards

- colleges have explained in the notes the accounting policies they have adopted to deal with material items.
- changes to any of the policies that result in a material adjustment to prior periods have been disclosed in detail.

18. Colleges should disclose a statement in the going concern section of their accounting policies where the transfer of reserves to charitable foundations results in a negative reserve total in their balance sheet.

Departures from SORP requirements have not been disclosed

19. In exceptional circumstances, a college may conclude it is necessary to depart from the requirements of the SORP or accounting standards in order for the financial statements to give a true and fair view.

20. Auditors should confirm any departure from the SORP is justified, and that the following has been disclosed for material departures
    - A statement that there has been a departure from the requirements of the SORP or accounting standards in order to give a true and fair view.
    - The nature of the departure including the prescribed treatment, the treatment adopted, and the reasons why the college judge that the treatment adopted is more appropriate to the college's particular circumstances.
    - An estimate of the financial effect on the financial statements.

3 Intangible assets

Purpose of this section

21. This section of the module provides information on, and guidance on the risks of misstatements in, intangible assets

Definition

22. Intangible assets are those that do not have physical substance but are identifiable and are controlled by a college through custody or legal rights.

Financial reporting requirements

23. FRS 10 Goodwill and intangible assets applies to colleges that have intangible assets. Specific requirements are included at paragraphs 117 to 125 of the SORP.

Further guidance

24. There is no further guidance on intangible assets.

Changes in 2014/15

25. There are no changes in accounting requirements in 2014/15.

Guidance on risks of misstatement

26. The following paragraphs highlight potential risks of misstatement in respect of intangible assets, explain the required treatment, and set out actions for auditors to consider.

Acquired intangible assets are not recognised

27. Auditors should confirm that any intangible asset that has been acquired has been recognised in the balance sheet at fair value if it can be measured reliably on initial recognition.

28. It is expected that in most cases, purchased computer software will represent an intangible asset.

Developed intangible assets are not recognised

29. Auditors should confirm that any internally developed intangible asset has been recognised in the balance sheet if it has a readily ascertainable market value. This means a value which can be established by reference to a market where

- the asset belongs to a homogeneous population of assets that are equivalent in all material respects; and
- an active market, evidenced by frequent transactions, exists for that population of assets.

30. SORP paragraph 119 states that the existence of funding to develop the asset is not considered to be an appropriate proxy for market value, and should not be used as such.

Intangible assets are not properly amortised/impaired

31. Auditors should confirm that any intangible asset regarded as having a limited useful economic life have been be amortised on a systematic basis over that life. FRS 10 has the rebuttable presumption that the useful economic life should be limited to 20 years.

32. Impairment tests should be carried out at the end of the first year and thereafter subject to normal periodic reviews for indications of impairment.

Required disclosures are not made

33. Auditors should confirm that colleges have complied with the disclosure requirements set out in paragraphs 52 to 60 of FRS 10.

4 Investments

Purpose of section

34. This section of the module provides information on, and guidance on the risks of misstatements in, investments.

Definition

35. Investments are equity instruments held in another entity.

Financial reporting requirements

36. Colleges are required to comply with the presentational requirements of *FRS 25 Financial instruments: disclosure and presentation*.

37. The requirements of *FRS 26 Financial instruments: recognition and measurement* apply to colleges qualifying as listed entities (including those with listed debt in issue) or those colleges adopting fair value accounting. For colleges which do not have listed debt or are not applying fair value accounting, the relevant parts of *FRS 4 Capital instruments* remain applicable.

38. The disclosure requirements of FRS 25 and *FRS 29 (IFRS 7) Financial instruments: disclosures* apply on adoption of FRS 26.

39. Specific requirements are include at SORP paragraphs 112 and 113.

Further guidance

40. There is no further guidance on investments.

Changes in 2014/15

41. There are no changes in accounting requirements in 2014/15.

Guidance on risks of misstatement

42. The following paragraphs highlight potential risks of misstatement in respect of investments, explain the required treatment, and set out actions for auditors to consider.

Investments held as fixed assets are not properly measured

43. Auditors should confirm that any listed investments intended to be held by a college for use on a continuing basis (i.e. as a fixed asset) have been measured at market value.

44. Market value should be the amount for which an asset could be exchanged between knowledgeable, willing parties in an arm's-length transaction. Published price quotations in an active market provide the best evidence of market value, and should be used where available.

45. In the absence of an active market, auditors should confirm that an appropriate valuation technique has been used which incorporates the factors that a market participant would consider in setting a price.

Changes in the value of fixed asset investments are not properly accounted for

46. SORP paragraph 113 requires increases in value arising on the revaluation of fixed asset investments to be carried as a credit to the revaluation reserve via the statement of total recognised gains and losses.

47. A diminution in value requires to be charged to the income and expenditure account as a debit to the extent that it is not covered by a previous revaluation surplus.

Investments in subsidiary undertakings are not properly measured

48. Auditors should confirm that investments in subsidiary undertakings are shown at cost, subject to a review for impairment, in the college's balance sheets.

Current asset investments are not properly measured

49. Auditors should confirm that, in accordance with SORP paragraph

- current asset investments, which may include listed investments, have been measured at the lower of cost and net realisable value
- the market value of listed investments held as current asset investments have been disclosed.

