

PROPOSED PRACTICE NOTE 10: AUDIT OF FINANCIAL STATEMENTS OF PUBLIC SECTOR BODIES IN THE UNITED KINGDOM (REVISED)

INVITATION TO COMMENT

1. The Public Audit Forum (PAF)¹ 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.
2. PAF is now inviting comments on the accompanying exposure draft of revised PN 10 following agreement from the FRC to consult publicly on the proposed changes.

Background

3. PN 10 sets out how auditors of public sector bodies in England, Scotland, Northern Ireland and Wales apply auditing standards to their work on financial statements. The aim of the Practice Note is to support consistency in the application of auditing standards while also recognising the specific legislative and regulatory frameworks that apply to the audits of public sector bodies.
4. The Practice Note focuses on the audits of financial statements and so is not relevant to public sector audit work on, for example, arrangements to secure value for money in the use of resources. Such work is subject to specific requirements in relevant Codes of Audit Practice and other guidance issued by the public audit agencies across the UK.
5. The previous version of PN 10 was issued in 2010. In recent years, public sector audit has been subject to significant legislative and regulatory changes within the devolved administrations and in respect of local audit arrangements in England. Following initial discussions between all the relevant public audit agencies and with other key stakeholders, including the FRC, PAF has prepared the accompanying exposure draft to ensure that PN 10 is up-to-date and appropriately reflects the legislative and regulatory frameworks as well as public sector auditing practice across the UK.
6. The revised PN 10 reflects recent changes in the legislative and regulatory frameworks by:
 - removing references to the Audit Commission and referring to the new local audit arrangements that apply in England under the Local Audit and Accountability Act 2014;
 - updating, where appropriate, references to the Codes of Audit Practice issued by the national audit agencies which require public sector auditors to comply with auditing standards in their work on financial statements; and
 - making the guidance more principles-based and applicable to all public sector auditors, whether these are audit agencies or auditing firms.

¹ PAF comprises the heads of the national public audit agencies in the UK, which are the National Audit Office, Audit Scotland, the Northern Ireland Audit Office, and the Wales Audit Office.

7. The revised PN 10 also takes account of recent changes to auditing standards. The FRC issued revised auditing and ethical standards in June 2016 which are effective for audits relating to periods commencing on or after 17 June 2016. Therefore, 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.
8. PAF has also sought to avoid duplicating, as far as possible, the relevant auditing standards which auditors need to read alongside the Practice Note. However, to help make the Practice Note as useful as possible to practitioners, the objectives and public sector interpretations are included for context. The proposed PN 10 only includes material where this is relevant and where public sector specific guidance would help to support consistency in the application of the auditing standards.
9. A key aim of PN 10 is to provide guidance on auditors' work on regularity at certain public bodies. This work, where required, is linked to the audit of the financial statements but leads to an explicit, separate opinion on regularity which is included in the auditor's statutory report. Therefore, PAF has taken the opportunity to update PN 10 to reflect current practice across the UK 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.

Impact Assessment

10. As a Practice Note is guidance to support best practice, and is not prescriptive, PAF has not completed a separate impact assessment. This is because the revised Practice Note does not impact on the level of auditor's work-effort required, under auditing standards, and because the level of work effort required in relation to regularity, where this required, reflects existing practice and does not include additional procedures.

Invitation to comment

11. The accompanying exposure draft has two main parts:
 - Part 1: Application of International Standards on Auditing (UK and Ireland)
 - Part 2: The audit of regularity
12. While these parts provide the main content on which respondents to this consultation will wish to focus, it would also be helpful to have any other comments on the material in the proposed PN 10 including the glossary.
13. The annex to this consultation document includes a more detailed summary of the revisions to PN 10 together with the rationale for the specific changes that are being proposed.

14. You are invited to provide comments in response to the following consultation questions, but please add any other additional comments that you think it would be helpful for PAF to consider when finalising the proposed revisions to PN 10.

