Practice Note 10: Audit of financial statements of public sector bodies in the United Kingdom

This Practice Note replaces Practice Note 10: Audit of Financial Statements of Public Sector Bodies in the United Kingdom (Revised), which was issued in October 2010.

Preface

This Practice Note contains guidance on the application of quality control and auditing standards issued by the Financial Reporting Council (FRC) to the audit of public sector bodies in the United Kingdom, as classified by the Office of National Statistics.

This Practice Note is supplementary to, and should be read in conjunction with, International Standards on Auditing (ISAs) (UK and Ireland) and International Standard on Quality Control 1 (ISQC 1) (UK and Ireland), which apply to all audits undertaken in the United Kingdom. The Practice Note sets out the special considerations relating to the audit of public sector bodies which arise from individual quality control and auditing standards. It is not the intention of the Practice Note to provide step-by-step guidance on the audit of public sector bodies, so where no special considerations arise from a particular ISA or ISQC 1 (UK and Ireland), no material is included.

This Practice Note has been prepared by the Public Audit Forum (PAF) with advice and assistance from representatives from each of the UK national audit agencies and certain private sector firms who carry out public sector audit work. It is based on auditing standards, legislation and regulations which were in effect at 1 September 2016. This Practice Note is not an exhaustive list of all of the obligations that public sector auditors may have under legislation.

PAF has been designated by the Financial Reporting Council (FRC) as a 'SORP-making body' for the purposes of maintaining and updating Practice Note 10: Audit of Financial Statements of Public Sector Bodies in the United Kingdom (PN 10). Under 'SORP-making body' arrangements PAF is responsible for preparing and consulting on revisions to PN 10 prior to seeking the FRC's endorsement that there is nothing within the Practice Note that is inconsistent with auditing standards or the FRC's wider objectives .

Since the previous revision of the Practice Note 10, there have been a number of changes in the legislative and regulatory frameworks within the devolved administrations and in respect of local audit arrangements in England. The Audit Commission has been disbanded and local auditors in England are now appointed under the Local Audit and Accountability Act 2014. Where appropriate, the Codes of Audit Practice were issued by the national audit agencies[1] which require public sector auditors to comply with auditing standards in their work on financial statements. Consequently, this Practice Note has been revised to be applicable to all public sector auditors, whether these are audit agencies or audit firms.

Revised Auditing Standards and a Revised Ethical Standard were issued in June 2016 and are effective for audits of financial statements for periods commencing on or after 17 June 2016. The proposed revised PN 10 refers to the revised auditing standards so that the guidance can remain relevant for the foreseeable future. This will also mean that the revised PN 10 will be relevant if auditors apply the revised standards early. If auditors do not apply the revised standards early, the guidance in the revised PN 10 will still be relevant except that auditors will need to refer to the requirements on extended reporting in ISA 700: The independent auditor's report on financial statements. This is explained in part 1 of the exposure draft.

Part 2 of this Practice Note relates to the audit of regularity. This guidance has been revised to reflect current practice across the United Kingdom in relation to auditors' work on regularity and the relevant legislative requirements and frameworks of authorities that apply to this work. In particular, the proposed revisions to PN 10 are clearer about the work needed to support a separate opinion on regularity where one is needed.

[1] The Codes can be found on the respective websites of the national audit agencies

Introduction

1. External auditors in the public sector give an independent opinion on the financial statements and may review and, where appropriate, report on aspects of the arrangements set in place by the audited body to ensure the proper conduct of its financial affairs and to manage its performance and use of resources. As such, external audit is an essential element in the process of accountability and makes an important contribution to the stewardship of public money and the corporate governance of public services.
2. Public sector auditors act and report in accordance with the mandates that govern their activities and provide the authority for the auditor to carry out and to report the results of the audit work. These mandates are embodied in legislation and, in some circumstances, set out in Codes of Audit Practice which may be established in accordance with legislation and issued by the national audit agencies.
3. The mandates of public sector auditors vary in accordance with the requirements laid down in the legislation relevant to each jurisdiction within the public sector and within each geographical area. The legislative framework governing the audit of public sector bodies UK wide and in England, Wales, Scotland and Northern Ireland is set out on websites of the Public Audit Forum and individual national audit agencies.
4. These mandates establish broadly similar responsibilities for each jurisdiction in relation to:
   - the financial statements;
   - compliance with legislative and other authorities (sometimes referred to as “regularity”); and
   - economy, efficiency and effectiveness (sometimes referred to as “performance audit”, “value for money” or “use of resources”).
5. In some parts of the UK, English is not the primary language used by public bodies for the conduct of business including preparation of accounts, for example as a result of applying options available under the Welsh Language Act 1993 and Welsh Language (Wales) Measure 2011. Where this occurs, the auditor ensures that the auditor's responsibilities under auditing standards can be properly discharged through, for example, including staff with the appropriate language skills in the engagement team and the use of translation services.
6. This Practice Note provides auditors with further guidance on the application of ISAs (UK and Ireland) to the audit of financial statements, including the regularity opinion where appropriate, in the public sector. The heads of the national audit agencies in the UK have chosen to apply ISAs (UK and Ireland) and follow Practice Note 10. They require auditors conducting work on their behalf to have regard to Practice Note 10 in the application of ISAs (UK and Ireland) to that work.
7. Public sector auditors may also be required to review and report on other information prepared by public bodies. Such other information may include aspects of corporate governance or arrangements to secure economy, efficiency and effectiveness in the use of resources. Practice Note 10 does not provide guidance to the auditor on conducting these assignments, unless it is directly related to reporting on the audit of financial statements or regularity. The standards governing other reporting assignments in the public sector are a matter for the national audit agencies and certain regulators to determine. These may be included in a separate Code of Audit Practice.

Part 1: Application of *International Standards on Auditing (UK and Ireland)*

1. A list of International Standards on Quality Control (ISQC) and International Standards on Auditing (ISAs) (UK and Ireland) is shown in the table below. This identifies those ISQC and ISAs in respect of which application guidance is included in this Practice Note and, for completeness, also shows those ISAs for which there is no need for further guidance:

International Standard on Auditing (UK and Ireland)	Further guidance relevant to the public sector context included in this part of PN10	No further guidance relevant to the public sector context provided
ISQC 1: Quality control for firms that perform audits and reviews of financial statements, and other assurance and related services engagements	✓	
ISA 200: Overall objectives of the independent auditor and the conduct of an audit in accordance with International Standards on Auditing (UK and Ireland)	✓	
ISA 210: Agreeing the terms of audit engagements	✓	
ISA 220: Quality control for an audit of financial statements	✓	
ISA 230: Audit documentation		✓
ISA 240: The auditor's responsibilities relating to fraud in an audit of financial statements	✓	
ISA 250A: Consideration of laws and regulations in an audit of financial statements	✓	
ISA 250B: The auditor's statutory right and duty to report to regulators of public interest entities and regulators of other entities in the financial sector[2]		✓
ISA 260: Communication with those charged with governance	✓	
ISA 265: Communicating deficiencies in internal control to those charged with governance and management	✓	

[2] "ISA 250B: The auditor's right and duty to report to regulators in the financial sector" was revised in June 2016 and is now referred to as "ISA 250B: The auditor's statutory right and duty to report to regulators of public interest entities and regulators of other entities in the financial sector".

International Standard on Auditing (UK and Ireland)	Further guidance relevant to the public sector context included in this part of PN10	No further guidance relevant to the public sector context provided
ISA 300: Planning an audit of financial statements		✓
ISA 315 – Identifying and assessing the risks of material misstatement through understanding the entity and its environment	✓	
ISA 320 – Materiality in planning and performing an audit	✓	
ISA 330 - The auditor's responses to assessed risks	✓	
ISA 402 – Audit considerations relating to an entity using a service organization	✓	
ISA 450 – Evaluation of misstatements identified during the audit	✓	
ISA 500 – Audit evidence		✓
ISA 501 – Audit evidence – specific considerations for selected items		✓
ISA 505 – External confirmations		✓
ISA 510 – Initial audit engagements – opening balances	✓	
ISA 520 – Analytical procedures	✓	
ISA 530 – Audit sampling		✓
ISA 540 – Auditing accounting estimates, including fair value accounting estimates and related disclosures	✓	
ISA 550 – Related parties	✓	
ISA 560 – Subsequent events	✓	

International Standard on Auditing (UK and Ireland)	Further guidance relevant to the public sector context included in this part of PN10	No further guidance relevant to the public sector context provided
ISA 570 – Going concern	✓	
ISA 580 – Written representations	✓	
ISA 600 – Special considerations – audits of group financial statements including the work of component auditors	✓	
ISA 610 – Using the work of internal auditors	✓	
ISA 620 – Using the work of an auditor's expert	✓	
ISA 700 – Forming an opinion and reporting on financial statements	✓	
ISA 701- Communicating key audit matters in the independent auditor's report[3]		✓
ISA 705 – Modifications to the opinion in the independent auditor's report		✓
ISA 706 – Emphasis of matter paragraphs and other matter paragraphs in the independent auditor's report	✓	
ISA 710 – Comparative information – corresponding figures and comparative financial statements		✓
ISA 720 – The auditor's responsibilities relating to other information	✓	

2. The following sections of this part set out the further guidance on the application of the ISQC (UK and Ireland) 1 and ISAs (UK and Ireland) for public sector audit. Where there are public sector considerations in the quality control and auditing standards, these have been included with grey background and referenced throughout this document. References to ISQC and ISAs in this Practice Note are to standards applicable in UK and Ireland. Part two of this Practice Note sets out guidance on the audit of regularity.

[3] This standard is effective for audits of financial statements for periods commencing on or after 17 June 2016. Early application is permitted.

International Standard on Quality Control (UK and Ireland) 1

3. ***The objective of the [audit organisation or] firm is to establish and maintain a system of quality control to provide it with reasonable assurance that:***
(a) The firm and its personnel comply with professional standards and applicable legal and regulatory requirements; and
(b) Reports issued by the firm or engagement partners are appropriate in the circumstances (ISQC1, 11).

Interpretation of the requirement to withdraw from an engagement where the appointment is made in statute

4. In the public sector, auditors may be appointed in accordance with statutory procedures. Accordingly, certain of the requirements and considerations regarding the acceptance and continuance of client relationships and specific engagements as set out paragraphs 26-28 and A18-A22 [of ISQC 1] may not be relevant. Nonetheless, establishing policies and procedures as described may provide valuable information to public sector auditors in performing risk assessments and in carrying out reporting responsibilities (ISQC1, A23 which relates to the requirements in ISQC 1, 26-28; ISA 240, A57 which relates to the requirements in ISA 240, 38).
5. In most cases, statutory-appointed auditors have the authority to report publicly such matters that may otherwise have caused their withdrawal or resignation from a statutory engagement.

Quality control for contracted-out engagements

6. A contracted-out engagement is an engagement where, although responsibility for issuing the audit report remains with the statutory auditor, all or some of the audit assignment is undertaken by another firm or auditor under contract or agreement, which in turn provides a fully ISA compliant audit report to the statutory auditor. For example, the Comptroller and Auditor General contracts out audit work on some of the statutory appointments, but is still responsible for signing the audit certificate and report.
7. For contracted-out engagements, responsibility for quality remains with the statutory auditor. This includes:
   - ensuring that the contractor auditor has sufficient personnel with the competencies, capabilities and commitment to ethical principles necessary for compliance with relevant standards;
   - confirming that the contractor auditor meets the relevant ethical standards, including independence, on appointment and periodically thereafter;
   - ensuring that there are policies and procedures in place to identify and resolve potential conflicts;
   - considering whether an internal consultation and the appointment of an engagement quality control reviewer is necessary for contracted-out engagements;
   - applying the organisation-wide quality control monitoring policies and procedures to contracted-out engagements;
   - reporting any deficiencies identified as a result of monitoring a contracted-out engagement to the contractor auditor undertaking the assignment; and
   - establishing policies and procedures designed to provide reasonable assurance that complaints and allegations relating to quality are dealt with appropriately.
8. This does not absolve contractor auditors of responsibility for systems of quality control within their organisations in accordance with *ISQC (UK and Ireland) 1*. In practice, the statutory auditor may obtain assurance over quality from its contractors or may undertake procedures to confirm that its contractors' systems of quality control are working effectively.
9. If the contractor auditor identifies deficiencies in any of its public sector assignments that fall within the remit of the statutory auditor, these are communicated, along with the action undertaken, to the relevant statutory auditor.
10. The contractor auditor establishes policies and procedures designed to provide reasonable assurance that it deals appropriately with complaints and allegations relating to quality. These policies and procedures allow for escalation of such issues to the statutory auditor, where relevant.

Quality control for engagements on an 'appointment by' basis

11. An assignment undertaken on an 'appointment by' basis is an engagement where another firm or individual is responsible for the assignment, its performance and the issuing of the audit report. An example of this arrangement is the relationship between the Accounts Commission in Scotland and its appointed auditors.

12. Where an auditor undertakes the engagement on an 'appointment by' basis and issues the audit report in its own name, it assumes responsibility for quality. This does not affect any statutory responsibility the national audit agency has for the oversight of, or quality assurance for, those assignments undertaken on its behalf. The responsibilities of the auditor include:
    - ensuring that the engagement has sufficient personnel with the competencies, capabilities and commitment to ethical principles necessary for compliance with relevant standards;
    - ensuring that the engagement meets the relevant ethical standards, including independence, on appointment and periodically thereafter;
    - ensuring that there are policies and procedures in place to identify and resolve potential conflicts;
    - considering whether an internal consultation and the appointment of an engagement quality control reviewer is necessary for 'appointment by' engagements;
    - applying the firm's quality control monitoring policies and procedures to 'appointment by' engagements;
    - reporting any deficiencies identified as a result of monitoring a 'appointment by' engagements to the national audit agency, where appropriate; and
    - establishing policies and procedures designed to provide reasonable assurance that complaints and allegations relating to quality are dealt with appropriately.
13. Where an engagement is undertaken on an 'appointment by' basis, the national audit agency should also:
    - ensure that the appointed auditor has sufficient personnel with the competencies, capabilities and commitment to ethical principles necessary for compliance with relevant standards;
    - consider whether to apply quality monitoring arrangements to such assignments;
    - confirm whether the appointed auditor meets the relevant ethical standards, including independence, on appointment and periodically thereafter; and
    - ensure that there are policies and procedures in place to identify and resolve potential conflicts.

Ethics

14. Auditors in the public sector may need to meet relevant ethical and propriety requirements in addition to the FRC's *Ethical standard*, such as restrictions on political activities or requirements established by regulators. The Official Secrets Act also covers some public sector activities. No other requirement should compromise the ability of the firm or individual auditors to comply with relevant ethical requirements required by ISQC (UK and Ireland) 1 and the FRC Ethical Standard.