5 Leases

Purpose of section

50. This section of the module provides information on, and guidance on the risks of misstatements in, leases.

Definition

51. A lease is an agreement whereby the lessor conveys to the lessee in return for payment the right to use an asset for an agreed period of time.

Financial reporting requirements

52. SSAP 21 Accounting for leases and hire purchase contracts applies to all colleges that have leases. Specific requirements are included at SORP paragraphs 108 to 111.

53. SSAP 21 requires leases to be classified as finance leases or operating leases. A finance lease is one that transfers substantially all of the risks and rewards of ownership of a fixed asset to the lessee. It should be presumed that such a transfer has occurred if at the inception of the lease the present value of the minimum lease payments amounts to 90% or more of the fair value of the leased asset.

Further guidance

54. There is no further guidance on leases.

Changes in 2014/15

55. There are no changes in accounting requirements in 2014/15.

Guidance on risks of misstatement

56. The following paragraphs highlight potential risks of misstatement in respect of leases, explain the required treatment, and set out actions for auditors to consider.

Finance leases are not identified

57. Auditors should confirm that a college has not automatically assumed that a lease is an operating lease solely because it does not meet the '90%' test. It may still require to be classified as a finance lease if the college controls access to the economic benefits of the asset.

Finance leases are not properly accounted for

58. Colleges should recognise finance leases as assets and as an obligation to pay future rentals at amounts equal to the present value of the minimum lease payments. Auditors should

confirm that the obligation has been properly calculated particularly where the lease is relatively informal and the end date is not specified.

59. Assets recognised under a finance lease require to be depreciated over the shorter of the lease term and the useful life. After initial recognition, assets recognised under a finance lease are subject to revaluation in the same way as any other asset.

6 Government grants

Purpose of section

60. This section of the module provides information on, and guidance on the risks of misstatements in, government grants.

Definition

61. Grants are assistance from the SFC and other sources in the form of cash in return for compliance with certain conditions relating to the operating activities of a college as set out the outcome agreement.

62. Revenue-based grant to finance the general activities of a college is referred to as grant-in-aid. Other grants are for specific purposes under a particular agreement or contract.

Financial reporting requirements

63. Colleges are required to account for government grants in accordance with SSAP 4 Accounting for government grants. SSAP 4 sets out the accounting treatment and disclosure of government grants and other forms of assistance. Specific requirements are set out in the SORP at paragraphs 52 to 54.

64. Grants-in-aid and grants should be recognised in the income and expenditure account when the conditions for their receipt have been complied with and there is reasonable assurance that the grant will be received.

Further guidance

65. Guidance on SFC funding is provided at paragraphs 7 and 8 of the guidance notes. Annex A of the guidance notes provide a model disclosure note.

66. The SFC has provided guidance on using cash grant-in-aid originally earmarked for depreciation.

Changes in 2014/15

67. There are no changes in accounting requirements in 2014/15 though grant-in-aid covers a 16 month period.

Guidance on risks of misstatement

68. The following paragraphs highlight potential risks of misstatement in respect of government grant, explain the required treatment, and set out actions for auditors to consider.

Revenue grants are not properly recognised

69. Auditors should confirm that grants-in-aid and other grants have been recognised in the income and expenditure account when
    - the conditions for their receipt have been complied with; and
    - there is reasonable assurance that it will be received.

70. Grant-in-aid should be recognised in the period to which is relates. Grant-in-aid should be apportioned to the 16 month period to 31 July 2015 in a manner consistent with the apportionment to the 8 month period in 2013/14.

Deferred income is not properly recognised

71. Auditors should confirm any grant received where not all conditions for its receipt have been complied with
    - has not been recognised in the income and expenditure account
    - has been recognised in the balance sheet as deferred income.

Grant is not recognised in case it is repaid

72. It is not necessary to postpone recognition of a grant solely because it might have to be repaid in the future. However, auditors should confirm that colleges
    - regularly consider whether a breach of conditions is likely
    - recognise a provision if repayment of the grant is considered probable.

Capital grants are not properly accounted for

73. Where a college receives a grant to finance the acquisition of an asset, the grant should be credited to deferred capital grants and an annual transfer made to the income and expenditure account over the same period as depreciation.

74. Auditors should confirm that the deferred capital grant release disclosed in the income notes agrees to the movement on the deferred grant account.

Information on grants is not properly disclosed

75. The SORP requires there to be a note disclosed for SFC grants. 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.

7 Charitable funds

Purpose of section

76. This section of the module provides information on, and guidance on the risks of misstatements in, charitable funds.

Definition

77. Charitable funds are endowment funds, specific charitable donations or the results of appeals where the governing body of a college has a fiduciary duty to protect the assets of the fund, spend funds appropriately (and in accordance with any restrictions) and ensure accountability.

78. Endowment funds are held on trust to be retained for the benefit of the college as a capital fund.

Financial reporting requirements

79. Colleges are required to account for charitable donations in accordance with SORP paragraphs 139 to 152.

80. The SORP uses the concepts of 'restricted' and 'unrestricted' donations to distinguish how charitable donations should be accounted for.

Further guidance

81. Further guidance is provided at paragraphs 38 to 40 of the SFC guidance notes.

Changes in 2014/15

82. There are no changes in accounting requirements in 2014/15.

Guidance on risks of misstatement

83. The following paragraphs highlight potential risks of misstatement in respect of charitable funds, explain the required treatment, and set out actions for auditors to consider.