Consultation questions

Question 1

To reduce duplication, detailed information that is already included in relevant auditing standards (apart from the objectives and public sector interpretations retained for context), financial reporting frameworks and legislation have been taken out and referred to in the document. **Do you consider it is appropriate to remove this material and include only public sector specific guidance on the application of the ISAs (UK and Ireland) and the audit of regularity? If not, please describe in broad terms what other contextual information and guidance you would like to see and why such content would be an improvement?**

Question 2

The information on local audit and devolved administrations arrangements was updated to reflect changes in legislation and to refer to relevant Codes of Audit Practice. **Do you consider that the guidance in Part1: Application of International Standards on Auditing (UK and Ireland) is appropriate, sufficient and applicable to all parts of the public sector? If not, what changes would you like to see made and why?**

Question 3

This Practice Note was updated to reflect recent changes to the auditing standards. **Do you believe that the appropriate guidance is included in Part 1: Application of International Standards on Auditing (UK and Ireland) in relation to the application of the revisions to ISAs (UK and Ireland)? If not, what changes would you like to see made and why?**

Question 4

The section on the audit of regularity reflects existing practice in the public sector. **Do you consider that the guidance in Part2: The audit of regularity is appropriate, sufficient and applicable to all parts of the public sector? If not, what changes would you like to see made and why?**

Question 5

Are there any other changes you believe would be appropriate? If so, what changes would you like to see made and why?

Commenting on the proposals

PAF has established a project team to develop the revisions to PN 10. PAF's project team would prefer to receive letters of comment in an electronic form that facilitates "copy and paste". These may be sent by e-mail to PracticeNote10@public-audit-forum.org.uk. If this is not possible, please send letters of comment to the project director:

Practice Note 10 (Revised): Invitation to comment

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Letters of comment should be sent so as to be received no later than 5pm on 23 September 2016. All comments will be regarded as being on the public record unless otherwise requested.

ANNEX: KEY REVISIONS TO PRACTICE NOTE 10 AND RATIONALE FOR CHANGES

Reference	Key changes and rationale
Preface	<ul style="list-style-type: none"> • Scope updated to cover the audit of public sector bodies in the United Kingdom, as classified by the ONS • Reference to changes in the local audit and devolved administration arrangements • Reference to revised auditing standards and their effective date • Reference to revisions of part two: the audit of regularity to reflect current practice and regulatory framework • PAF stated as preparer of the PN 10, as designated by the FRC
Introduction	<ul style="list-style-type: none"> • Moved definitions to the glossary of terms • Removed duplication on the role of public sector auditors and rephrased the first paragraphs • Removed legislative framework/mandate and referred to information on PAF and audit agencies websites
Part 1: General	<ul style="list-style-type: none"> • Included a table summarising which ISAs are interpreted for the public sector • Included all guidance specific to the public sector from ISQC and ISAs (UK and Ireland). These are clearly referenced and have grey background. • Moved all definitions to glossary of terms • Moved all regularity guidance to Part 2: The audit of regularity
Part 1: ISQC 1	<ul style="list-style-type: none"> • Expanded guidance on contracted-out arrangements and engagements on an 'appointment by' basis and moved relevant content to these sections from other parts of ISQC 1 guidance • Updated confidentiality guidance to align with FOI legislation • Replaced references to the Audit Commission with relevant local audit arrangements
Part 1: ISA 200	<ul style="list-style-type: none"> • Only changes indicated in Part 1: General
Part 1: ISA 210	<ul style="list-style-type: none"> • Removed section on preconditions for an audit as the guidance was not specific to public sector and legislative mandate was already mentioned in this chapter • Revised sections on central government and local government & health entities- combined and made more high level to reduce duplication and unnecessary content • Annex included as a separate section ("area that may be covered in a letter of engagement or understanding"). "Other services" phrase expanded for consistency with ISAs.
Part 1: ISA 220	<ul style="list-style-type: none"> • Engagement Quality Control Review guidance was included in the ISQC 1 section as it covers the same requirements.
Part 1: ISA 230	<ul style="list-style-type: none"> • Removed as guidance was not public sector specific and is already contained in ISAs which are followed by auditors who apply this Practice Note.
Part 1: ISA 240	<ul style="list-style-type: none"> • Moved section on "fraud in the context of the regularity opinion" to part two: the audit of regularity • Moved reporting sections to the bottom to align with the audit process. • Guidance on fraud responsibilities and reporting to third parties provided detailed information specific to individual audit agencies-