Independence

15. Statutory measures may provide safeguards for the independence of public sector auditors. However, threats to independence may exist regardless of any statutory measures designed to protect it. Therefore, in establishing the policies required by paragraphs 21-25 [of ISQC 1], the public sector auditor may have regard to the public sector mandate and address any threats to independence in that context (ISQC 1, A15 which relates to the requirements of ISQC 1, 21-25).
16. Listed entities as referred to in paragraphs 25 and A14 are not common in the public sector. However, there may be other public sector entities that are significant due to size, complexity or public interest aspects, and which consequently have a wide range of stakeholders. Therefore, there may be instances when [an auditor or] a firm determines, based on its quality control policies and procedures, that a public sector entity is significant for the purposes of expanded quality control procedures (ISQC 1, A16 which relates to the requirements of ISQC1, 25).
17. In the public sector, legislation may establish the appointments and terms of office of the auditor with engagement partner responsibility. As a result, it may not be possible to comply strictly with the engagement partner rotation requirements envisaged for listed entities. Nonetheless, for public sector entities considered significant, as noted in paragraph A16 [of ISQC 1], it may be in the public interest for public sector organisations to establish policies and procedures to promote compliance with the spirit of rotation of engagement partner responsibility (ISQC 1, A17 which relates to the requirements of ISQC1, 25).

Confidentiality

18. In addition to the provisions of ISQC (UK and Ireland) 1, public sector auditors may have additional statutory obligations relating to confidentiality, for example under the Official Secrets Act 1989.

19. As well as complying with applicable statutory obligations relating to confidentiality, auditors must also consider whether audit work is potentially disclosable under applicable freedom of information legislation. For example, where the auditor is classified as a public authority under Schedule 1 of the Freedom of Information Act 2000 or Freedom of Information (Scotland) Act 2002, legislation provides a right of access to recorded information held by that auditor.
20. For auditors not classified as public authorities, relevant audit legislation may permit an auditor to disclose information obtained in the course of an audit except where it would prejudice the effective performance of the auditor's functions.
21. The acceptance of some appointments in the public sector requires the auditor to acknowledge that their working papers may be subject to inspection by the national audit agency that appointed the auditor or that is responsible for the audit of a higher tier entity or by review agencies that have statutory rights of access to information relevant to the auditor's duties. If not bound by a specific statutory requirement (for example, freedom of information legislation), ethical considerations normally require that the national audit agency acquires the duty of confidentiality that is held by the auditor.

Engagement quality control review

22. Although not referred to as listed entities, as described in paragraph A16 [of ISQC 1], certain public sector entities may be of sufficient significance to warrant performance of an engagement quality control review (ISQC 1, A46 which relates to the requirements of ISQC 1, 38).
23. In the public sector, a statutorily appointed auditor (for example, an Auditor General, or other suitably qualified person appointed on behalf of the Auditor General) may act in a role equivalent to that of engagement partner with overall responsibility for public sector audits. In such circumstances, where applicable, the selection of the engagement quality control reviewer includes consideration of the need for independence from the audited entity and the ability of the engagement quality control reviewer to provide an objective evaluation (ISQC 1, A51 which relates to the requirements of ISQC 1, 40; ISA 220, A30-31 which relates to the requirements of ISA 220, 20-21).
24. Auditors may also appoint engagement quality control reviewers at their discretion, where considered necessary.

ISA (UK and Ireland) 200: Overall objective of the independent auditor and the conduct of an audit in accordance with International Standards on Auditing (UK and Ireland)

25. ***In conducting an audit of financial statements, the overall objectives of the auditor are:***
   (a) To obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, thereby enabling the auditor to express an opinion on whether the financial statements are prepared, in all material respects, in accordance with an applicable financial reporting framework; and
   (b) To report on the financial statements, and communicate as required by the ISAs (UK and Ireland), in accordance with the auditor's findings.

26. ***In all cases when reasonable assurance cannot be obtained and a qualified opinion in the auditor's report is insufficient in the circumstances for purposes of reporting to the intended users of the financial statements, the ISAs (UK and Ireland) require that the auditor disclaim an opinion or withdraw (or resign) from the engagement, where withdrawal is possible under applicable law or regulation (ISA 200, 11-12).***

Responsibilities of the public sector auditor

27. The mandates for audits of the financial statements of public sector entities may be broader than those of other entities. As a result, the premise, relating to management's responsibilities, on which an audit of the financial statements of a public sector entity is conducted may include additional responsibilities, such as the responsibility for the execution of transactions and events in accordance with law, regulation or other authority (ISA 200, A11 which relates to the requirements of ISA 200, 4).
28. The ISAs (UK and Ireland) are relevant to engagements in the public sector. The public sector auditor's responsibilities, however, may be affected by the audit mandate, or by obligations on public sector entities arising from law, regulation or other authority (such as ministerial directives, government policy requirements, or resolutions of the legislature), which may encompass a broader scope than an audit of financial statements in accordance with the ISAs (UK and Ireland). These additional responsibilities are not dealt with in the ISAs (UK and Ireland). They may be dealt with in the pronouncements of the International

Organisation of Supreme Audit Institutions or national standard setters, or in guidance developed by national audit agencies (ISA 200, A57 which relates to the requirements of ISA 200, 18).

ISA (UK and Ireland) 210: Agreeing the terms of audit engagements

29. ***The objective of the auditor is to accept or continue an audit engagement only when the basis upon which it is to be performed has been agreed, through:***
(a) Establishing whether the preconditions for an audit are present; and
(b) Confirming that there is a common understanding between the auditor and management and, where appropriate, those charged with governance of the terms of the audit engagement (ISA 210,3).

Agreeing the terms of public sector audit engagements

30. In the public sector, specific requirements may exist within the legislation governing the audit mandate; for example, the auditor may be required to report directly to a minister, the legislature or the public if the entity attempts to limit the scope of the audit (ISA 210, A37 which relates to the requirements of ISA 210, 21).
31. Law or regulation governing the operations of public sector audits generally mandate the appointment of a public sector auditor and commonly set out the public sector auditor's responsibilities and powers, including the power to access an entity's records and other information. When law or regulation prescribes in sufficient detail the terms of the audit engagement, the public sector auditor may nonetheless consider that there are benefits in issuing a fuller audit engagement letter than permitted by paragraph 11 [of ISA 210] (ISA 210, A27 which relates to the requirements of ISA 210, 10-11).
32. With some exceptions, the statutory framework allows national audit agencies to mandate a substantial part of the scope and objectives of the audit. In other cases, an appointment letter or Code of Audit Practice issued by a national audit agency may determine the nature and scope of the audit engagement. For this reason, formal engagement letters for statutory engagements may not always be necessary. However, for audits of local bodies in England, for example where appointments have been made directly by the audited bodies under the Local Audit and Accountability Act 2014 or for the audit of Foundation Trusts, a letter of engagement is required.
33. Nevertheless, it remains important that management and the auditor formally recognise their respective responsibilities. It may also be necessary, where legislation does not provide sufficient detail on the scope of the audit, to ensure that is appropriately understood by those charged with governance. A letter of understanding may therefore be necessary.
34. The auditor may find it appropriate to conclude letters of understanding with the audited entity to confirm the auditor's understanding of the roles of the parties with an interest in the engagement, the requirements of the audit, the responsibilities of each party, how the responsibilities will be met, and the expectations that each party can have of the other. Such a document is not intended to be a substitute for the clarification of any uncertainties in the auditing framework that will need to be resolved with the relevant national audit agency.
35. In circumstances where roles, requirements and responsibilities mandated by the national audit agency are not clear or are debatable, the auditor requests that the national audit agency provides greater clarity in the terms of its appointment; auditor and audited entities should not seek to interpret the intentions behind the uncertainties, without the advice of the national audit agency.
36. Where the auditor has not been appointed under statute, an engagement letter is required to set out the responsibilities of the auditor and the audited body. The auditor agrees the terms of engagement with the addressee of the auditor's report.
37. Where financial statements are laid before Parliament, either by statute or command, the auditor also considers whether HM Treasury agreement of these terms may be required.

Areas that may be covered in a letter of engagement or understanding

38. The auditor determines the areas that may be covered by the letter of engagement or understanding. These areas may change over time and the auditor will need to consider developments that may be relevant to the audited body. In preparing the letter of engagement or understanding, the auditor may consider the following:

- responsibilities of the Accounting Officer or Accountable Officer, and, where relevant, those charged with governance;
- responsibilities of the auditor, with reference to the relevant legislative framework;
- the audit framework, distinguishing between statutory and non-statutory requirements. Statutory considerations might include examination in respect of regularity and Whole of Government Accounts. Non-statutory elements might include, if relevant, the involvement of other auditors and the relationship between the national audit agency and the other auditors;
- reporting responsibilities, acknowledging that there may be wider responsibilities to report to other entities, such as Parliament, or those charged with governance;
- wider auditor responsibilities, such as obligations under the Freedom of Information Act or the Proceeds of Crime Act;
- reviewing the Governance Statement;
- electronic Publication of Financial Statements;
- value for money examinations;
- other audit related services, for example limited assurance reports and other assurance products that are closely related to the work carried out on the audit; and
- audit fees.

ISA (UK and Ireland) 220: Quality control for an audit of financial statements

*39. **The objective of the auditor is to implement quality control procedures at the engagement level that provide the auditor with reasonable assurance that:***
(a) The audit complies with professional standards and applicable legal and regulatory requirements; and
(b) The auditor's report issued is appropriate in the circumstances (ISA 220, 6)

Quality control for an audit of financial statements in the public sector

40. Statutory measures may provide safeguards for the independence of public sector auditors. However, public sector auditors or audit firms carrying out public sector audits on behalf of the statutory auditor may, depending on the terms of the mandate in a particular jurisdiction, need to adapt their approach in order to promote compliance with the spirit of paragraph 11 [of ISA 220]. This may include, where the public sector auditor's mandate does not permit withdrawal from the engagement, disclosure through a public report, of circumstances that have arisen that would, if they were in the private sector, lead the auditor to withdraw (ISA 220, A7 which relates to the requirements of ISA 220, 11).
41. In the public sector, auditors may be appointed in accordance with statutory procedures. Accordingly, certain of the requirements and considerations regarding the acceptance and continuance of client relationships and audit engagements as set out in paragraphs 12, 13 and A8 [of ISA 220] may not be relevant. Nonetheless, information gathered as a result of the process described may be valuable to public sector auditors in performing risk assessments and in carrying out reporting responsibilities (ISA 220, A9 which relates to the requirements of ISA 220, 12-13).
42. In the public sector, additional appropriate competence may include skills that are necessary to discharge the terms of the audit mandate in a particular jurisdiction. Such competence may include an understanding of the applicable reporting arrangements, including reporting to the legislature or other governing body or in the public interest. The wider scope of a public sector audit may include, for example, some aspects of performance auditing or assessment of compliance with law, regulation or other authority and preventing and detecting fraud and corruption (ISA 220, A12 which relates to the requirements of ISA 220, 14).

ISA (UK and Ireland) 240: The auditor's responsibilities relating to fraud in an audit of financial statements

*43. **The objectives of the auditor are:***
(a) To identify and assess the risks of material misstatement of the financial statements due to fraud;
(b) To obtain sufficient appropriate audit evidence regarding the assessed risks of material misstatement due to fraud, through designing and implementing appropriate responses; and
(c) To respond appropriately to fraud or suspected fraud identified during the audit (ISA 240, 10)

The public sector auditor's responsibilities relating to fraud

44. The public sector auditor's responsibilities relating to fraud may be a result of law, regulation or other authority applicable to public sector entities or separately covered by the auditor's mandate. Consequently, the public sector auditor's responsibilities may not be limited to consideration of risks of material misstatement of the financial statements, but may also include a broader responsibility to consider risks of fraud (ISA 240, A6 which relates to the requirements of ISA 240, 3).

The auditor's consideration of the risk of fraudulent financial reporting

45. A public sector auditor needs to consider misstatements that may arise from fraudulent financial reporting where the audited body may manipulate its results to meet externally set targets, for example, the achievement of a statutory break-even duty by a health body or where financial results impact on achievement of objectives and/or wider performance reporting.
46. ISA (UK and Ireland) 240 states that the auditor ordinarily presumes that there are risks of fraud in revenue recognition, as material misstatements due to fraudulent financial reporting often result from a misstatement of revenue. For those public sector bodies where revenue is immaterial, the auditor may rebut this presumption. However, the auditor may need to consider whether there is a risk of material misstatements due to fraud related to revenue recognition where the audited body is required to meet externally set targets. For example, within central government departments, income may be an immaterial transaction stream but could be manipulated in order to ensure that net expenditure is within the resource limits.
47. In the public sector, auditors consider the risk that material misstatement may arise from the manipulation of expenditure recognition and plan and perform appropriate audit procedures. As most public bodies are net spending bodies, then the risk of material misstatement due to fraud related to expenditure recognition may be greater than the risk of material misstatements due to fraud related to revenue recognition.

The auditor's consideration of the risk of fraud external to the audited entity

48. As well as misstatements resulting from the misappropriation of assets and misstatements resulting from fraudulent financial reporting, auditors in the public sector also consider the risk of external fraud. The risk of external fraud may be particularly high where there is an increased risk of fraudulent activity by individuals or groups outside the immediate control of the entity, for example fraudulent benefit or prescription claims.

The auditor's responsibility for reporting suspected or actual fraud

49. In considering whether to report a suspected or actual instance of fraud to a proper authority, in addition to paragraph 43 of ISA (UK and Ireland) 240, the public sector auditor has regard to:
    - the provisions relevant to the entity that set out the responsibilities of those charged with governance for the reporting of misconduct, fraud or other irregularity; and
    - the duties which the auditor may have under the terms of engagement to report to a third party.
50. In the public sector, requirements for reporting fraud, whether or not discovered through the audit process, may be subject to specific provisions of the audit mandate or related law, regulation or other authority (ISA 240, A67 which relates to the requirements of ISA 240, 43).
51. Where the public sector auditor considers that there is a duty to report instances or suspected or actual fraud to a third party, they determine the proper authority to whom they are initially expected to report. The relevant authority differs for different parts of the public sector, depending upon the terms of the engagement and statutory requirements. This is in addition to responsibilities under Money Laundering Regulations (2007).

ISA (UK and Ireland) 250A – Consideration of laws and regulations in an audit of financial statements

52. ***The objectives of the auditor are:***
    (a) To obtain sufficient appropriate audit evidence regarding compliance with the provisions of those laws and regulations generally recognized to have a direct effect on the determination of material amounts and disclosures in the financial statements;
    (b) To perform specified audit procedures to help identify instances of non-compliance with other laws and regulations that may have a material effect on the financial statements; and

(c) To respond appropriately to non-compliance or suspected non-compliance with laws and regulations identified during the audit (ISA 250A, 10).

The auditor’s consideration of laws and regulations

53. In the public sector, there may be additional audit responsibilities with respect to the consideration of laws and regulations which may relate to the audit of financial statements or may extend to other aspects of the entity’s operations (ISA 250A, A6 which relates to the requirements of ISA 250A, 3-8).
54. Auditors of central government and some health bodies have wider regard to laws and regulations as part of their responsibilities in respect of the audit of regularity. ISA (UK and Ireland) 250A is concerned with ensuring that the auditor considers the risks of material misstatement in the financial statements due to non-compliance with laws and regulations and performs further audit procedures whose nature, timing and extent are responsive to assessed risks.
55. Auditors of other public sector entities may be required to have a wider regard to laws and regulations than those to which ISA (UK and Ireland) 250A is directly relevant. These requirements are set out in the relevant auditing framework and assign particular duties to the auditor in relation to the entity's arrangements to prevent non-compliance and to matters that come to the auditor's attention.