Unrestricted donations are not properly accounted for

84. Auditors should confirm that charitable donations are recognised in the income and expenditure account
    - where the donation has no specific terms, or where the restrictions are sufficiently general that it has no material impact (i.e. an expendable unrestricted donation)
    - when the donation has been received or there is evidence that the receipt is certain.

Restricted donations are not properly accounted for

85. Auditors should confirm that charitable donations are accounted for as an endowment fund where there is some form of restriction placed on the donation by the donor.

Expendable endowment funds are not properly accounted for

86. Where the college has the power to convert the endowed capital into income, it is an expendable endowment fund.

87. Where capital is expended, auditors should confirm that this has been recognised by transferring the relevant amount from expendable endowment funds to general reserves.

Permanently endowment funds are not properly accounted for

88. Where the college is required to maintain permanently the capital of the endowment fund, this permanent endowment fund cannot be spent as though it were income.

89. The capital fund requires to be maintained in the balance sheet but the income on the endowment asset, which may or may not be restricted to a particular purpose, should be transferred to the income and expenditure account.

Endowment funds are not properly presented in the balance sheet

90. Auditors should confirm that expendable endowment funds have been distinguished from permanent endowment funds on the face of the balance sheet.

Endowment funds are not properly disclosed in the notes

91. Auditors should confirm that the notes to the accounts disclose
    - the nature, structure and capital value of endowment funds
    - any accumulated income that has yet to be applied to the purpose of the endowment fund.

8 Untaken annual leave accrual

Purpose of section

92. This section of the module provides information on, and guidance on the risks of misstatements in, an untaken annual leave accrual.

Definition

93. This is an accrual to recognise the liability for untaken annual leave that may be carried forward and used in future periods.

Financial reporting requirements

94. The FReM reflects the requirement in *IAS 19 Employee benefits* for bodies to recognise a liability for the untaken element of annual leave at the year end. The SFC considers that this requirement applies to colleges in 2014/15.

Further guidance

95. The guidance notes refer to the accrual at paragraph 21, but note that it is unlikely to be material at 31 July 2015.

Changes in 2014/15

96. Some colleges may be recognising an accrual for the first time in 2014/15..

Guidance on risks of misstatement

97. The following paragraphs highlight potential risks of misstatement in respect of the untaken annual leave accrual, explain the required treatment, and set out actions for auditors to consider.

Accrual is not properly calculated

98. Where a college recognises an accrual, auditors should confirm that
    - the accrual has been measured as the additional amount that the college expects to pay as a result of the unused leave entitlement that has accumulated at 31 July 2015
    - the accrual includes salary as well as associated employer's national insurance and pension contributions, and possibly overtime.
    - where employees who leave are not entitled to a cash payment, the possibility that an employee may leave (e.g. when they have given notice) and lose their entitlement has been taken into account in measuring the accrual

- the accrual has been based on the proportion of the annual salary and associated costs which relates to the number of untaken days. Colleges are therefore required to gather information on the number of days of untaken leave as at 31 July 2015 to allow them to make the calculation.

99. If colleges cannot obtain the information for the whole workforce, it may be acceptable to conduct a sample to establish the level of accrual required. Auditors should confirm that

- the samples are representative of all groups of staff, and reflect any differences in continuing pre-merger terms and conditions
- the size of the sample depends on issues such as the amount of expenditure and the expected level of leave.

Accrual is not properly accounted for

100. Auditors should confirm that

- any accrual at 31 March 2014 has been reversed in 2014/15, and replaced with the accrual at 31 July 2015
- the net increase or decrease has been recognised in the income and expenditure account.

101. Where an accrual was not recognised at 31 March 2014, auditors should confirm that the change in accounting policy has been reflected as a prior year adjustment.

9 Group financial statements

Purpose of section

102. This section of the module provides information on, and guidance on the risks of misstatements in, group financial statements.

Definition

103. Group financial statements are the financial statements of a group prepared by the process of adjusting and combining financial information from the individual financial statements of a parent institution and its subsidiary undertakings to prepare consolidated financial statements that present financial information for the group as a single economic entity.

Financial reporting requirements

104. Colleges with subsidiary undertakings or associates are required to prepare group financial statements in accordance with FRS 2 Accounting for subsidiary undertakings as amended and FRS 9 Associates and joint ventures. Specific requirements are set out SORP paragraphs 206 to 222.

105. The group's financial statements should follow the format set out in Appendix 2 to the SORP. These are

- consolidated income and expenditure account
- statement of group historical cost surpluses and deficits
- statement of group total recognised gains and losses
- college and group balance sheets
- consolidated cash flow statement.

106. To the extent that they are reflected in the book value of assets to be included in the consolidation, gains or losses on any intra-group transactions should be eliminated in full. Amounts in relation to debts and claims between undertakings included in the consolidation should also be eliminated.

Further guidance

107. There is no further guidance on group financial statements.

Changes in 2014/15

108. There are no changes in accounting requirements in 2014/15.

Guidance on risks of misstatement

109. The following paragraphs highlight potential risks of misstatement in respect of group financial statements, explain the required treatment, and set out actions for auditors to consider.