The public sector auditor’s consideration of legislation on corruption

56. The public sector auditor considers to whom the auditor may report suspected or actual acts of corruption, irrespective of whether, in the auditor's opinion, the consequences of the corruption could have a material effect on the financial statements. In the first instance, the auditor normally brings the matter to the attention of those charged with governance. It is then the responsibility of those charged with governance to report the matter to the proper authorities. If the auditor of an entity identifies a suspected or actual instance of corruption and if, having reported the matter to those charged with governance the auditor is unable to establish whether those charged with governance have reported the matter to the relevant third party, the auditor takes the steps set out in paragraph 43 of ISA (UK and Ireland) 240.

Money laundering regulations in the public sector

57. Guidance on the auditor's responsibilities in relation to the UK anti-money laundering legislation when auditing and reporting on financial statements is provided in the FRC's Practice Note 12. This legislation includes the Money Laundering regulations 2007 and the Proceeds of Crime Act 2002.
58. Under regulation 49 of the Money Laundering Regulations 2007, various listed public authorities (including the Comptroller and Auditor General, the Auditors General for Wales and Scotland and the Comptroller and Auditor General for Northern Ireland) must, if they know or suspect or have reasonable grounds for knowing or suspecting that a person is or has engaged in money laundering or terrorist financing, as soon as reasonably practicable, inform the National Crime Agency. This report will normally be made by the audit organisation's nominated Money Laundering Reporting Officer.
59. The auditor considers the offence of tipping off under section 333 of the 2002 Act. There is also an offence under section 342 of the 2002 Act which applies to all persons. This offence occurs where a person knows or suspects that an appropriate officer (such as an officer from the National Crime Agency) is acting (or proposing to act) in connection with a money laundering investigation which is being or about to be conducted, and makes a disclosure which is likely to prejudice the investigation or falsifies, conceals, destroys or otherwise disposes of, or causes or permits the falsification, concealment, destruction or disposal of, documents which are relevant to the investigation.

Reporting non-compliance

60. The public sector auditor may be obliged to report on instances of non-compliance to the legislature or other governing body or to report them in the auditor’s report (ISA 250A, A20 which relates to the requirements of ISA 250A, 28).

ISA (UK and Ireland) 260: Communication with those charged with governance

61. ***The objectives of the auditor are:***

(a) To communicate clearly with those charged with governance the responsibilities of the auditor in relation to the financial statement audit, and an overview of the planned scope and timing of the audit;
(b) To obtain from those charged with governance information relevant to the audit;
(c) To provide those charged with governance with timely observations arising from the audit that are significant and relevant to their responsibility to oversee the financial reporting process; and
(d) To promote effective two-way communication between the auditor and those charged with governance (ISA 260, 9).

Determining who is charged with governance in the public sector context

62. At the outset of the audit, the auditor determines who is charged with governance. This may include the Accounting/Accountable Officer (or equivalent) and other individuals responsible for decision making, for example a Board, scrutiny committee, Council, governing body or another group.
63. The responsibilities of those charged with governance may include, for example:
    - ensuring that effective management systems appropriate for the achievement of the organisation's objectives including financial monitoring and control systems have been put in place;
    - keeping proper accounts;
    - ensuring internal audit is established and organised in accordance with the Public Sector Internal Audit Standards; and
    - ensuring the regularity and propriety of public finances.
64. If the two-way communication between the auditor and those charged with governance is not adequate and the situation cannot be resolved, the public sector auditor may communicate the matter to a responsible government minister or Parliament (ISA 260, A53 which relates to the requirements of ISA 260, 22).

Communication with sponsoring bodies

65. Special arrangements may have developed for reporting to those charged with governance by auditors of some entities sponsored by government departments. In such cases the Accounting/Accountable Officer of the sponsor department must obtain assurance that the financial and other management controls applied by the sponsored entity are adequate to ensure regularity and propriety. Reports from the auditor of the lower tier entity may assist the Accounting/Accountable Officer in obtaining such assurance. Sponsor departments may, therefore, require auditors of their arm's length bodies to:
    - provide the sponsor department with copies of management letters and other relevant correspondence; and
    - report significant matters arising out of the audit work to the sponsor department, including
        - failures of internal control, misconduct, fraud or other irregularity,
        - occasions where the Board, Chief Executive or any other official has fallen short of the high standards of financial integrity expected of those responsible for the management of public assets, or
        - occasions where the entity has incurred expenditure of an extravagant or wasteful nature.
66. The auditors of local health bodies in England have specific responsibilities to refer certain matters to the Secretary of State or other relevant national body.
67. These and any other matters on which the auditor may be required to report to management are normally specified in the terms of appointment or engagement letter or Codes of Audit Practice.

Third party interest in reports to those charged with governance

68. In the public sector there may be a requirement to make public communications between the auditor and audited body. Even where this is not the case, third parties may seek to place reliance on a report by a public sector auditor addressed to those charged with governance. As such, auditors may need to state that the report is for use only by the audited entity to ensure that third parties who see the communication understand that it was not prepared with their use in mind.
69. Codes of Audit Practice applicable to local public audit in England, Northern Ireland, Scotland and Wales set out requirements relating to reporting to those charged with governance and considerations relating to defining who those charged with governance are, addressees and any relevant considerations relating to

their purpose. Effective reference to relevant Codes of Audit Practice, as appropriate, in any report to those charged with governance achieves the purpose intended in the ISAs (UK and Ireland).

Matters to be communicated

70. Law or regulation, or an agreement with the entity or additional requirements applicable to the engagement may provide for broader communication with those charged with governance. In the public sector, the auditor’s mandate may provide for matters to be communicated that come to the auditor’s attention as a result of other work, such as performance audits (ISA 260, A10 which relates to the requirements of ISA 260, 14).
71. The communication requirements relating to auditor independence that apply in the case of listed entities may also be relevant to some public sector entities. The auditor may determine that the requirements apply where the audited entity has a wide range of stakeholders, as a result of their business, their size or their corporate status.

ISA (UK and Ireland) 265: Communicating deficiencies in internal control to those charged with governance and management

72. ***The objective of the auditor is to communicate appropriately to those charged with governance and management deficiencies in internal control that the auditor has identified during the audit and that, in the auditor’s professional judgment, are of sufficient importance to merit their respective attentions (ISA 265, 5)***

73. Public sector auditors may have additional responsibilities to communicate deficiencies in internal control that the auditor has identified during the audit, in ways, at a level of detail and to parties not envisaged in this ISA (UK and Ireland). For example, significant deficiencies may have to be communicated to the legislature or other governing body. Law, regulation or other authority may also mandate that public sector auditors report deficiencies in internal control, irrespective of the significance of the potential effects of those deficiencies. Further, legislation may require public sector auditors to report on broader internal control-related matters than the deficiencies in internal control required to be communicated by this ISA (UK and Ireland), for example, controls related to compliance with legislative authorities, regulations, or provisions of contracts or grant agreements (ISA 265, A27 which relates to the requirements of ISA 265, 9-10).

ISA (UK and Ireland) 315: Identifying and assessing the risks of material misstatement through understanding the entity and its environment

74. ***The objective of the auditor is to identify and assess the risks of material misstatement, whether due to fraud or error, at the financial statement and assertion levels, through understanding the entity and its environment, including the entity’s internal control, thereby providing a basis for designing and implementing responses to the assessed risks of material misstatement (ISA 315, 3).***

75. Auditors of public sector entities often have additional responsibilities with regard to internal control and compliance with applicable laws and regulations. Inquiries of appropriate individuals in the internal audit function can assist the auditors in identifying the risk of material noncompliance with applicable laws and regulations and the risk of deficiencies in internal control over financial reporting (ISA 315, A13 which relates to the requirements of ISA 315, 6).
76. For the audits of public sector entities, law, regulation or other authority may affect the entity's operations. Such elements are essential to consider when obtaining an understanding of the entity and its environment (ISA 315, A28 which relates to the requirements of ISA 315, 11).
77. For the audits of public sector entities, ‘management objectives’ may be influenced by concerns regarding public accountability and may include objectives which have their source in law, regulation or other authority (ISA 315, A42 which relates to the requirements of ISA 315, 11).
78. Public sector auditors often have additional responsibilities with respect to internal control, for example to report on compliance with an established code of practice. Public sector auditors can also have responsibilities to report on compliance with law, regulation or other authority. As a result, their review of internal control may be broader and more detailed (ISA 315, A72 which relates to the requirements of ISA 315, 12).

79. When making assertions about the financial statements of public sector entities, in addition to those assertions set out in paragraph A124 [of ISA 315], management may often assert that transactions and events have been carried out in accordance with law, regulation or other authority. Such assertions may fall within the scope of the financial statement audit (ISA 315, A126 which relates to the requirements of ISA 315, 25).

80. There are a number of additional factors that may be considered by the auditor when assessing business risks for public sector entities. These arise from the particular coincidence in the public sector of a closely regulated regime, a large volume of transactions processed and a public reporting process. These additional factors may arise where:
    - major new legislation or expenditure programmes have been introduced;
    - there is the possibility of manipulation by management to achieve performance or other targets;
    - an entity is likely to be wound up, reorganised, merged, sold or privatised;
    - there is political pressure on an entity to complete transactions quickly; and
    - the final form of account does not reflect the underlying management and accounting processes.

81. Where entities are required to work to annual limits on resources, the risk of transactions being recorded in the wrong accounting period is increased, since there is a temptation for an entity in surplus to bring forward payments and for an entity in deficit to delay them.

82. When considering compliance with the applicable financial reporting framework, the public sector auditor's procedures are performed in the knowledge that entities have their own legislative framework and accounting provisions that prescribe the form and content of financial statements.

ISA (UK and Ireland) 320: Materiality in planning and performing an audit

83. ***The objective of the auditor is to apply the concept of materiality appropriately in planning and performing the audit (ISA 320, 8).***

84. In the case of a public sector entity, legislators and regulators are often the primary users of its financial statements. Furthermore, the financial statements may be used to make decisions other than economic decisions. The determination of materiality for the financial statements as a whole (and, if applicable, materiality level or levels for particular classes of transactions, account balances or disclosures) in an audit of the financial statements of a public sector entity is therefore influenced by law, regulation or other authority, and by the financial information needs of legislators and the public in relation to public sector programmes (ISA 320, A2 which relates to the requirements of ISA 320, 10).

85. In an audit of a public sector entity, total cost or net cost (expenses less revenues or expenditure less receipts) may be appropriate benchmarks for programme activities. Where a public sector entity has custody of public assets, assets may be an appropriate benchmark (ISA 320, A9 which relates to the requirements of ISA 320, 10).

86. Therefore, gross expenditure or gross assets may be more appropriate than profit or revenue as benchmarks for setting materiality for financial statements as a whole.

ISA (UK and Ireland) 330: The auditor's responses to assessed risks

87. ***The objective of the auditor is to obtain sufficient appropriate audit evidence regarding the assessed risks of material misstatement, through designing and implementing appropriate responses to those risks (ISA 330, 3).***

88. In the public sector, the audit mandate and any other special auditing requirements may affect the auditor's consideration of the nature, timing and extent of further audit procedures (ISA 330, A17 which relates to the requirements of ISA 330, 7).

ISA (UK and Ireland) 402: Audit considerations relating to an entity using a service organisation

89. ***The objectives of the user auditor, when the user entity uses the services of a service organization, are:***

(a) To obtain an understanding of the nature and significance of the services provided by the service organization and their effect on the user entity's internal control relevant to the audit, sufficient to identify and assess the risks of material misstatement; and

(b) To design and perform audit procedures responsive to those risks (ISA 402, 7).

Use of service organisations in the public sector

90. Public sector entities often use shared service providers. For example, transaction processing or payroll services may be outsourced to another entity, which could be private sector, another public sector organisation, or a joint venture between the two sectors.
91. Auditors consider how the audited body oversees the provider's performance and considers whether this raises the risk of misstatement. Where a national audit agency is the auditor of more than one user organisation for a service provider, the agency obtains an understanding of how each user entity is affected by the service organisation and makes individual assessments of risk and impact on the audit approach for each user entity.

Access rights to service organisations

92. Public sector auditors generally have broad rights of access established by legislation. However, there may be situations where such rights of access are not available, for example when the service organisation is located in a different jurisdiction. In such cases, a public sector auditor may need to obtain an understanding of the legislation applicable in the different jurisdiction to determine whether appropriate access rights can be obtained. A public sector auditor may also obtain or ask the user entity to incorporate rights of access in any contractual arrangements between the user entity and the service organisation (ISA 402, A10 which relates to the requirements of ISA 402, 9).
93. ISA (UK and Ireland) 402 in itself is not sufficient to secure access rights for the public sector auditor. It is important that such access rights and the purpose of such rights are recognised and provided for in the contract between the service organisation and the audited body.
94. Public sector auditors may use another auditor to perform tests of controls or substantive procedures in relation to compliance with law, regulation or other authority (ISA 402, A11 which relates to the requirements of ISA 402, 9)
95. In some cases, law or regulation may require a reference to the work of a service auditor in the user auditor's report, for example, for the purposes of transparency in the public sector. In such circumstances, the user auditor may need the consent of the service auditor before making such a reference (ISA 402, A43 which relates to the requirements of ISA 402, 21).

ISA (UK and Ireland) 450: Evaluation of misstatements identified during the audit

96. ***The objective of the auditor is to evaluate:***
   (a) The effect of identified misstatements on the audit; and
   (b) The effect of uncorrected misstatements, if any, on the financial statements (ISA 450, 3).

97. In the case of an audit of a public sector entity, the evaluation whether a misstatement is material may also be affected by the auditor's responsibilities established by law, regulation or other authority to report specific matters, including, for example, fraud (ISA 450, A19 which relates to the requirements of ISA 450, 11).
98. Furthermore, issues such as public interest, accountability, probity and ensuring effective legislative oversight, in particular, may affect the assessment whether an item is material by virtue of its nature. This is particularly so for items that relate to compliance with law, regulation or other authority (ISA 450, A20 which relates to the requirements of ISA 450, 11).

ISA (UK and Ireland) 510: Initial audit engagements – opening balances

99. ***In conducting an initial audit engagement, the objective of the auditor with respect to opening balances is to obtain sufficient appropriate audit evidence about whether:***
   (a) Opening balances contain misstatements that materially affect the current period's financial statements; and
   (b) Appropriate accounting policies reflected in the opening balances have been consistently applied in the current period's financial statements, or changes thereto are appropriately accounted for and adequately presented and disclosed in accordance with the applicable financial reporting framework (ISA 510, 3).

Opening balances in the context of a machinery of government change

100. ISA (UK and Ireland) 510 is concerned with the opening balances for initial engagements. This can occur when the financial statements for the prior period were audited by another auditor, but is also relevant for 'machinery of government changes' that transfer functions from one part of the public sector to another as a going concern.
101. Where opening balances are clearly identifiable from the preceding period's audited financial statements for the transferring entity the auditor adopts the requirements in paragraphs 6 and 7 of ISA (UK and Ireland) 510.
102. Where opening balances are not clearly identifiable from the preceding period's audited financial statements for the transferring entity, but have been derived from balances contained in those statements, the auditor discusses with the auditor of the predecessor organisation whether information is available that would provide substantive evidence for the opening balances. In the absence of such evidence, the auditor carries out substantive testing on opening balances to confirm they have been brought-forward appropriately in accordance with the terms of the transfer, at an appropriate valuation in line with the accounting policies of the receiving body.
103. Where opening balances have been calculated as part of a separate disaggregation or merger exercise, subject to a separate specific review and report by an auditor, the auditor considers the scope and outcomes of that separate review, and considers whether the conclusions can be relied on in accordance with ISA (UK and Ireland) 500. Where the work from the separate specific review cannot be used, the auditor considers carrying out substantive testing on opening balances.
104. Where opening balances have been calculated as part of a separate disaggregation/merger exercise, but not subject to separate specific review and report, the auditor considers substantive testing on opening balances. Completeness of assets and liabilities, together with appropriate valuation can be risks in a disaggregation exercise, and engagement with the audited body should be made at an early stage.
105. Where, after performing the procedures described above, the auditor is unable to obtain sufficient appropriate audit evidence concerning the opening balances of the entity, the auditor considers the implications for the auditor's report.

The audit of opening balances by the incoming auditor

106. In the public sector, in the interests of efficiency and reducing the audit burden, the predecessor auditor is expected by the national audit agencies, relevant Codes of Audit Practice or terms of appointment to adopt a co-operative approach in dealing with enquiries and requests for information from the incoming auditor.
107. Arrangements to support a co-operative approach typically include enabling the incoming auditor to have access to particular reports or papers that may be required rather than the transfer of all the relevant papers or data. While there is a clear expectation that auditors co-operate in support of effective hand-over arrangements, the incoming auditor remains responsible for meeting the requirements of ISA (UK and Ireland) 510. Outgoing auditors may provide additional supporting documentation that will facilitate the meeting of these responsibilities.
108. In the public sector, there may be legal or regulatory limitations on the information that the current auditor can obtain from a predecessor auditor. For example, if a public sector entity that has previously been audited by a statutorily appointed auditor (for example, an Auditor General, or other suitably qualified person appointed on behalf of the Auditor General) is privatised, the amount of access to working papers or other information that the statutorily appointed auditor can provide a newly-appointed auditor that is in the private sector may be constrained by privacy or secrecy laws or regulations. In situations where such communications are constrained, audit evidence may need to be obtained through other means and, if sufficient appropriate audit evidence cannot be obtained, consideration is given to the effect on the auditor's opinion (ISA 510, A1 which relates to the requirements of ISA 510, 6).
109. If the statutorily appointed auditor outsources an audit of a public sector entity to a private sector audit firm, and the statutorily appointed auditor appoints an audit firm other than the firm that audited the financial statements of the public sector entity in the prior period, this is not usually regarded as a change in auditors for the statutorily appointed auditor. Depending on the nature of the outsourcing arrangement, however, the audit engagement may be considered an initial audit engagement from the perspective of the private sector auditor in fulfilling their responsibilities, and therefore this ISA (UK and Ireland) applies (ISA 510, A2 which relates to the requirements of ISA 510, 6).

ISA (UK and Ireland) 520: Analytical Procedures

110. ***The objectives of the auditor are:***

(a) To obtain relevant and reliable audit evidence when using substantive analytical procedures; and

(b) To design and perform analytical procedures near the end of the audit that assist the auditor when forming an overall conclusion as to whether the financial statements are consistent with the auditor's understanding of the entity (ISA 520, 3).

111. The relationships between individual financial statement items traditionally considered in the audit of business entities may not always be relevant in the audit of governments or other non-business public sector entities; for example, in many public sector entities there may be little direct relationship between revenue and expenditure. In addition, because expenditure on the acquisition of assets may not be capitalised, there may be no relationship between expenditures on, for example, inventories and fixed [(non-current)] assets and the amount of those assets reported in the financial statements. Also, industry data or statistics for comparative purposes may not be available in the public sector. However, other relationships may be relevant, for example, variations in the cost per kilometer of road construction or the number of vehicles acquired compared with vehicles retired (ISA 520, A11 which relates to the requirements of ISA 520, 5).

ISA (UK and Ireland) 540: Auditing accounting estimates, including fair value accounting estimates, and related disclosures

112. ***The objective of the auditor is to obtain sufficient appropriate audit evidence about whether:***

(a) accounting estimates, including fair value accounting estimates, in the financial statements, whether recognized or disclosed, are reasonable; and

(b) related disclosures in the financial statements are adequate,

in the context of the applicable financial reporting framework (ISA 540, 6).

The risk of management bias in accounting estimates in the public sector

113. In the public sector, factors outside of the scope of the financial reporting framework can have a significant influence on management's estimates. For example, central government departments must adhere to HM Treasury budgetary controls, so estimates in the financial statements can be influenced by the impact they have on departmental expenditure limits or the administration budget. In the health sector, statutory limits or targets can similarly influence management decisions.

114. Auditors need to understand these influences, some of which come from elsewhere within a departmental or sector group, when considering the appropriateness of accounting estimates and the assumptions applied by management.

The use of third-party estimates in the financial statements

115. Some public sector entities are reliant on accounting estimates provided by other entities within the public sector, such as prescription pricing or dental cost estimates. The auditor understands how these estimates have been derived, and may need to communicate with the auditors of the entities compiling the accounting estimates on which the public sector body relies.

Non-current assets in the public sector

116. Public sector entities may have significant holdings of specialised assets [for example, heritage or infrastructure assets] for which there are no readily available and reliable sources of information for purposes of measurement at fair value or other current value bases, or a combination of both. Often specialised assets held do not generate cash flows and do not have an active market. Measurement at fair value therefore ordinarily requires estimation and may be complex, and in some rare cases may not be possible at all (ISA 540, A11 which relates to the requirements of ISA 540, 2).

ISA (UK and Ireland) 550: Related parties

117. ***The objectives of the auditor are:***

(a) Irrespective of whether the applicable financial reporting framework establishes related party requirements, to obtain an understanding of related party relationships and transactions sufficient to be able:

> ***(i) To recognize fraud risk factors, if any, arising from related party relationships and transactions that are relevant to the identification and assessment of the risks of material misstatement due to fraud; and***
>
> ***(ii) To conclude, based on the audit evidence obtained, whether the financial statements, insofar as they are affected by those relationships and transactions:***
>
> > ***a. Achieve fair presentation (for fair presentation frameworks); or***
> >
> > ***b. Are not misleading (for compliance frameworks); and***

(b) In addition, where the applicable financial reporting framework establishes related party requirements, to obtain sufficient appropriate audit evidence about whether related party relationships and transactions have been appropriately identified, accounted for and disclosed in the financial statements in accordance with the framework (ISA 550, 9).

Public sector specific considerations with regards to related party transactions

118. The public sector auditor's responsibilities regarding related party relationships and transactions may be affected by the audit mandate, or by obligations on public sector entities arising from law, regulation or other authority. Consequently, the public sector auditor's responsibilities may not be limited to addressing the risks of material misstatement associated with related party relationships and transactions, but may also include a broader responsibility to address the risks of non-compliance with law, regulation and other authority governing public sector bodies that lay down specific requirements in the conduct of business with related parties. Further, the public sector auditor may need to have regard to public sector financial reporting requirements for related party relationships and transactions that may differ from those in the private sector (ISA 550, A8 which relates to the requirements of ISA 550, 11).

119. Financial reporting frameworks establish specific accounting and disclosure requirements for related party relationships, transactions and balances to enable users of the financial statements to understand their nature and actual or potential effects on the financial statements. In particular, the audited body may need to consider the definition of a related party in respect of public sector bodies. A public sector body is not automatically a related party to another public sector body due to its classification. The related parties of public sector entities are subject to specific restrictions on the nature and scope of the relationships that they can enter into with the entity, which prescribe practices that might be permissible in relationships outside the public sector.

120. The auditor has a responsibility to perform audit procedures to identify, assess and respond to the risks of material misstatement arising from the entity's failure to appropriately account for or disclose related party relationships, transactions or balances in accordance with the requirements of the financial reporting framework.

ISA (UK and Ireland) 560: Subsequent events

121. ***The objectives of the auditor are:***

> ***(a) To obtain sufficient appropriate audit evidence about whether events occurring between the date of the financial statements and the date of the auditor's report that require adjustment of, or disclosure in, the financial statements are appropriately reflected in those financial statements in accordance with the applicable financial reporting framework; and***
>
> ***(b) To respond appropriately to facts that become known to the auditor after the date of the auditor's report, that, had they been known to the auditor at that date, may have caused the auditor to amend the auditor's report (ISA 560, 4).***

Additional considerations with regards to subsequent events in the public sector

122. In the public sector, the auditor may read the official records of relevant proceedings of the legislature and inquire about matters addressed in proceedings for which official records are not yet available (ISA 560, A10 which relates to the requirements of ISA 560, 7).

123. In addition to giving audit opinions on the financial statements, auditors of certain local government and health entities may be required to:

- discharge certain statutory responsibilities and duties; and
- issue a certificate confirming that the audit and all related responsibilities and duties have been completed in accordance with the legislation.

124. The issue of the audit completion certificate marks the end of the exercise of the auditor's powers and duties in respect of that statutory audit.

125. Fulfilling the auditor's other statutory responsibilities and duties may lead to a significant delay between when the auditor has obtained sufficient appropriate audit evidence to provide the opinion on the financial statements and when the auditor is in a position to issue the audit completion certificate.

126. In such circumstances, the auditor assesses whether the actions the auditor expects to take in discharge of those additional statutory responsibilities and duties could give rise to matters that could have a material effect on the financial statements. If the auditor believes that discharge of those statutory responsibilities and duties are likely to give rise to matters that would have a material effect on the financial statements, the auditor does not provide an opinion on the financial statements until after those additional steps have been completed.

127. An opinion given on the financial statements of a local government or health entity in advance of the issue of the audit completion certificate is:

- the final opinion on the financial statements for the purposes of compliance with ISAs (UK and Ireland); and
- issued to coincide with the proposed date of issue of the financial statements by the audit committee.

128. After the financial statements have been issued an auditor has no obligation to perform audit procedures regarding those financial statements. Accordingly, when subsequently issuing the audit completion certificate, there is no requirement for the auditor to seek out information that may have implications for the audit opinion that has already been given.

129. If, after the financial statements have been issued, a fact becomes known to the auditor that, had it been known to the auditor at the date of the auditor's report on the financial statements, may have caused the auditor to amend the auditor's report:

- ISA (UK and Ireland) 560, paragraph 14, requires the auditor to perform further procedures; and
- If, after completing such further procedures, the auditor concludes that there is relevant information that would have impacted the opinion on the financial statements, the auditor refers to such matters in the audit completion certificate.

130. If the auditor has not issued an audit completion certificate on the prior year audit then an audit completion certificate is not issued on the current year audit until the audit completion certificate in relation to the prior year has been issued.

Facts which become known to the auditor after the date of the auditor's report but before the financial statements are issued

131. The financial statements of central government entities are considered to be issued on the following dates:

Central government entities where the statutory auditor is responsible for the printing of the document containing the audited financial statements	Date of despatch by the auditor to the Clerk of the House of Commons or House of Lords for laying before Parliament. This is normally the same date as the auditor's certificate and report.
Central government entities where the financial statements are laid before the Houses of Parliament by the Secretary of State of the sponsoring department or by HM Treasury, and where the statements are considered by an intermediate body before being laid before Parliament	Date of despatch by those charged with governance to the Secretary of State of the sponsoring department or HM Treasury, or to the Members of the intermediate body, whichever is the earlier.
Welsh Government and its sponsored and related public bodies, and NHS Wales entities	Date of despatch by the Auditor General to the Table Office of the National Assembly.
Central government entities in Scotland	Date of despatch by the Auditor General for laying by the Scottish Ministers before the Scottish Parliament.

Central government and health entities in Northern Ireland	Date of despatch by the department, body or person specified in the relevant legislation for laying before the Northern Ireland Assembly.

Date financial statements are laid before members or equivalent

132. In the case of the public sector, the date the financial statements are issued may be the date the audited financial statements and the auditor's report thereon are presented to the legislature or otherwise made public (ISA 560, A5 which relates to the requirements of ISA 560, 5).

133. In central government, the financial statements of most reporting entities are generally laid before: the House of Commons; the House of Lords; both of these Houses of Parliament; the National Assembly for Wales, the Northern Ireland Assembly or the Scottish Parliament. However, for certain entities, usually arm's length public bodies, the financial statements may also be considered by an intermediate body (often a board, trustees or equivalent) before being formally laid before Parliament, either by the intermediate body, by the Secretary of State of the department responsible for the entity, or by HM Treasury. Where such a reporting hierarchy exists, the auditor considers subsequent events that the auditor becomes aware of and that occur from the date of the auditor's report until the date on which the financial statements are laid before the Parliament or the Assembly.

134. The financial statements of some central government entities are not formally laid before the Houses of Parliament but may be deposited in the libraries of the House of Commons and House of Lords by the sponsor department. Because the financial statements of these entities are not formally laid before Parliament, the auditor only considers subsequent events that occur up to the date on which the financial statements are issued. Otherwise, the auditor of a central government entity follows the requirements of ISA (UK and Ireland) 560 for subsequent events occurring between the dates of issue and of laying before the Parliament or the Assembly.

135. If those charged with governance decide not to amend the financial statements, where the auditor believes that they need to be revised, the auditor considers taking appropriate steps on a timely basis to prevent reliance on the auditor's report:
   - if the financial statements are considered by an intermediate body before being despatched to the Secretary of State of the sponsor department and before being laid before Parliament, the auditor considers making a statement to that body, depending on the auditor's relationship with the intermediate body as may be set out in the auditor's terms of engagement, and in the light of any legal advice on the auditor's position; and
   - if there is no intermediate body, and the entity has despatched the financial statements to the Secretary of State of the sponsor department but they have yet to be laid before Parliament, then subject to any legal advice on the auditor's position, the auditor considers reporting the auditor's concerns to the department. If the content of the auditor's letter of appointment is based on the guidance issued by HM Treasury, the auditor normally has right of access to report to the department any matters of importance arising out of the auditor's work.

136. In the public sector, the actions taken in accordance with paragraph 13 [of ISA 560] when management does not amend the financial statements may also include reporting separately to the legislature, or other relevant body in the reporting hierarchy, on the implications of the subsequent event for the financial statements and the auditor's report (ISA 560, A14 which relates to the requirements of ISA 560, 13).

137. Where the financial statements are produced by an entity which is audited by the Comptroller and Auditor General, the auditor has the possibility of reporting separately to Parliament on the implications of the subsequent event for the financial statements and the auditor's report. Similar arrangements enable the Auditor General for Wales to report separately to the National Assembly for Wales, the Auditor General for Scotland to report to the Scottish Parliament and for the Comptroller and Auditor General for Northern Ireland to the Northern Ireland Assembly. For local government or health entities the issue of the audit completion certificate marks the closure of the audit and the end of the exercise of the auditor's powers.

138. Where the subsequent event occurred after the date of the auditor's report, the auditor may, in addition to seeking legal advice, discuss the matter with the entity's Chief Executive and with the sponsor department to establish whether it might be possible to withdraw the auditor's report before the financial statements are laid before the Parliament or the Assembly.