Subsidiaries are not identified

110. An entity is a subsidiary if a college is able to exercise control over its operating and financial policies. Auditors should confirm that colleges have identified the entities they control. A college is deemed to be able to exercise control if, for example, it

- controls the majority of the voting rights; or
- has the right to appoint or remove members of the governing body holding the majority of voting rights; or
- exercises dominant influence, e.g.. it can set the operating and financial policies of the entity.

111. Auditors should confirm that a college's local charitable foundation does not require to be accounted for as a subsidiary. Paragraph 209 of the SORP states that dominant influence may arise 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 a charitable foundation are set so narrowly that the benefits cannot be applied to any party other than the college. Auditors should examine the documentation for their college's local charitable foundation and assess whether this is the case.

112. Subsidiary undertakings may be excluded from consolidation where the total impact of all subsidiaries is not material. FRS 2 also sets out specific circumstances where a subsidiary can be excluded, e.g. when there are severe restrictions over the management of the subsidiary, or the interest is held exclusively with the intention to resell.

Quasi-subsidiaries are not identified

113. An entity which does not meet the definition of a subsidiary may be a quasi-subsidiary if it is controlled by the college and gives rise to benefits that are no different in substance to those that would arise if the entity were a subsidiary.

Associates are not identified

114. An entity is an associate when a college is able to exercise significant influence over its operating and financial policies. This occurs when a college is actively involved and is influential in the direction of an entity through its participation in policy decisions.

115. A holding of at least 20% of voting rights is presumed to confer significant influence.

College and subsidiary year ends are not aligned

116. Auditors should confirm that the financial statements of all subsidiary undertakings have, wherever practicable, been prepared to the same financial year-end and for the same accounting period as the college.

117. Where the financial year of a subsidiary undertaking does not coincide, interim financial statements should be prepared.

118. Where this is not practicable, the financial statements of the entity may be used providing

- the year-end is not more than three months before the relevant year end of the college
- there are adjustments for any material changes in the period.

College and subsidiary accounting policies are not aligned

119. Auditors should confirm that uniform group accounting policies were used for determining the amounts to be included in the group financial statements. Where necessary, this may mean adjusting the amounts reported by subsidiary undertakings for the purposes of the consolidation.

10 Events after the balance sheet date

Purpose of section

120. This section of the module provides information on, and guidance on the risks of misstatements in, events after the balance sheet date.

Definition

121. Events after the balance sheet date are those which occur between the balance sheet date and the date on which the financial statements are authorised for issue.

Financial reporting requirements

122. Colleges are required to account for events after the balance sheet date in accordance with *FRS 21 Events after the balance sheet date*. Specific accounting requirements are set out at SORP paragraphs 234 and 235.

123. The financial statements should reflect material events between the balance sheet date and the date they were authorised for issue, where the event provides evidence of conditions that existed at that balance sheet date.

Further guidance

124. There is no further guidance on events after the balance sheet date.

Changes in 2014/15

125. There are no changes in accounting requirements in 2014/15.

Guidance on risks of misstatement

126. The following paragraphs highlight potential risks of misstatement in respect of events after the balance sheet, explain the required treatment, and set out actions for auditors to consider.

Event which provides evidence of conditions that existed at the balance sheet date are not reflected in the accounts

127. Auditors should confirm that the amounts recognised in the 2014/15 financial statements, including the notes, were adjusted to reflect material events between 31 July 2015 and the date they were authorised for issue, where the event provides evidence of conditions that existed at that date.

128. Examples of an adjusting event are

- the receipt of information after the 31 July indicating that an asset was impaired at that date
- the determination after 31 July of the amount of a gift aid payment to a college by a subsidiary undertaking, if the subsidiary had a present, legal or a constructive obligation at that date.

Events after the balance sheet date which could influence the decision of users are not disclosed

129. Auditors should confirm that
    - amounts recognised in the 2014/15 financial statements were not adjusted where the events were indicative of conditions that arose after 31 July 2015.
    - material non-adjusting events between 31 July and the date the financial statements are authorised for issue have been disclosed in the notes where non-disclosure could influence the decision of users taken on the basis of the accounts.

130. Colleges are required to disclose the nature of the event, and an estimate of its financial effect (or a statement that an estimate cannot be made).

131. An example of a non-adjusting event would be a decline in market value of investments.

Authorised for issue date is not disclosed

132. The date the financial statements were authorised for issue by the board of management, and who gave that authorisation, should be disclosed in the financial statements.

11 Specific disclosures required by accounts direction

Purpose of section

133. This section of the module provides information on, and guidance on the risks of misstatements in, specific disclosures in the notes required by the accounts direction.

Financial reporting requirements

134. The accounts direction requires colleges to disclose in the notes to the accounts

- emoluments of higher paid staff
- an explanation for any deficit caused by using cash-funding previously earmarked for depreciation
- the audit fees and non-audit fees paid to external and internal auditors.

Further guidance

135. SFC/AN/03/2015 provides details on the release of funding previously earmarked for depreciation to be used for other purposes in 2014/15.

Changes in 2014/15

136. The requirement to disclose an explanation regarding the effect of using funding previously earmarked for depreciation is new in 2014/15.

Guidance on risks of misstatement

137. The following paragraphs highlight potential risks of misstatement in respect of disclosure required by the accounts direction, explain the required treatment, and set out actions for auditors to consider.

Emoluments of higher paid staff are not disclosed

138. Auditors should confirm that the number of higher paid staff above an emoluments threshold of £50,000 have been disclosed in bands of £10,000.