139. In some jurisdictions, entities in the public sector may be prohibited from issuing amended financial statements by law or regulation. In such circumstances, the appropriate course of action for the auditor

may be to report to the appropriate statutory body (ISA 560, A17 which relates to the requirements of ISA 560, 15).

Facts which become known after the financial statements have been issued

140. In the public sector, the issue of the auditor's statutory audit opinion marks the end of the audit and once the financial statements have been issued they cannot be revised and the auditor's report cannot be re-issued.

141. If a matter that needs to be drawn to the attention of stakeholders arises once the financial statements have been issued, the auditor has other mechanisms available for making a public statement. For example, in the central government sector the relevant Auditor General can report to Parliament/Assembly or local auditors can consider the issue of a public interest report.

ISA (UK and Ireland) 570: Going concern

142. ***The objectives of the auditor are:***

(a) To obtain sufficient appropriate audit evidence regarding, and conclude on, the appropriateness of management's use of the going concern basis of accounting in the preparation of the financial statements;

(b) To conclude, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the entity's ability to continue as a going concern; and

(c) To report in accordance with this ISA (UK and Ireland). (ISA 570, 9)

Going concern in the public sector

143. Going concern issues arise in the public sector. They include, but are not limited to, situations where public sector entities operate on a for-profit basis, where government support may be reduced or withdrawn, or in the case of privatisation. Events or conditions that may cast significant doubt on an entity's ability to continue as a going concern in the public sector may include situations where the public sector entity lacks funding for its continued existence or when policy decisions are made that affect the services provided by the public sector entity (ISA 570, A2 which relates to the requirements of ISA 570, 10).

144. In the public sector, entities may have a deficit of income over expenditure or an excess of liabilities over assets. However, the operational existence of a public sector entity will not always cease, or its scale of operations be subject to a forced reduction, as a result of an inability to finance its operations or of net liabilities. The reasons for this are:

- local government entities are statutory bodies that are required to maintain delivery of functions essential to the local communities, are themselves revenue-raising bodies and have the possibility, on application, of recovering losses over a period;
- there is a general assumption that no part of the NHS will be allowed to cease operations other than by deliberate closure by central government, announced in advance. Legislation is in place under which the liabilities of NHS trusts are transferred to another public entity if the trust is closed; and
- government departments can act to avoid financial failures by individual entities in central government and other parts of the public sector and thus secure continuation of the delivery of public services.

145. Cessation is most likely to result from a legislative change or a decision made by Parliament/Assembly. A decision may be taken to:

- wind-up and dissolve an entity in its entirety, where central government determines that the entity's functions are no longer required;
- wind-up and dissolve all or part of an entity, but transfer some or all of its functions to another entity in the same sector or another sector;
- merge the entity, or some part of it, with another in the same sector; or
- privatise an entity, or some part of it, where the government decides that certain functions would be better delivered by the private sector.

146. In each of these cases the operational existence of all or part of the entity ceases, but only in the case of dissolution without any continuation of operations would the going concern basis cease clearly to be appropriate. In the other cases the auditor considers the basis on which the activities are transferred, from the viewpoint of the entity that is relinquishing the assets and liabilities at the accounting date.

147. In the public sector it is not uncommon for statutory bodies to give guarantees which, if called upon, can not be met by the resources currently available to the organisation. In such circumstances, the auditor considers if the matter needs to be referred to in an emphasis of matter paragraph within the auditors report.

148. Where a central government entity operates at arm's length from government, particularly in a trading capacity, the auditor may determine that a deficit of income over expenditure or an excess of liabilities over assets undermines the going concern assumption.

Consideration of the foreseeable future

149. ISA (UK and Ireland) 570 specifies that, in assessing whether the going concern assumption is appropriate, those charged with governance take into account all available information for the foreseeable future, which is at least twelve months from the reporting date. If the period to which those charged with governance have paid particular attention in assessing going concern is less than one year from the date of approval of the financial statements, and those charged with governance have not disclosed this fact, the auditor complies with the requirements of paragraph 17-2 of ISA (UK and Ireland) 570.

150. Decisions to abolish, transfer or privatise the functions of public sector bodies are inherently subject to political uncertainty, for example changes of Government or ministerial positions. However, it is rare that the future cannot be predicted with some certainty for the period up to one year from the date of approval of the financial statements. Political decisions are often no more uncertain than those completely unforeseeable risks faced by all private sector companies, of which neither the directors nor the auditor could be aware. The provisions of paragraph 4 of ISA (UK and Ireland) 570 are therefore applied by the auditor.

The auditor's responsibilities for the consideration of the appropriateness of the going concern basis

151. In forming a view on the entity's ability to continue its operations, the public sector auditor's consideration of going concern covers two separate, but sometimes overlapping, factors:
- the risk associated with changes in policy direction; and
- operational or business risk.

152. The auditor ascertains whether the Parliament/Assembly has a known intention to abolish, transfer or privatise the activities of the audited entity.

153. When the auditor becomes aware of information which indicates that the Parliament/Assembly has made, or plans to make, a decision which is likely to impact on the entity's continued operational existence, the auditor first establishes whether the entity's operational activities are likely to be transferred elsewhere in the public sector. If they are, irrespective of whether the entity will continue to operate, the going concern basis of preparation of the financial statements is likely to remain appropriate. If not, then in considering the going concern assumption, the auditor may decide to request that the audited entity secures from the relevant department or executive body a letter of financial support, confirming that the entity continues to have financial backing to utilise its assets and meet liabilities as they fall due.

154. Some public sector bodies may have a statutory duty to break even. The existence of such a requirement may influence the scope and nature of audit procedures, for example, it may be appropriate to consider the financial performance of the entity, including the effectiveness of financial recovery plans.

155. Given that a key consideration in the public sector is Parliament's/Assembly's intention, the public sector auditor considers whether to request that the entity secures direct confirmation from the department or executive body responsible for providing financial backing to the entity. In such circumstances, a representation provided by the Accounting/Accountable Officer or responsible financial officer of the entity that financial backing will continue to be received may not be sufficient as meaningful assurance over the future of an entity. This is because the representation could be based upon presumption of knowledge of facts about the intentions of the financial backer that might not be possessed by the entity or judgements about future conditions for support that the entity is not capable of making.

156. Where the auditor judges that the going concern basis is appropriate for the preparation of a public sector entity's financial statements substantially on the basis of third party confirmations received from the department or executive body responsible for providing financial backing, the auditor considers whether this is a matter of such significance that the confirmations are referred to in the financial statements and in the auditor's report as being relevant to a proper understanding of the basis of the auditor's opinion.

157. If no appropriate representations or confirmations can be obtained, the auditor considers whether there is a limitation on the scope of the audit work that requires a modified opinion or a fundamental uncertainty that requires an emphasis of matter paragraph in the auditor's report.

Going concern where public sector entities prepare financial statements on a cash basis

158. Where central government entities prepare financial statements on a cash basis, ISA (UK and Ireland) 570 does not apply to the audit as the going concern basis is not used in the preparation of the statements. However, the auditor still considers whether there are any matters affecting the audited entity's ability to continue as a going concern. Where the auditor identifies such matters, the auditor considers the need to report separately to Parliament on those matters and may include an emphasis of matter paragraph in the auditor's report. The auditor does not, however, modify the audit opinion on the proper presentation of the financial statements.

Public sector auditors' responsibilities for reviewing and reporting upon an entity's arrangements for securing value for money

159. Auditing frameworks may require public sector auditors to review and report upon the entity's arrangements for securing value for money and in such cases it may be appropriate for auditors to consider how the entity ensures that it is able to maintain the sustainability of its services and finances. But, where auditors identify concerns about an entity's general financial health, or its arrangements for maintaining the sustainability of its services and finances, this does not necessarily cast doubt upon the entity's ability to continue to prepare its financial statements on a going concern basis.

ISA (UK and Ireland) 580: Written representations

160. ***The objectives of the auditor are:***

(a) To obtain written representations from management and, where appropriate, those charged with governance that they believe that they have fulfilled their responsibility for the preparation of the financial statements and for the completeness of the information provided to the auditor;

(b) To support other audit evidence relevant to the financial statements or specific assertions in the financial statements by means of written representations if determined necessary by the auditor or required by other ISAs (UK and Ireland); and

(c) To respond appropriately to written representations provided by management and, where appropriate, those charged with governance, or if management or, where appropriate, those charged with governance do not provide the written representations requested by the auditor. (ISA 580, 6)

Identifying who is competent to give written representation in the public sector

161. The auditor takes care to ensure that representations are only accepted from those competent to give them, such that:
- acknowledgement of the responsibilities of 'directors' for the financial statements is made by those in whom the responsibilities are vested; and
- management representations on matters material to the financial statements are made by persons who have knowledge of the facts or who are authorised to make the judgement or express the opinion.

162. In central government and health entities, representations will usually be obtained from the Accounting Officer or the Accountable Officer. At local government bodies, the responsible finance officer has statutory responsibility for the proper administration of the entity's financial affairs. The auditor of a local government entity may therefore obtain representations from the responsible finance officer.

The content on written representations in the public sector

163. The mandates for audits of the financial statements of public sector entities may be broader than those of other entities. As a result, the premise, relating to management's responsibilities, on which an audit of the financial statements of a public sector entity is conducted may give rise to additional written representations. These may include written representations confirming that transactions and events have been carried out in accordance with law, regulation or other authority (ISA 580, A9 which relates to the requirements of ISA 580, 10-11).

ISA (UK and Ireland) 600: Special considerations – audits of group financial statements (including the work of component auditors)

164. ***The objectives of the auditor are:***

(a) To determine whether to act as the auditor of the group financial statements; and

(b) If acting as the auditor of the group financial statements:

(i) To communicate clearly with component auditors about the scope and timing of their work on financial information related to components and their findings; and

(ii) To obtain sufficient appropriate audit evidence regarding the financial information of the components and the consolidation process to express an opinion on whether the group financial statements are prepared, in all material respects, in accordance with the applicable financial reporting framework (ISA 600, 8).

165. In certain parts of the public sector where the responsibilities of principal and other auditors are governed by statutory provisions, these may override the provisions of ISA (UK and Ireland) 600 (ISA 600, A1-1 which relates to the requirements of ISA 600, 3).

166. In the public sector, the option of declining or withdrawing from an engagement may not be available to the auditor due to the nature of the mandate or public interest considerations. In these circumstances, ISA (UK and Ireland) 600 still applies to the group audit, and the effect of the group engagement team's inability to obtain sufficient appropriate audit evidence is considered in terms of ISA (UK and Ireland) 705.

167. Where the group auditor uses the work of component auditors, the group auditor should determine the component materiality. In particular, the group auditor may need to give careful consideration to the implications of auditors of different entities within the group, some of which may be companies, using a different benchmark for setting materiality for their audited body. The group auditor should consider whether the component materiality is appropriate in respect of the group materiality.

168. Groups are common in certain parts of the public sector. For example, central government in the United Kingdom issues consolidated financial statements for government departments and Whole of Government Accounts. Individual public sector entities may have shares or ownership in companies.

169. Auditors should be aware of the specific public sector interpretations in respect of preparation of the group accounts and a definition of control. These may be included in the applicable financial reporting framework, for example the Government Financial Reporting Manual.

ISA (UK and Ireland) 610: Using the work of internal auditors

170. ***The objectives of the external auditor, where the entity has an internal audit function and the external auditor expects to use the work of the function to modify the nature or timing, or reduce the extent, of audit procedures to be performed directly by the external auditor, or to use internal auditors to provide direct assistance, are:***

(a) To determine whether the work of the internal audit function or direct assistance from internal auditors can be used, and if so, in which areas and to what extent;

and having made that determination:

(b) If using the work of the internal audit function, to determine whether that work is adequate for purposes of the audit; and

(c) If using internal auditors to provide direct assistance, to appropriately direct, supervise and review their work. (ISA 610, 13)

Using the work of internal audit in relation to the auditor's other responsibilities

171. The auditor may have responsibilities to review the systems of internal control, in addition to the audit of financial statements, for example to provide a negative assurance on the Governance Statement. The work of internal audit may be assessed for such purposes, even if the auditor considers that it may not be possible or desirable to use its work in specific areas for the purpose of the external audit of the financial statements.

172. The work of internal audit may also be considered in relation to the auditor's other responsibilities. Where matters come to the auditor's attention relating to the work of internal audit, these findings are properly reviewed in accordance with ISA (UK and Ireland) 610 for their potential impact on the audit of the financial statements.

ISA (UK and Ireland) 620: Using the work of an auditor's expert

173. ***The objectives of the auditor are:***

(a) To determine whether to use the work of an auditor's expert; and

(b) If using the work of an auditor's expert, to determine whether that work is adequate for the auditor's purposes. (ISA 620, 5)

174. In the public sector, there may be circumstances (in addition to those described in ISA (UK and Ireland) 620), where the auditor is required to use the work of an auditor's expert. For example, for the audit of specialist or complex accounting estimates, the auditor may need to appoint an expert to obtain understanding of the estimation process.

175. In some cases, law or regulation may require a reference [in the audit report] to the work of an auditor's expert, for example, for the purposes of transparency in the public sector (ISA 620, A41 which relates to the requirements of ISA 620, 14).

ISA (UK and Ireland) 700: Forming an opinion and reporting on financial statements

176. ***The objectives of the auditor are:***

(a) To form an opinion on the financial statements based on an evaluation of the conclusions drawn from the audit evidence obtained; and

(b) To express clearly that opinion through a written report (ISA 700, 6)

177. Due to the introduction of the revised auditing standards in June 2016, the section of this guidance on extended auditor's reporting has been amended to reflect the fact that some requirements previously included in ISA (UK and Ireland) 700 are now covered in a separate standard- ISA (UK and Ireland) 701. Auditors, who have regard to this Practice Note but have not yet adopted the revised standards, should refer to the requirements on extended reporting in the applicable ISA 700: The independent auditor's report on financial statements.

Addressee of the auditor's report in the public sector

178. ISA (UK and Ireland) 700 requires the title of an auditor's report to identify the person or persons to whom it is addressed. This is normally the person or persons on whose behalf the audit is undertaken and will vary across the public sector, depending upon the relevant auditing framework.

Reports by contracted-out auditors to national audit agencies

179. Where an audit is carried out on a 'contracted-out' basis then the contract between the firm and the audit agency may specify that the firm issues an audit report to the audit agency. Under these circumstances this is outside of the scope of ISA (UK and Ireland) 700 and the reporting arrangements will be defined by the contract between the firm and the audit agency. The report the firm issues to the audit agency reflects the scope of the engagement under the terms of the contract.

The requirement to certify that the audit has been completed in the public sector

180. For certain entities there is a requirement to certify that the audit has been carried out or to certify that the audit has been completed. The former is a fundamental part of the audit opinion as required by the legislation for specific public bodies and is incorporated into the wording of the introductory paragraph to the auditor's report. The latter is a wider responsibility for auditors of local government in England and Wales and health entities in England and its link with the opinion on the financial statements needs to be understood. Auditors may refer to the separate guidance on this issue that is published by the relevant national audit agency.

Reference to the basis for the audit in the public sector auditor's report

181. Where the requirement to audit an entity's financial statements is provided for under statute, the auditor refers to the relevant Act of Parliament and accounts direction when identifying the financial statements have been audited. The relevant Act of Parliament and accounts direction will vary across the public sector.

Implications of the prescribed wording of the audit opinion on compliance with International Standards on Auditing (UK and Ireland)

182. Although most public sector financial statements require an opinion as to whether the financial statements give a true and fair view, some auditing frameworks requires an opinion as to whether the financial statements present fairly or properly present the entity's transactions or balances. Whichever wording is used will not have an impact on the extent to which the auditor observes the requirements of auditing standards.

Extended auditor reporting

183. Listed entities are not common in the public sector. However, public sector entities may be significant due to size, complexity or public interest aspects. In such cases, an auditor of a public sector entity may be required by law or regulation or may otherwise decide to communicate key audit matters in the auditor's report (ISA 700, A38 which relates to the requirements of ISA 700, 31).

184. Auditors of public sector entities may also have the ability pursuant to law or regulation to report publicly on certain matters, either in the auditor's report or in a supplementary report, which may include information that is consistent with the objectives of ISA 701. In such circumstances, the auditor may need to tailor certain aspects of the communication of key audit matters in the auditor's report required by ISA 701 or include a reference in the auditor's report to a description of the matter in the supplementary report (ISA 700, A70 which relates to the requirements of ISA 700, 50).

185. Extended auditor's reporting requirements including key audit matters (as determined by ISA 701[4]) apply in the public sector, where the audited body is required by the regulator or voluntarily chooses to adopt the UK Corporate Governance Code. While many public sector bodies do not meet these criteria, the auditor may consider it appropriate to include this information required by ISA 701 in the audit report or issue a separate report for additional openness and transparency or where required by relevant Codes of Audit Practice or equivalent.

186. Some public sector auditors may have additional statutory powers and responsibilities to report on matters of interest to the relevant Parliament, Assembly or regulator. This may include, for example, background information on the basis for the audit opinion, inadequate financial control or propriety issues.

Matters to be reported by exception in the public sector

187. The Companies Act 2006 requires company auditors to report on certain matters by exception, including where:
   - adequate accounting records have not been kept, or returns adequate for the audit have not been received from branches not visited during the audit; or
   - the financial statements are not in agreement with the accounting records or returns; or
   - they have not received all of the information and explanations they require for their audit.

188. Public sector auditors report on these matters by exception, as set out in the terms of the engagement.

ISA (UK and Ireland) 706: Emphasis of matter paragraphs and other matter paragraphs in the independent auditor's report

189. ***The objective of the auditor, having formed an opinion on the financial statements, is to draw users' attention, when in the auditor's judgment it is necessary to do so, by way of clear additional communication in the auditor's report, to:***

(a) A matter, although appropriately presented or disclosed in the financial statements, that is of such importance that it is fundamental to users' understanding of the financial statements; or

(b) As appropriate, any other matter that is relevant to users' understanding of the audit, the auditor's responsibilities or the auditor's report. (ISA 706, 6)

190. In the public sector withdrawal from the audit may not always be possible. Where this option is preferential, but not available, the auditor may also consider it necessary to include an Other Matter paragraph in the auditor's report or to report relevant matters to the appropriate statutory body.

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[4] ISA 701 is effective for audits of financial statements for periods commencing on or after 17 June 2016. Early application is permitted.

ISA (UK and Ireland) 720: The auditor's responsibilities relating to other information

191.***The objectives of the auditor, having read the other information, are:***
- ***(a) To consider whether there is a material inconsistency between the other information and the financial statements;***
- ***(b) To consider whether there is a material inconsistency between the other information and the auditor's knowledge obtained in the audit;***
- ***(c) To respond appropriately when the auditor identifies that such material inconsistencies appear to exist, or when the auditor otherwise becomes aware that other information appears to be materially misstated;***
- ***(c)-1 Where required by law or regulation, to form an opinion on whether the information given in the other information is consistent with the financial statements and the auditor's knowledge obtained in the audit; and***
- ***(d) To report in accordance with this ISA (UK and Ireland). (ISA 720, 11)***

The auditor's responsibilities relating to the annual report

192.Many public sector entities are required to include an annual report in the same documents as the financial statements. For the most part, entities are required to incorporate the elements of the Companies Act Strategic and Directors' Report within this additional material. The terms of engagement for the national audit agency also normally require an opinion to be made on the consistency of that material with the financial statements audited. As the material may be dispersed within other surrounding information published with the accounts, it is important for the audit report to identify what is covered by the consistency opinion.

193.In addition to this consistency opinion, ISA 720 (UK and Ireland) requires the auditor to read all information published with the financial statements, which includes all material covered by the consistency opinion. Again, the audit report clarifies what content has been read.

194. By agreement with the relevant bodies, some public sector auditors report by exception where the Governance Statement does not reflect compliance with the relevant guidance. The auditor's responsibility in respect of the Governance Statement is to review the statement. This review is not to provide assurance on the statement, but to:
- consider the completeness of the disclosures in meeting the reporting requirements;
- identify whether the disclosures are misleading; and
- identify any inconsistencies between the disclosures and the information that the auditor is aware of from audit work.

195.Requirements for publishing other information alongside financial statements varies depending on the nature of the entity's operations and the reporting requirements. Typically, they may include a statement setting out the responsibilities of the Accounting/Accountable Officer or equivalent and a corporate governance statement.

196.The auditor might be required to provide a separate opinion on consistency of summary financial information (or equivalent) with financial statements. Where this information is not published alongside the financial statements, the auditor issues a separate report with a consistency opinion to accompany this information.

Reporting to the legislature

197.In the public sector, withdrawal from the engagement may not be possible. In such cases, the auditor may issue a report to the legislature providing details of the matter or may take other appropriate actions (ISA 720, A47 which relates to the requirements of ISA 720, 18).

Part 2: The audit of regularity

Introduction

1. This part of the Practice Note sets out guidance on public sector auditors' considerations of regularity and related matters. It covers:
   - understanding the concept of regularity:
   - how regularity relates to other concepts including propriety and compliance with laws and regulations;
   - the audit of regularity – an overview;
   - understanding the entity and its environment;
   - understanding the entity's internal controls;
   - materiality for the audit of regularity;
   - assessing the risk of material irregularity;
   - planning and performing audit procedures;
   - areas requiring special consideration;
   - written representations;
   - using the work of others;
   - evaluating irregularities;
   - the risk of fraud in the audit of regularity;
   - regularity opinion on financial statements; and
   - other reporting on regularity.
2. Public sector auditors may have statutory powers and responsibilities in relation to how audited bodies use public funds. Some of these responsibilities may be discharged through the audit of regularity, where required by legislation. The audit of regularity is related to the audit of financial statements and so it is covered by this Practice Note. Auditors may also be required to report in respect of propriety or the economy, efficiency and effectiveness (value for money) of the use of public funds. These are not covered by this Practice Note and the auditors should refer to the specific legislative framework and other guidance, for example Codes of Audit Practice development by a relevant audit agency.
3. This part of the Practice Note focuses on the audit of regularity to provide a reasonable assurance opinion. Some public sector auditors may be required to provide a limited assurance opinion on regularity. Guidance on such engagements is not included in this Practice Note and the auditors should consult other relevant information on engagements of this type.

Understanding the concept of regularity

4. Regularity is the concept that transactions that are reflected in the financial statements of an audited entity must be in accordance with the relevant framework of authorities.
5. Frameworks of authorities are external frameworks, specific to the audited entity, with which the audited entity's transactions must conform. These frameworks are set up by bodies able to issue and/or enforce the authorities for that entity and might include, for example:
   - authorising legislation;
   - regulations issued under governing legislation;
   - Parliamentary authorities (including budgetary laws, for example budget estimates voted by the relevant Parliament/Assembly);
   - Government or related authorities (for example Managing Public Money[5] issued by HM Treasury)
6. The concept of regularity reflects concerns of the users of the public sector accounts that public money raised is used only for the purposes intended by relevant framework of authorities. The preparation of financial statements by public bodies is an important means by which they are held accountable for the use of public funds.
7. For the audit of central government (or equivalent) and some health bodies, there is an explicit statutory requirement on the auditor to provide an additional audit opinion on whether, in all material respects, expenditure and income (payments and receipts) have been applied for the purposes intended by

[5] https://www.gov.uk/government/publications/managing-public-money

Parliament, where applicable and conform with the authorities which govern them. The auditor can adopt an integrated audit approach covering the audit of the financial statements and of regularity.

How regularity relates to other concepts including propriety and compliance with laws and regulations

8. Whereas regularity is concerned with compliance with a relevant framework of authorities, propriety is concerned more with standards of conduct, behaviour and corporate governance. It includes matters such as fairness, integrity, the avoidance of personal profit from public business, even-handedness in the appointment of staff, open competition in the letting of contracts and the avoidance of waste and extravagance.
9. Propriety is not readily susceptible to objective verification and, as such, is not expressly covered in the opinion on financial statements. When issues of propriety come to light in the course of the audit of financial statements, the auditor considers whether and, if so, how they may be reported.
10. Propriety might be part of the wider statutory role of the auditor or might fall within the terms of the audit engagement. For example, in Scotland, the Public Finance and Accountability (Scotland) Act 2000 requires audits of accounts for which the Auditor General is responsible to include auditor's reports that set out findings on whether the expenditure and receipts shown in the account were incurred or applied in accordance with relevant statutory provisions and with any applicable guidance (whether as to propriety or otherwise) issued by Scottish Ministers.
11. As part of the audit of regularity, the auditor assesses the audited body's compliance with relevant laws and regulations. This consideration feeds into work performed by the auditor under ISA (UK and Ireland) 250A. The guidance on the application of this ISA can be found in part one of this Practice Note.

The audit of regularity – an overview

12. The auditor's approach to the audit of the regularity of transactions in the financial statements of public sector entities is similar to the audit approach set out in ISA 250A (UK and Ireland) Section A: Consideration of laws and regulations in an audit of financial statements. It can be summarised as:
    - obtaining a sufficient understanding of the framework of authorities that are specific to the entity. The auditor obtains 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. The auditor also considers the systems and procedures in place to ensure compliance with the framework of authorities. The auditor obtains an understanding of the internal control environment to enable a preliminary assessment of controls which mitigate the risk of material irregularity;
    - obtaining sufficient appropriate evidence to obtain assurance over regularity. Taking into account materiality, the auditor performs audit procedures on transactions through a combination of tests of controls and substantive procedures. Audit procedures can be integrated with those relating to the audit of the financial statements.; and
    - reporting on regularity through a separate and explicit opinion on regularity or separate reports on regularity issues.
13. In certain parts of the public sector, the principles and procedures applied to obtain sufficient appropriate evidence to support an opinion on the regularity are similar to those applied to the audit of the financial statements. Thus, in forming an opinion on regularity, the auditor seeks to provide reasonable assurance that the financial statements are free from material irregularity.
14. There may however be particular considerations in respect of the auditor's assessment of materiality, risk and the design of audit procedures in relation to regularity that are set out in this Practice Note. In addition to these considerations, the auditor may have particular regard to the regularity of receipts, the disclosure of transactions in accordance with relevant framework of authorities, and securing management representations.
15. The auditor, in the audit of regularity, is expected to comply with the Financial Reporting Council's ethical, auditing and quality control standards and the guidance set out in this Practice Note.

Understanding the entity and its environment

16. An auditor in the public sector has, or obtains an understanding of the framework of authorities governing the audited body and its activities which is sufficient to enable identification of events, transactions and practices which may have a material effect on the regularity of transactions in the financial statements.

17. The extent of the auditor's work in relation to obtaining a sufficient understanding of the regulatory framework will depend on the complexity of the laws and regulations. In complex regulatory environments, the auditor considers the translation of the framework of authorities into relevant rules and procedures used by the audited entity.
18. In all regards, the audited entity retains the responsibility for ensuring the regularity of its transactions and for disclosing these transactions in the financial statements. However, the auditor has a responsibility for understanding the framework of authorities and cannot wholly rely on management representations about the framework, as the auditor's opinion on regularity must be based on evidence of compliance with the framework of authorities, rather than on evidence of compliance with the entity's understanding of the framework.
19. The auditor can identify the framework of authorities from a number of sources, including:
    - a framework document or accounts direction, where issued under the authorising legislation
    - previous experience with the entity or similar entities;
    - review of legislation and regulations governing the audited body;
    - discussions with the staff employed by the entity (finance officers, internal audit, policy and legal branches); or
    - documents produced by the entity (for example: minutes of board and other principal committee meetings, correspondence and minutes of meetings with relevant authorising bodies, prior years' financial and annual reports, budgets, internal management reports, management policy manuals, manuals of accounting and internal control, scheme control plans).
20. In considering the framework of authorities, the auditor distinguishes between those authorities which are specific to the entity and provide specific direct authority for its financial transactions and those laws and regulations which provide the general framework within which it conducts its activities.
21. Laws and regulations that fall within the general framework include, for example, those relating to health and safety, environmental protection and employment. While non-compliance with those laws and regulations that provide the general legal framework would not affect the auditor's opinion on the regularity of transactions, some of these may be relevant to the auditor’s assessment of compliance with laws and regulations under ISA (UK and Ireland) 250 Section A.
22. Understanding the framework of authorities and using this information appropriately will assist the auditor in developing the audit plan and in identifying potential material irregularity in the financial statements, for example, from new and complex legislation or from a misinterpretation of legislation and its scope. The auditor's understanding of the authorities includes knowledge of the reasons for the legislation and its objectives as this will aid the auditor's understanding of any secondary legislation or subsidiary regulations. The nature and complexity of the relevant legislation and other authorities has an impact on the extent of the auditor's work on regularity.

Understanding the entity’s internal controls

23. In planning the audit of regularity, the auditor considers how the entity's management complies with the framework and where relevant, addresses the risk of material irregularity through controls. This involves an assessment of the general control environment at the entity level and control procedures relating to individual transaction streams that are designed to prevent or detect and correct material irregularities.
24. As part of the auditor's review of the control environment, the auditor considers the general control framework for ensuring regularity, including:
    - the entity's organisational structure and the extent to which the responsibility for ensuring regularity is delegated;
    - methods of ensuring regularity and accountability where the responsibility for it is delegated;
    - the results of any relevant internal audit work which covers controls over compliance with laws and regulations or regularity;
    - the entity's corporate governance arrangements, in so far as the arrangements address compliance with regulations, in particular the work carried out by the entity to support the corporate governance statements, and the auditor's own work in reviewing the statements.
25. Controls and procedures which the audited body operates to ensure regularity of individual transaction streams may include, for example:
    - application of desk instructions for staff which translate statutory requirements into a set of operating procedures;
    - monitoring of compliance with financial memoranda; or

- receipt of reports on compliance from auditors of other entities.