139. Emoluments should exclude pension contributions and employers national insurance, and should be annualised for those colleges with a 16 month accounting period.

140. The number of senior post holders within each band requires to be separately disclosed.

An explanation regarding the effect of using funding previously earmarked for depreciation is not disclosed

141. Prior to reclassification as central government bodies, colleges used available funds to cover depreciation charges on their fixed assets. Following reclassification, colleges have been given a cash budget to cover their costs (including depreciation) and a separate budget for fixed assets.

142. As depreciation is not a cash cost, there is additional budget available which can be used to meet other revenue expenditure, including student support. As colleges are required to spend the full amount of their cash budgets, this additional revenue expenditure may result in an operational deficit in colleges' 2014/15 income and expenditure accounts equivalent to their net depreciation charges.

143. Auditors should confirm that an adequate explanation is disclosed in the accounts. Appendix 5 of the accounts direction provides illustrative wording which colleges may use.

12 Agency arrangements disclosure

Purpose of section

144. This section of the module provides information on, and guidance on the risks of misstatements in, disclosure of agency arrangements.

Definition

145. A college is an agent when it is acting as an intermediary, and is a principal when it is acting on its own behalf.

Financial reporting requirements

146. The accounting treatment of transactions should reflect whether a college is acting as an agent or principal. Colleges are required to account for agency arrangements in accordance with SORP paragraphs 55 and 56.

Further guidance

147. Further guidance on student support funds is provided at paragraphs 12 to 19 of the guidance notes.

Changes in 2014/15

148. There are no changes in accounting requirements in 2014/15.

Guidance on risks of misstatement

149. The following paragraphs highlight potential risks of misstatement in respect of agency arrangements, explain the required treatment, and set out actions for auditors to consider.

College do not identify transactions when they act as agents

150. 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.

151. The guidance notes list the following as being agency arrangements

- national bursary funds
- educational maintenance allowances.

152. Agency arrangements do not include

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

- childcare funds.

Agency arrangements are not properly accounted for

153. Auditors should confirm that any transactions where a college is acting as an agent are not recognised in the income and expenditure account.

154. Instead, auditors should confirm that the arrangement has been accounted for as follows
    - In respect of cash collected or expenditure incurred on behalf of the principal, the balance sheet should reflect the debtor or creditor position, and the net cash position should be included in the financing activities in the cash flow statement.
    - Where a college receives a commission for acting as an agent, it should recognise it as income.

Agency arrangements are not properly disclosed

155. The SFC guidance notes set out a recommended standard note at Annex C. The amounts disclosed should reconcile to the student support returns.

13 Related parties disclosure

Purpose of section

156. This section of the module provides information on, and guidance on the risks of misstatements in, disclosure of related parties.

Definition

157. Parties are considered to be related if one party has the ability to control, or exercise significant influence over, the other party, or if the college and another entity are subject to common control.

Financial reporting requirements

158. Colleges are required to disclose material transactions with related parties in accordance with FRS 8 Related party disclosures, as amended in 2008 and improved in 2010. The definition of related party in Improvements to financial reporting standards 2010 applies to colleges.

159. Specific requirements are set out in paragraphs 230 to 233 of the SORP

Further guidance

160. There is no further guidance on related party disclosures.

Changes in 2014/15

161. There are no changes in 2014/15.

Guidance on risks of misstatement

162. The following paragraphs highlight potential risks of misstatement in respect of related parties, explain the required treatment, and set out actions for auditors to consider.

Related parties are not identified

163. Auditors should confirm that colleges have identified their related parties. 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 arms-length foundations

- senior staff, including those who hold influential posts in other bodies with which the college has transactions, e.g. an NHS board.

164. Colleges should also have given due consideration as to whether bodies such as students' unions, separate development trusts and arm's length foundations are related parties in the context of FRS 8.

Related parties are not properly disclosed

165. Disclosure should be made of material transactions with related parties, irrespective of whether a price is charged. Auditors should confirm that disclosures include

- the names of the transacting related parties, and a description of their relationship
- a description of the transactions, and the amounts involved
- the amounts due to or from related parties at the balance sheet date, and any amounts written off.

166. Although the standard excludes disclosure of transactions with government departments and their sponsored bodies, SORP paragraph 231 requires disclosure of SFC grants on the face of the income and expenditure account, the balance sheet (for deferred capital grants), and in the relevant notes to the accounts.

167. Transactions between group entities that are eliminated on consolidation do not require disclosure in either the group or college's financial statements.

Audit of 2014/15 annual report and accounts (further education)

Technical guidance note 2015/6(FE) - module 5 regularity

AUDIT SCOTLAND

Prepared by the Technical Services Unit
17 August 2015

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.

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Regularity of expenditure and income

Purpose of module

1. This module of technical guidance note 2015/6(FE) provides guidance on auditor's responsibilities for the regularity of income and expenditure.

Definition

2. The concept of regularity reflects Parliament's concern that public money raised through taxation on the public is used only for those purposes approved by Parliament. Regularity can be defined as the requirement that a financial transaction is in accordance with authorising legislation.