26. It is sometimes necessary for the auditor to consider major or new legislation affecting the financial transactions or to consider whether regulations are appropriately translated into relevant rules and procedures. The auditor's work on legislation or regulations need only focus on those authorities that are relevant to the entity's financial transactions, such as those that govern the powers of the entity to make payments or receive money, or set out the value of such payments or receipts. It is not concerned with administrative rules or regulations that are not directly linked to financial transactions.
27. The auditor's consideration of the translation of framework of authorities may involve reviewing the legislation to identify the provisions that authorise activities and reviewing the process for their translation and interpretation in subsidiary regulations and guidelines. It may also extend to the process for translation of those regulations into working manuals or other key documentation. In conducting this review the auditor pays particular attention to the statutory regulations which govern, for example:
    - the powers of relevant bodies to determine the rules and procedures;
    - the controls to be operated by the entity responsible for the administration of a scheme;
    - the eligibility of beneficiaries to receive grants or other kinds of financial support under a scheme;
    - the calculation of grant or any other payments; and
    - the setting of fees and charges and other revenues.
28. In considering relevant rules and procedures relating to schemes, the auditor also identifies those controls that are designed to prevent or detect and correct material irregularities.
29. Where the volume of laws or regulations is significant, entities may have systems for the design and monitoring of procedures and controls to ensure that they are appropriate and meet legislative requirements.
30. The auditor should remain alert for significant problems encountered by the audited body relating to the interpretation of new and existing legislation or the application of regulations and the impact on the audit.

Materiality for the audit of regularity

31. The concept of materiality applies to the audit of regularity. The auditor is required to obtain sufficient appropriate evidence that the audited body has complied with the relevant framework of authorities “in all material respects”. This explicitly recognises the fact that the auditor cannot detect all occurrences of irregularity through the audit work. Materiality affects both the way in which the auditor plans the audit work on regularity and evaluates and reports the results of that work.
32. The auditor follows ISA (UK and Ireland) 320 when determining the materiality in the context of regularity. However, the materiality threshold for the audit of regularity may be different to the materiality for the financial statements as a whole. The auditor's assessment of what is material is a matter of judgement and includes both quantitative and qualitative considerations. This is because the users might have an interest in breaches of authority even where the sums of money involved may be small in relation to the overall expenditure in the financial statements.
33. This might mean that certain classes of transactions, account balances or disclosures need to be considered against a threshold lower than the materiality level. For example, in the context of regularity in central government in the United Kingdom, the auditor may consider material any expenditure incurred in excess of the amounts authorised by Parliament.
34. The auditor remains alert to the nature of irregularities and considers their significance having regard to the interest of the users of the financial statements in the matter.
35. The determination of materiality in the public sector is influenced by legislative and regulatory requirements, and by the financial information needs of legislators and the public in relation to public sector programmes. The list of matters will vary from audited body to audited body, however considerations may include:
    - the need for openness and transparency, for example senior staff or board members' remuneration;
    - public expectations and public interest which might deem separate disclosure necessary; and
    - the context in which a matter appears, for example if the matter is also subject to compliance with the framework of authorities, legislation or regulations.

Assessing the risk of material irregularity

36. The auditor considers the risks of material irregularity through the process of obtaining an understanding of the entity, its environment and its internal controls.

37. To assess the inherent risk of a material irregularity occurring, the auditor uses judgement to evaluate a range of factors, for example:
    - the complexity of the regulations;
    - the introduction of major new legislation or regulations changes in existing ones;
    - services and programmes delivered through third parties;
    - payments and receipts made on the basis of claims or declarations.
38. The auditor considers the controls which mitigate the risk that a material irregularity could occur in an account balance or class of transactions and would not be prevented, or detected and corrected on a timely basis by the accounting and control systems. Where the auditor expects to be able to rely on the operation of internal controls to reduce the extent of substantive procedures relating to regularity, the auditor assesses the design and implementation of those controls and plans and performs tests of their effectiveness.
39. Examples of areas of risk and possible mitigating controls in relation to regularity are summarised below.

Risk	Description	Mitigating Controls
Complexity of Regulations	The more complex the regulations the greater the risk of error. This may occur either through a misunderstanding or misinterpretation of the regulation or through an error in application.	• Formal procedures for the translation of statutory requirements into operating instructions. • Formal control plans prepared and monitored by scheme managers. • Review of scheme control plans and operating manuals by internal audit or some other independent audit function.
New Legislation	New legislation may require the introduction of new administrative and control procedures. This may result in errors in either the design or operation of controls required to ensure regularity.	The controls identified above involving formal procedures for the translation of statutory requirements into scheme rules. Formal control plans and the independent review of operating instructions and control plans will also apply where schemes are introduced following new legislation.
Services and programmes delivered through third parties	Where programmes are administered by agents, departments lose a degree of direct control and may have to rely on agents to ensure compliance with authorities.	• Formal agreements between the entity and the agent defining control procedures to be applied in the administration of services. • Management control and monitoring of third party activities. • Inspection visits by internal audit to third parties to review systems and procedures, including those relevant to regularity. • Independent assurance report on, or certification of, payments and receipts by the third parties' reporting accountant or auditor.

Risk	Description	Mitigating Controls
Payments and receipts made on the basis of claims or declarations	An entity's ability to confirm compliance with authorities may be restricted where, for example, criteria specified for receipt of grant are not subject to direct verification.	• Established criteria for making claims, clearly set out in departmental instructions and guidance to claimants. • Standard requirements for documentation evidencing entitlement to be submitted in support of claims. (This may be a condition of payment of grant or a requirement once the activity supported by the grant has been completed). • Physical inspection of claimants' records etc., to confirm eligibility. • Procedures for assessing the financial standing of claimants before awarding a grant and for monitoring continuing solvency. • Independent assurance report on, or certification of, the application of grant by reporting accountant or external auditor.

40. The auditor considers the significance of the identified risks of material irregularity in determining the nature, timing and extent of substantive procedures required to reduce audit risk to an acceptable level. As part of the risk assessment, the auditor determines which of the risks identified require special audit consideration.

Planning and performing audit procedures

41. The nature, timing and extent of the audit procedures is dependent on the complexity of the framework of authorities. For example, where an entity pays grants that are subject to specific restrictions in the grant agreement, the auditor plans and performs adequate procedures to obtain assurance that the grant receiving entity complied with these restrictions.
42. Audit procedures designed to obtain assurance over the regularity of transactions are usually based on a combination of tests of controls and substantive procedures. The auditor performs these in line with ISA (UK and Ireland) 330.
43. For tests of controls, the auditor determines whether the controls are adequately designed and implemented and are operating effectively to prevent or detect and correct material irregularity. If the auditor concludes that the controls are not effective, the auditor will not obtain assurance from them.
44. For substantive procedures, the auditor confirms that financial transactions conforms to framework of authorities, the range and scope being dependent on identified risks of material irregularity and the extent to which evidence from tests of control provides audit assurance.
45. Where the auditor obtains satisfactory evidence as to the operating effectiveness of the entity's controls in relation to regularity, the auditor may seek to reduce the extent of substantive procedures. The auditor may also have regard to work carried out on the auditor's review of the Governance Statement.
46. Evidence in relation to regularity can be gathered as part of an integrated approach with the audit of financial statements. The auditor considers whether the audit evidence available is sufficient and appropriate to obtain assurance over regularity of transactions.
47. Analytical procedures on their own are unlikely to provide the auditor with sufficient appropriate evidence in support of regularity. They may nevertheless, assist the auditor in assessing whether amounts recorded in financial statements are consistent with expectations. For example, where allowances under a scheme

are subject to a maximum value and the number of recipients is known the auditor may use analytical procedures to identify whether the permitted maximum may have been breached.

48. The auditor may carry out specific substantive procedures to identify activities and transactions that are not in accordance with the framework of authorities. These tests might involve:
    - the review of financial statements and any specific legislation;
    - the review of the entity's management accounts to identify any unusual transaction streams or account balances or any incorrect analysis of transactions; and
    - the substantive testing of transactions and account balances.

Areas requiring special consideration

49. The auditor may encounter difficulties obtaining audit evidence regarding certain aspects of regularity, for instance eligibility for grants. Ideally, the auditor requires direct evidence to satisfy the objective of the test. Where this is not available, the auditor considers how the entity satisfied itself as to regularity. This may be through the work of a separate inspection function or by receiving advice or assurance from an independent third party.
50. Rather than pay grants directly to the recipients intended by relevant framework of authorities, public sector bodies may fund other bodies to administer a scheme. Where this is the case, the auditor of the body may assess the arrangements put in place by the body to ensure proper accountability for such grants. This includes consideration of any work undertaken by the auditor of the other body on the regularity of expenditure.
51. An auditor engaged in the examination of expenditure on schemes funded by the European Union considers the compliance of transactions with the relevant European legislation and the impact of any non-compliance on the audit of regularity. In particular, the auditor obtains satisfaction that any regulations established in the UK are consistent with the provisions in the governing European Council or Commission Regulation and that these provisions are properly translated into instructions and procedures.
52. The auditor also remains alert to any legal actions that challenge the provisions of Acts or delegated legislation implementing European legislation by making enquiries of the entity and obtaining representations.
53. The auditor takes into account particular considerations when auditing the regularity of fees and charges levied by public sector entities, for example:
    - reviewing the relevant primary legislation to confirm that it provides appropriate authority for the audited body to levy fees and charges for the services concerned;
    - confirming that fee orders and other types of Statutory Instrument issued under the governing legislation are in accordance with those authorities;
    - confirming that the relevant legislation provides the appropriate authority for the receipts to be applied in aid of expenditure and not used to generate surplus (set up on a cost recovery basis).
54. As well as determining the authorities for levying fees and charges, the auditor also confirms that receipts are properly utilised and disclosed in the financial statements as authorised in the appropriate legislation.
55. Depending on the financial reporting framework, there may be additional requirements for disclosures in the financial statements in respect of regularity. In particular, the audited body may be required to disclose any non-compliance with frameworks of authorities. Taking into account materiality, the auditor considers the implications of lack of or inadequate disclosure on the audit opinion on regularity and the need to present a separate report on the matter to a relevant authority.

Written representations

56. Audit evidence on regularity is gathered from the audit procedures. However, the auditor may also seek representations from management (for example, Accounting Officers or Accountable Officers) on the discharge of their responsibility for the regularity of transactions. This is particularly important in areas, such as benefit and grant schemes, where direct evidence may not be available to the auditor.
57. Management is normally expected to provide a formal statement on the discharge of their responsibility each year. Where this statement is included in the financial statements, the auditor makes reference to the statement or discloses, in the responsibilities section of the auditor's report, the fact that the statement is not included or is not comprehensive in setting out management's responsibilities. The length and formality of management representations on regularity do not influence the scope of the auditor's procedures in obtaining evidence to support the regularity opinion.

Using the work of others

58. The auditor may wish to use the work of the internal auditor to obtain sufficient appropriate evidence in support of regularity. Where the auditor considers internal audit work, the auditor applies ISA (UK and Ireland) 610. In particular, the auditor is prohibited from the direct use of internal audit staff as part of the engagement team.
59. The auditor may seek to use the work of the auditor of another entity. The auditor may encounter the work of another auditor, for example where the entity:
    - consolidates or summarises the financial statements of other bodies;
    - has paid a grant to another entity; or
    - has contracted out services to a service organisation.
60. Where the entity prepares group financial statements, the auditor of a group determines how to obtain sufficient appropriate evidence over regularity of the group's transactions. Where the auditor of a group wishes to use the work of a component auditor in the audit of regularity, the auditor follows the standards and guidance in ISA (UK and Ireland) 600.
61. Frameworks of authorities are specific to each entity and the fact that an entity is consolidated does not result in that entity having to apply their parent entity's framework of authorities. For example, a public sector body may not have a specific framework of authorities. Therefore, the component may not require the audit of regularity for the purpose of a group regularity opinion, except for fraud considerations. However, where a consolidated entity has a framework of authorities but was not subject to the audit of regularity, the group auditor may carry out audit procedures (or instruct a component auditor to do so) to obtain assurance over regularity of the component's transactions.
62. The group auditor obtains representations from the component auditor as to that auditor's independence from the entity and their compliance with the relevant auditing and ethical requirements. This also applies if the group auditor uses audited financial statements, signed by the component auditor, which contain a specific opinion on regularity.
63. Where a public sector entity has paid a grant to another entity, it will usually establish controls designed to ensure that the recipient complies with the grant conditions. The management might specify in the financial memoranda or grant conditions to receive an auditor's report or certificate on regularity.
64. The auditor may need to examine the application of grants paid to other entities through, for example:
    - examination of the evidence available in the principal entity, including reports by their own internal audit function;
    - using the work of the other entity's external auditor;
    - consideration of the work of the other entity's internal audit function;
    - direct access to the other entity and performance of appropriate audit procedures.
65. The auditor may use the certificate and reports issued by the auditor of the grant recipient by:
    - confirming that the instructions issued to that auditor address the regularity considerations satisfactorily;
    - agreeing the scope; and
    - reviewing the results of the quality control review.
66. Where the auditor of a public sector entity does not have a right of access to the other entity or other sources to obtain sufficient appropriate evidence, an auditor considers whether there is a limitation on the scope of the audit in accordance with ISA (UK and Ireland) 705.
67. Where another auditor is required to provide a report or certificate on regularity to the principal entity, it is often the case that this is done a considerable time after the financial period being audited. The auditor ensures that only the evidence available to the principal entity relating to the reporting period is used. Where this is not possible, or if the principal and other entities have different year end dates, then the principal auditor may have to perform additional procedures, including the exercise of inspection rights, where appropriate.
68. Where the public sector entity has contracted out services to a service organisation, the need to access that organisation and/or their auditor depends on the nature of the services provided, the information available at the principal entity, and the terms of engagement of the other auditor.
69. Where a public sector auditor is considering the need to obtain legal opinions concerning the interpretation of statutes or regulations the auditor follows the standards and guidance in ISA (UK and Ireland) 620.
70. When determining whether to seek legal advice on a matter of regularity, the auditor considers:
    - the materiality of the matter in the context of the financial statements;

- the risk of irregularity based on the nature and complexity of the framework of authorities; and
- the availability of other relevant audit evidence, in particular whether the entity has sought its own legal advice.

71. Usually where there is doubt about the regularity of transactions, management may seek clarification on the legal position. Where the entity is unwilling to seek legal advice or where the auditor has concerns about the legal advice given to the entity, the auditor may wish to seek a separate legal opinion.
72. Where the auditor is uncertain about the regularity of expenditure in relation to the framework of authorities other than legislation, the auditor first determines whether the entity sought clarification or, where necessary, obtained the appropriate authorisation from the relevant bodies. The auditor may also seek advice directly from the relevant authority. In these circumstances, the auditor follows similar steps to those the auditor would take when seeking legal advice.

Evaluating irregularities

73. Where non-compliance with regulations is suspected or discovered, the auditor considers the wider implications for the audit opinion on regularity. This will also include consideration of the implications for the auditor's assessment of risks and controls in relation to material irregularities and the extent of assurance that the auditor can obtain from the overall control environment and representations from management.
74. The auditor considers the nature and extent of any non-compliance and, in particular, whether it arises from a fundamental misinterpretation of legislation or a misapplication of rules.
75. Cases of non-compliance with regulations may be reported to management of the entity to allow corrective action to be taken, for example, by recovering overpayments of grant. Where it is not possible for the entity to take corrective action, the management may disclose the non-compliance in the financial statements by outlining the circumstances surrounding the breach of regulations and the possible extent of irregular transactions. Even where a breach of regularity is disclosed, the auditor considers the implications for the audit opinion on regularity and the need to present a separate report on the matter to the relevant authority. In doing so, the auditor considers the materiality of the matter at issue.
76. If the entity's management does not accept the auditor's opinion that the relevant transactions are not in compliance with the appropriate authorities, then the auditor may:
    - communicate in a report to the appropriate level of management or those charged with governance the findings from the auditor's investigations into the circumstances surrounding the suspected irregularity and the conclusions drawn therefrom;
    - consider whether the matter is one which management is required to report to the relevant authority or group management and if so, request in writing that management notify them;
    - report directly to the relevant authority or group management if management are required to do so and the auditor is unable to establish whether management have complied with the requirement; and
    - consider modifying the opinion on regularity.