Auditor requirements

3. Auditors of further education colleges are required by section 22(1)of the *Public Finance and Accountability (Scotland) Act 2000* to set out their independent auditor's report their findings in on whether the expenditure and receipts shown in the account were incurred or applied in accordance with
   - any enactment by virtue of which the expenditure was incurred or the income received and the relevant Budget Act
   - any applicable guidance (whether as to propriety or otherwise) issued by the Scottish Ministers.
4. Although, the Act uses the term 'receipts' and 'income', normal practice is to refer to 'income'. Auditors are therefore required to report whether, in their opinion, in all material respects, expenditure and income were incurred or applied in accordance with applicable enactments and guidance issued by the Scottish Ministers.
5. This is generally referred to as the regularity opinion.

Guidance on auditing regularity

6. Practice note 10 Audit of financial statements of public sector bodies in the UK provides guidance the audit of regularity at pages 104 to 129.

Approach to auditing regularity

Overview

7. The responsibility to express an opinion on the regularity of income and expenditure is discharged through the audit of the financial statements and is reported in a separate section

of the independent auditor's report. Auditors should adopt an integrated approach to the audit of the financial statements and of regularity.

8. Auditors should be concerned with enactments and guidance which are specific to the college and provide direct authority for its financial transactions, rather than those laws and regulations which provide the general framework within which it conducts its activities.

9. ISA 250 provides the basis for the auditor's approach to the audit of regularity. It states that, where statutory requirements exist which requires the auditor to report whether a body complies with certain provisions of laws or regulations, the auditor should

   - obtain a general understanding of the legal and regulatory framework applicable to the college or sector, and how the college is complying with that framework
   - obtain sufficient appropriate audit evidence regarding compliance with the provisions of those laws and regulations generally recognised to have a direct effect on the determination of material amounts and disclosures in the financial statements.

10. In summary, the approach to regularity should involve auditors

    - obtaining a sufficient understanding of the framework of relevant enactments and guidance
    - testing the regularity of transactions
    - expressing an opinion on regularity in the report on the financial statements.

Understanding the regularity framework

11. In order to understand the regularity framework, auditors should

    - identify the enactments and guidance from the Scottish Ministers that apply to colleges (e.g. authorising legislation and regulations issued thereunder)
    - obtain a broad understanding that is sufficient to enable identification of transactions or events that may have a significant effect on the regularity of transactions in the financial statements
    - consider the systems and procedures in place at the college to ensure compliance with the applicable enactments and guidance
    - obtain an understanding of the internal control environment to enable a preliminary assessment of controls which mitigate against the risk of material irregularity.

Testing for regularity

12. Auditors are required to obtain sufficient appropriate evidence to substantiate assertions about regularity, and therefore will usually perform substantive procedures on transactions. The extent of these procedures will depend on the auditor's assessment of the effectiveness of the design of systems in translating enactments and guidance into controls and the extent to which the auditor derives controls assurance from tests of those controls.

13. Tests should be integrated with those relating to the audit of the financial statements.

14. Auditors should confirm that there is proper disclosure of any transactions which are not in compliance with applicable enactments and guidance.

Reporting on regularity

15. Cases of non-compliance with applicable enactments and guidance should be reported to the management of the college to allow corrective action to be taken.

16. Where it is not possible for the college to take corrective action, auditor should encourage it to disclose the non-compliance in its financial statements by outlining the circumstances surrounding the breach and the possible extent of irregular transactions.

17. Even where the non-compliance is disclosed, auditors are still required to consider the implications for the audit opinion on regularity.

18. A model auditor's report, including the regularity opinion, is provided in technical guidance note 2015/7(FE).

Contact point

19. The contact point in the TSU for this module of the technical guidance note is Helen Cobb, Technical Adviser (Central Government, Health and Further Education) - 0131 625 1901 or HCobb@audit-scotland.gov.uk.

Audit of 2014/15 annual report and accounts (further education)

Technical guidance note 2015/6(FE) - module 6 other statements

AUDIT SCOTLAND

Prepared by the Technical Services Unit

17 August 2015

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1 Introduction

Purpose of module

1. This module of technical guidance note 2015/6(FE) provides guidance on the auditors' responsibilities to
   - read the operating and financial review (OFR) and report any inconsistency with the financial statements
   - audit part of the remuneration report
   - read and report on the governance statement.

Contact point

2. The contact point in the TSU for this module of the technical guidance note is Helen Cobb, Technical Adviser (Central Government, Health and Further Education) - 0131 625 1901 or HCobb@audit-scotland.gov.uk.

2 Operating and financial review

Purpose of section

4. This section of the module provides information and guidance on the auditor's responsibility to read the OFR.

Definition

5. An OFR should provide an overview of a college's finances and operations.

Changes in 2014/15

6. The requirement for details on the estates strategy to be disclosed applies in 2014/15 for the first time.

Financial reporting requirements

7. Requirements for an OFR are set out at paragraphs 25 to 28 of the SORP.

8. The 2014/15 accounts direction requires the following specific disclosures at Appendix 2
   - A list of members of the governing body and key committees. This should cover all those who served during the period and include any changes up to the date of signing the financial statements.
   - 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.
   - A statement on the employment of disabled persons where the average number of persons employed in the year exceeds 250.
   - Details of the estates strategy. This is a FReM requirement which is required from 2014/15 as the disclosure goes beyond the requirements of the SORP.

9. The accounts direction recommends inclusion of an explanation for any deficit caused by using funding previously earmarked for depreciation (explained at section 11 of module 4 of this technical guidance note).

Further guidance

10. The SFC's Operating and financial review guidance require the OFR to take account of the good practice set out in the Reporting statement The operating and financial review.

Auditor requirements

11. The *Companies Act 2006* requires the auditor of a company to state in the auditor's report whether the information given in the strategic report and directors' report is consistent with the financial statements. Audit Scotland requires appointed auditors in the public sector to also report on this matter, and the OFR is considered to be the further education equivalent of the strategic report and directors' report.

12. Auditors are therefore required to read the OFR and express an opinion in the auditor's report as to whether it is consistent with the financial statements. Auditors should report an inconsistency in accordance with *ISA 720 Section B The auditor's statutory reporting responsibility in relation to directors' reports* as follows
    - If auditors are of the opinion that the information in the OFR is materially inconsistent with the financial statements, and have been unable to resolve the inconsistency, auditors should state that opinion and describe the inconsistency in the auditor's report.
    - If an amendment is necessary to the financial statements, and the college refuses to make the amendment, auditors should express a modified opinion on the financial statements.

13. The model independent auditor's report in technical guidance note 2015/7(FE) includes wording for the OFR opinion.

14. Auditors should also read the OFR under ISA 720A to identify any information that is apparently materially incorrect based on, or materially inconsistent with, the knowledge acquired by auditors in the course of performing the audit. If revision of the OFR is necessary, and a college refuses to make the revision, auditors should include in the auditor's report an 'other matter' paragraph under ISA 706 describing the matter.

15. Auditors are not required to verify, or report on, the completeness of the information in the OFR. If, however, auditors become aware that required information has been omitted, they should communicate this to the college.

Risk of inconsistencies

16. An inconsistency is anything in the OFR that contradicts information contained in the audited financial statements.

17. Auditors should aim to identify any
    - differences between amounts or narrative appearing in the financial statements and the OFR
    - differences between the bases of preparation of related items where the figures are not directly comparable and the different bases are not disclosed
    - contradictions between figures in the financial statements and the narrative explanation of those figures in the OFR.

3 Remuneration report

Purpose of section

18. This section of the module provides information and guidance on auditing the remuneration report.

Definition

19. A remuneration report discloses information about the remuneration and accrued pension benefits of a college's senior officials.

Changes in 2014/15

20. 2014/15 is the first year that colleges are required to prepare a remuneration report.

Financial reporting requirements

21. The 2014/15 accounts direction at Appendix 2 requires the preparation of a remuneration report in accordance with the FReM.

22. The FReM requires a remuneration report to show the remuneration and pension benefits of the senior officials using the headings set out in the *The Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008* (as amended) to the extent they are relevant and as interpreted by FReM paragraphs 5.2.25 and 5.2.27.

23. The accounts direction requires the amounts disclosed to be for the 16 months to 31 July 2015, as well as pro-rata annual equivalents

Further guidance

24. Further guidance is provided in employer pension notice 430 issued by the Cabinet Office.

25. A template remuneration report is provided at Appendix 4 of the accounts direction.

Auditor requirements

26. In line with *Companies Act 2006* requirements, auditors are required by the *Code of audit practice* to audit the remuneration and pension benefit disclosures and express a separate opinion within their independent auditor's report on whether they have been properly prepared in accordance with the accounts direction.

27. Other narrative disclosures are also required which are not covered by the opinion.

Guidance on material misstatements

28. The following paragraphs highlight potential risks of misstatement in respect of the remuneration report, explain the required treatment, and set out actions for auditors to consider.

Information is not given on all relevant senior officials

29. FReM paragraph 5.2.13 states that senior officials include

- the chairman and chief executive
- the management board having authority or responsibility for directing or controlling the major activities of the body during the year.

30. FReM paragraph 5.2.26 is written on the basis that the prior consent of individuals to disclose information in remuneration reports is no longer required. However, auditors should note that this requirement remains in Scotland. Subject to the need to obtain their prior consent, there is a presumption that information about named individuals will be given, except in circumstances specified in the FReM, including national security or where an individual may be at risk if their name is disclosed. Where non-disclosure is agreed, auditors should confirm that the fact that certain disclosures have been omitted has been disclosed.

Officials appointed or left during the year are not included

31. Where individuals were appointed or left during 2014/15, auditors should confirm that the following has been disclosed

- The date of appointment or last day of service.
- The remuneration and pension information that relates to the period during which they were in post.
- The full year equivalent salary.

Remuneration disclosures are not made

32. The 2008 regulations require disclosure of a single total remuneration figure. The remuneration disclosures which are covered by the audit opinion are as follows for each senior official who served during 2014/15

- Salary in bands of £5,000. Salary covers both pensionable and non-pensionable amounts and includes: gross salaries; overtime; recruitment and retention allowances; and other allowances to the extent that they are subject to UK taxation and any ex-gratia payments. It does not include amounts which are a reimbursement of expenses directly incurred in the performance of an individual's duties.
- Performance pay or bonuses for officials in bands of £5,000, which should relate to the year in which they become payable. If the appraisal process does not allow sufficient time for the inclusion of any bonuses relating to 2014/15 performance, bonuses based on 2013/14 performance should be disclosed.