The risk of fraud in the audit of regularity

77. A particular transaction can be determined as fraudulent only through the applicable legal framework. However, the auditor often encounters situations where there is suspicion of fraud, identified by management, internal audit, third parties or the auditor. Although the auditor does not have the authority to determine whether or not a fraud has actually occurred, the auditor considers whether, in the auditor's opinion, the transactions concerned are in compliance with the relevant framework of authorities.
78. Fraudulent transactions are always irregular regardless of the manner or extent of disclosure in the financial statements since they are without proper authority. The auditor considers the impact of suspected or proven fraudulent transactions on the audit opinion, taking into account the materiality of the irregularities.
79. For the purpose of auditing regularity, fraudulent financial reporting is not itself irregular, although it may disguise underlying irregular transactions. However, misappropriation of assets is irregular and risk of material misappropriation of assets due to fraud should be considered for both the risk of management override and the audit of regularity.
80. Whilst ISA 240 is not written to address the audit of regularity, in some instances compliance with its requirements may be used to gain assurance over regularity, for example by:
    - evaluating whether unusual or unexpected relationships that have been identified through analytical procedures are indicative of material irregularity due to fraud;

- testing the appropriateness of journal entries; and
- considering the rationale for significant transactions undertaken outside the normal course of business.

Regularity opinion on financial statements

81. For the audit of central government (or equivalent) and some health bodies, the auditor provides an opinion on the regularity of transactions. The form of words used in the regularity opinion should relate to the statutory requirements or the scope of the engagement agreed with the audited body. The wording also needs to be accompanied by:
    - disclosure of management's responsibilities in relation to regularity in the statement of responsibilities and a reference to the disclosure in the responsibilities section of the auditor's report; or, full disclosure in the responsibilities section; and
    - inclusion of the overall work performed with regard to regularity in the scope of the basis of opinion section of the auditor's report.
82. If the auditor modifies the audit opinion on regularity, the auditor should apply the principles of ISA (UK and Ireland) 705.
83. Where the auditor concludes that material financial transactions do not comply with the relevant framework of authorities, the auditor qualifies the regularity opinion, stating that the audited body complies with a relevant framework of authorities, except for the non-compliance identified. Where the impact of the non-compliance on the financial statements is pervasive, the auditor issues an adverse opinion on regularity.
84. Where the auditor is unable to obtain sufficient evidence to reach an opinion, the auditor qualifies the regularity opinion as limitation of scope or if pervasive, the auditor issues a disclaimer.
85. A qualified opinion on regularity does not in itself lead to a qualification of the truth and fairness, fair presentation or proper presentation opinion on the financial statements. However, the auditor considers whether the matter is properly disclosed in the financial statements and whether it is so pervasive as to make the financial statements misleading.

Other reporting on regularity

86. In certain parts of the public sector, the auditor may be required to provide separate reports, other than through audit opinions, on issues of regularity. The auditor may be required to report matters relating to regularity to third parties, for example a component auditor reporting to the group’s management or reporting to a regulator such as the Charity Commission. The form and scope of these reports may be determined by the third party as part of a specific condition of the grant or subsidy and will be subject to specific instructions to the auditor. In other entities, the auditor may be required to submit a more general report on the entities' compliance with regulations, determined by the auditor's terms of engagement.
87. The auditor may also have statutory powers to issue a public interest report on any regularity or propriety matter which comes to the auditor's attention in the course of the audit in order that it is considered by the entity concerned or brought to the attention of the public.
88. In certain parts of the public sector, the auditor considers the need for a separate report where the audit opinion is modified as a consequence of material irregularity. The purpose of a separate report is to provide the users of the financial statements with a detailed explanation of the basis for qualification and support the relevant authority in holding the audited entity to account. This is linked to guidance on additional reporting responsibilities in part 1 of this Practice Note (ISA 700).
89. The auditor may in some cases identify irregularities during the course of the audit which are not material to the financial statements but which need, in the auditor's judgement, to be drawn to the attention of the addressees of the auditor's report. An example of this may be where expenditure in previous years is retrospectively deemed to be irregular by virtue of a legal challenge to the provisions of an Act.

Appendix 1- Glossary of terms

Accountable Officer[(1)] – members of the staff of the Scottish Administration designated by the Principal Accountable Officer with responsibility for parts of the Administration, bodies or office-holders as regards signing the accounts of the entity and ensuring the propriety and regularity of its finances.

Accountable Officer[(2)] – the officer (directed as the Chief Executive) responsible for the propriety and regularity of the public finances of health entities, and for the keeping of proper records, as set out in the Accountable Officers' Memorandum issued by the Department of Health or Chief Executive, NHS Wales. In Northern Ireland, the Accountable Officers' Memorandum is issued by the Department of Health.

Accounting Officer – usually the permanent head or senior full-time official of a central government entity or an NHS Foundation Trust, appointed or designated as the Accounting Officer for that entity and with a personal responsibility for, amongst other things, signing of the financial statements, ensuring that proper financial procedures are followed and accounting records maintained, ensuring that public funds and assets are properly managed and safeguarded and all relevant financial considerations, including issues on propriety, regularity or value for money are taken into account.

Accounts Commission – the independent body with statutory responsibilities for securing the audit of local government entities in Scotland, and to assist such entities in achieving best value. In relation to the audit of the financial statements, the Commission is responsible for appointing auditors, setting the required standards for its appointed auditors and regulating the quality of audits.

Accounts Direction – the document issued by HM Treasury or the Secretary of State of a parent or sponsor department, or by Welsh Ministers or Scottish Ministers which sets out the accounting and disclosure requirements to be applied in preparing the entity's financial statements. In Northern Ireland, the Department of Finance is responsible for issuing accounts directions for central government departments and executive agencies whilst normally the sponsoring department is empowered to direct the form of accounts for non-departmental public bodies and health service entities, with the consent of the Department of Finance

'Appointment By' Basis Engagement – An engagement where another firm or individual is responsible for the assignment, its performance and the issuing of the audit report.

Assembly – the National Assembly for Wales or the Northern Ireland Assembly.

Audit Scotland- national audit agency which supports both the Accounts Commission and the Auditor General for Scotland in carrying out their work.

Auditor of a public sector body (a public sector auditor) - a person, or persons appointed under statute or agreement; or appointed by, employed by or acting as the agent of a national audit agency, a secretary of state or a government department acting under statute or by agreement; or appointed as auditor to a body regulated by an independent regulator which has determined that this Practice Note applies.

Auditor General for Scotland – the individual responsible for authorising the issue of public funds from the Scottish Consolidated Fund to government departments and other public sector bodies; for examining or ensuring the examination of parliamentary accounts (which includes determining whether sums paid out of the Fund have been paid out and applied in accordance with statute), and certifying and reporting on them; for carrying out or ensuring the carrying out of examinations into the economy, efficiency and effectiveness with which the Scottish Ministers and the Lord Advocate have used their resources in discharging their functions; and for carrying out or ensuring the carrying out of examinations into the economy, efficiency and effectiveness with which other persons determined under Scottish legislation to whom sums are paid out of the Fund have used those sums in discharging their functions.

Auditor General for Wales – the individual responsible for examining and certifying the accounts of the Welsh Government, its sponsored and other related public bodies, Welsh local government bodies and NHS Wales entities. The Auditor General for Wales is responsible for authorising the issue of public funds from the Welsh Consolidated Fund to Welsh Ministers and other public sector bodies. The Auditor General is also responsible for carrying out value for money work at those bodies.

Auditor's report – any auditor's report expressing an opinion on the truth and fairness, fair presentation or proper presentation of financial statements and, in specified cases, on the regularity of the financial transactions included in them and any other legal and regulatory requirements. In central government, the auditor's report may also be referred to as a Certificate.

Central government entities – defined as government departments and their executive agencies, any entity which operates as a trading fund (a government department, part of a department or an executive agency) and arm's length bodies. For the purposes of this Practice Note, central government does not include National Health Service bodies, local authorities, public corporations or nationalised industries.

Certificate[(1)] – the title of an audit report containing the opinion of the Comptroller and Auditor General, the Auditor General for Wales or the Comptroller and Auditor General for Northern Ireland on financial statements audited under statute where there is a statutory requirement for the examination to be certified, usually on the resource and other accounts produced by government departments (and on accounts produced by health entities in Wales and Northern Ireland). Use of the word "certificate" clearly differentiates the audit report from any other report of the Comptroller and Auditor General, Auditor General for Wales and the Comptroller and Auditor General for Northern Ireland.

Certificate[(2)] – the declaration by auditors under the Local Audit and Accountability Act 2014 that the audit of a local government or health entity has been completed in accordance with the Act. The certificate is normally, but not necessarily, incorporated in the audit report. A similar certificate is issued by local government auditors in Wales under the Public Audit (Wales) Act 2004 and by local government auditors in Northern Ireland under the Local Government (Northern Ireland) Order 2005.

Chief Executive – the title applied to the senior official of a public sector body, accountable for the management and operations of that agency.

Code of Audit Practice – any document identified as such, issued by a national audit agency or the relevant head of that agency, that prescribes the way in which the auditor is to carry out their functions in respect of the audits of specified entities, embodying what the national audit agency considers to be the best professional practice with respect to the standards, procedures and techniques to be adopted by the auditor.

Comptroller and Auditor General (the C&AG) – the head of the National Audit Office. As Comptroller, the C&AG's duties are to authorise the issue by HM Treasury of public funds from the Consolidated Fund and National Loans Fund to government departments and others; as Auditor General, the C&AG certifies the accounts of all central government departments and some other public bodies, and carries out value-for-money examinations.

Comptroller and Auditor General for Northern Ireland –the individual responsible for authorising the issue of public funds to Northern Ireland departments and other public sector bodies, for carrying out the audit of the financial statements of Northern Ireland central government and health entities (which includes satisfying themselves that expenditure and income have been applied in accordance with the Assembly's intentions and conforms to governing authorities) and for examining the economy, efficiency and effectiveness with which Northern Ireland central government entities have discharged their functions.

Contractor auditor – An auditor who has been engaged to undertake all or some of an auditor assignment on behalf of the statutory auditor under a contract or agreement.

Contracted-out engagement – An engagement where, although responsibility for issuing the audit report remains with the statutory auditor, all or some of the audit assignment is undertaken by another firm or auditor under contract or agreement.

Corruption – the offering, giving, soliciting or acceptance of any inducement or reward that may influence the actions taken by an entity, its members or its officers.

Firm- sole practitioner, partnership, limited liability partnership, or corporation or other entity of professional accountants engaged in the provision of engagements. In the public sector context, firm can also mean a national audit agency and local auditors.

Framework of Authorities – external frameworks, specific to the audited entity, with which the audited entity's transactions must conform. These frameworks are set up by bodies able to issue and/or enforce the authorities for that entity and might include, for example: authorising legislation; regulations issued under governing legislation; Parliamentary authorities (including budgetary laws); Government or related authorities.

Government Departments – these represent the top tier of central government, or equivalent, in each country. Parliament/Assembly provides money annually to each department to spend for purposes that are specified in Supply Estimates/Budget Act or equivalent. Each government department is headed by an Accounting Officer who is responsible to Parliament for the application and expenditure of the funds provided in the Supply Estimates.

Grant – payments made by departments to outside bodies to reimburse expenditure on agreed items or functions.

Health entities – individual corporate entities that are part of the National Health Service but that do not form part of a department or are constituted as executive agencies, arm's length bodies or public corporations. Includes NHS foundation trusts, NHS trusts and clinical commissioning group. In Wales, health entities are NHS Trusts and Local Health Boards. In Northern Ireland health entities are Health and Social Services Boards, Trusts and Special Agencies.

Legislation – Acts of Parliament and delegated or subordinate legislation including, for example, Welsh Measures, Statutory Instruments, or Rules and Orders issued by Ministers and submitted to Parliament. The term legislation also includes Regulations, Directives and Decisions issued by the European Council of Ministers and the European Commission.

Local auditors – Auditors of local public sector entities in England, such as local government bodies, appointed under the Local Audit and Accountability Act 2014.

Other responsibilities – any function, other than the audit of the financial statements and the giving of an opinion on regularity, that public sector auditors take on whether as a result of statutory prescriptions or direction by the relevant national audit agency.

National audit agency - one of the United Kingdom public audit agencies responsible for carrying out the audit of the financial statements of public sector bodies (the National Audit Office for the Comptroller and Auditor General, Wales Audit Office for the Auditor General for Wales, Audit Scotland for the Auditor General for Scotland and the Accounts Commission, and the Northern Ireland Audit Office for the Comptroller and Auditor General for Northern Ireland) and/or responsible for the appointment and regulation of auditors of public sector bodies;

The National Audit Office (NAO)- national audit agency which supports the Comptroller and Auditor General (the C&AG) in scrutinising public spending for Parliament.

Northern Ireland Audit Office (NIAO)- national audit agency which supports the Comptroller and Auditor General for Northern Ireland in fulfilling their responsibilities

Parliament – the United Kingdom Parliament and the Scottish Parliament, but not the National Assembly for Wales or the Northern Ireland Assembly.

Performance audit- work performed by the auditor in relation to the economy, efficiency and effectiveness of use of public funds. It may be also referred to as "value for money" work.

Public Audit Forum (PAF) – A consultative and advisory forum of the four national audit agencies in the UK designed to provide a focus for developmental thinking about public audit.

Public sector bodies – include bodies designated as public sector by the Office of National Statistics: government departments and their executive agencies; the Scottish Government, Welsh Government, the Northern Ireland

Executive and their sponsored and associated bodies; trading funds; arm's length bodies; local authorities and other local government bodies; National Health Service bodies; in Scotland, further education colleges and the water authority. It does not include other public corporations or the nationalised industries.

Regularity – a concept that transactions that are reflected in the financial statements of an audited entity must be in accordance with the relevant framework of authorities.

Responsible financial officer – the officer appointed by a local government entity to be responsible for the proper administration of its financial affairs.

Sponsor department – normally the department through which Parliamentary funding and accountability is conducted for arm's length bodies.

Statutory auditor – The auditor appointed to perform an engagement by statute. In this Practice Note the term statutory auditor is not used in the sense in which this is used in the Audit Directive and Regulation and related frameworks.

Tier – any level in a series of entities through which a grant is passed down from Parliament to the intended recipients. Top tier entities are usually government departments. Lower tier entities comprise agencies, arm's length bodies and non-central government sector organisations

Wales Audit Office – national audit agency constituted as a statutory board, which employs staff, secures and utilises other resources, including additional expertise from private sector accountancy firms, to enable the Auditor General for Wales to carry out his functions.