- The estimated value of any non-cash benefits (e.g. cars) to the nearest £100.
- The value of pension benefits, which should be calculated as the real increase in pension multiplied by 20, plus the real increase in any lump sum, less contributions made by the member. The real increases exclude increases due to inflation or any change due to a transfer of pension rights.
- The total of the above which is the single total figure of remuneration.

33. Auditors should confirm that disclosures are for
    - actual amounts for the 16 months to 31 July 2015
    - actual amounts for the 8 months to 31 March 2014
    - pro-rata annual equivalents for both years.

34. There is also a requirement to disclose the total remuneration of the college's highest paid official expressed as a £5,000 banding.

35. Payments for compensation for loss of office made under the terms of an approved compensation scheme also require to be disclosed, including a description of the compensation payment and details of total amounts made.

Median pay disclosures are not made

36. The FReM requires disclosure of the mid-point of the banded remuneration of the highest paid official and the ratio with the median remuneration of the college's staff. There is guidance from the Treasury on this requirement (i.e. Hutton review of fair pay - implementation guidance), but in summary the median pay multiples disclosures, which are covered by the audit opinion, are as follows
    - The median remuneration of the college's staff is the total remuneration of the staff member lying in the middle of the linear distribution of the total staff excluding the highest paid official, based on annualised, full-time equivalent remuneration at the end of the reporting period.
    - The pay multiple between the mid-point of the highest paid official's banding and the median total remuneration of all staff.
    - Additional narrative explaining the calculation, including the causes for any significant variances.

37. The accounts direction requires the calculation to be based on the annual equivalent figures.

Pension disclosures are not made

38. Auditors should confirm that the following, which are covered by the audit opinion, has been disclosed for each senior official who has served during the year
    - The real increase during 2014/15 in the pension and, if applicable, related lump sum at age 60 in bands of £2,500.

- The value at 31 July 2015 of the accrued pension and, if applicable, related lump sum at age 60 in bands of £5,000
- the value of the cash equivalent transfer value (CETV) at 1 April 2014 and 31 July 2015 to the nearest £1,000. CETV is the actuarially assessed capitalised value of the pension scheme benefits accrued by a member. The real increase in the CETV funded by the employer during 2014/15 should also be disclosed to the nearest £1,000.

Other disclosures are not made

39. Remuneration reports are also required by the 2008 Regulations to include other disclosures, which are not covered by the audit opinion These disclosures form part of the other information which auditors are required to read under ISA 720A, and include a statement of the policy on the remuneration of officials for 2014/15 and future financial years.

4 Governance statement

Purpose of section

40. This section of the module provides information and guidance on reading the governance statement.

Definition

41. This is a statement covering the responsibilities of a college's board of management in relation to corporate governance.

Changes in 2014/15

42. Colleges are required to take account of the requirements of the governance statement section of the SPFM for the first time in 2014/15.

Financial reporting requirements

43. 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.

44. 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. Explanations are required for any non-compliance.

45. Colleges are required to take account of the requirements of the governance statement section of the SPFM.

Further guidance

46. Guidance on preparing the statement is contained in Appendices 2 and 3 of the accounts direction.

Auditor requirements

47. Auditors are required by the *Code of audit practice* to review the governance statement and report by exception in the auditor's report if it does not comply with SFC requirements.

48. Auditors are required by ISA 720A to read the information in the governance statement to identify any material inconsistencies with the financial statements. An inconsistency arises when information in the governance statement contradicts information contained in the financial statements.

49. The *Companies Act 2006* requires the auditor of a company to state in the auditor's report whether, in their opinion, the information given in the corporate governance statement is

consistent with the financial statements. Audit Scotland does not require appointed auditors in the public sector to provide an explicit opinion on consistency with the governance statement. Auditors should instead report a material inconsistency in accordance with ISA 720A as follows

- If auditors are of the opinion that the information in the governance statement is materially inconsistent with the financial statements, and the college refuses to revise it, auditors should include in the auditor's report an 'other matter paragraph under ISA 706 describing the material inconsistency.
- If an amendment is necessary to the financial statements, and the college refuses to make the amendment, auditors should express a modified opinion on the financial statements.

50. Auditors are also required by ISA 720A to identify any information that is apparently materially incorrect based on, or materially inconsistent with, the knowledge acquired by auditors in the course of performing the audit. If revision of the governance statement is necessary, and a college refuses to make the revision, auditors should include in the auditor's report an 'other matter' paragraph under ISA 706 describing the matter.

Risks of non-compliance

Statement does not comply with good governance code

51. Colleges are required to comply with the code as a condition of grant from the SFC. Each college is required to state its adoption of the code in the governance statement. The chair is encouraged to report personally as to how the principles have been applied by the board.

52. Where a college's practice is not consistent with any principle of the code, auditors should confirm that an explanation for that inconsistency has been clearly stated in the governance statement. Colleges are be expected to offer a clear rationale for exceptions in the context of their operational model and to identify mitigations.

Statement does not comply with SPFM

53. Auditors should confirm that the governance statement includes the following essential features required by the SPFM

- The governance framework, including information about the committee structure.
- The operation of the governing board during the period.
- An assessment of corporate governance with reference to compliance with generally accepted best practice principles and relevant guidance, and explanations where a different approach has been adopted.
- An assessment of the body's risk management arrangements and risk profile, including details of significant risk-related matters arising during the period.
- A record of any written authorities provided to the Accountable Officer.
- Details of any significant lapses of data security.