	revised guidance to make it more high level and applicable to all public sector auditors
Part 1: ISA 250A	<ul style="list-style-type: none"> Removed few paragraphs that were not public sector specific Revised the section on compliance with laws and regulations as it included information that is very specific to individual agencies- made more high level
Part 1: ISA 260	<ul style="list-style-type: none"> Replaced all references to the Audit Commission to reflect implementation of new arrangements under the Local Audit and Accountability Act 2014
Part 1: ISA 265	<ul style="list-style-type: none"> Only changes indicated in Part 1: General
Part 1: ISA 300	<ul style="list-style-type: none"> Removed the section on ISA 300 as it wasn't public sector specific. A section on regularity was included in part two- the audit of regularity
Part 1: ISA 315	<ul style="list-style-type: none"> Removed the section on financial reporting framework as it is not the role of Practice Note 10 to determine these. Frameworks are determined by relevant legislation. Removed examples of additional factors significant risks as most of these are not specific to public sector (e.g. fixed assets valuations). These are covered already in ISA (UK and Ireland) 315.
Part 1: ISA 320	<ul style="list-style-type: none"> Removed an overview of materiality as it is not public sector specific Regularity considerations were moved to part two of PN 10.
Part 1: ISA 330	<ul style="list-style-type: none"> Only changes indicated in Part 1: General
Part 1: ISA 402	<ul style="list-style-type: none"> Removed detail on legislation in respect of right of access as it is already referred to in previous paragraphs that some entities might have statutory access established by legislation.
Part 1: ISA 450	<ul style="list-style-type: none"> Added section due to public sector specific references in ISA 450
Part 1: ISA 500	<ul style="list-style-type: none"> Moved guidance to part two on regularity
Part 1: ISA 505	<ul style="list-style-type: none"> Removed section as it is covered already by standards and is not public sector specific
Part 1: ISA 510	<ul style="list-style-type: none"> Table on the impact of Machinery of Government changes was included as text rather than a table.
Part 1: ISA 520	<ul style="list-style-type: none"> Removed examples for administrative and programme expenditure as central government entities in the UK no longer present these separately. Guidance in ISAs on data relationships is equally applicable to the public sector.
Part 1: ISA 540	<ul style="list-style-type: none"> Only changes indicated in Part 1: General
Part 1: ISA 550	<ul style="list-style-type: none"> Only changes indicated in Part 1: General
Part 1: ISA 560	<ul style="list-style-type: none"> Only changes indicated in Part 1: General
Part 1: ISA 570	<ul style="list-style-type: none"> Removed parts on requirements of the financial reporting framework as the role of this Practice Note is not to determine reporting requirements for public sector bodies Removed annex with examples of reports where going concern affects the audit opinion. This is already covered in existing guidance and requires auditor's judgment rather than prescriptive rules. Added a section on value for money arrangements, where these impact on the going concern
Part 1: ISA 580	<ul style="list-style-type: none"> Only changes indicated in Part 1: General
Part 1: ISA 600	<ul style="list-style-type: none"> Removed guidance on assessing the competence of a component as it was already covered by principles of ISA 600 and was not technically specific to public sector entities Added guidance on group and component materiality

Part 1: ISA 610	<ul style="list-style-type: none"> Removed roles and responsibilities of internal audit as this is specified in guidance for preparers of the accounts and internal audit standards rather than this Practice Note.
Part 1: ISA 620	<ul style="list-style-type: none"> Included guidance as there was public sector specific paragraph in ISA 620 Provided public sector context for the ISA paragraph
Part 1: ISA 700	<ul style="list-style-type: none"> Added sections on extended auditor reporting (includes communication of key audit matters) to align with recent revisions to the reporting standards (ISA 700 series) Removed guidance specific to individual agencies as it is covered by principles set out in this practice note and are for individual auditors to determine, e.g. addressee of the auditor's report, responsibilities of management and those charged with governance, applicable financial reporting framework
Part 1: ISA 706	<ul style="list-style-type: none"> Included guidance on inability to withdraw from statutory engagement in relation to Other Matter paragraph
Part 1: ISA 720	<ul style="list-style-type: none"> Removed references to Accounts Direction specific to each entity as it is not a role of this Practice Note to determine these Referred to the "consistency statement" as "consistency opinion" Removed guidance on dealing with inconsistencies as it is not public sector specific and is covered in ISA (UK and Ireland) 720 Replaced information specific to health entities with a more high level guidance on issuing a consistency opinion on information published separately to financial statements
Part 2: General	<ul style="list-style-type: none"> Moved all regularity guidance from part 1 Regularity referred to as a separate audit opinion rather than assertion Amended some headings and combined some sections of the guidance
Part 2: Introduction	<ul style="list-style-type: none"> Included introduction to set out which sections are covered by part 2 Provided an overview of additional responsibilities of public sector auditors in respect of use of public funds.
Part 2: The concept of regularity	<ul style="list-style-type: none"> Amended the definition of regularity and framework of authorities so that it is applicable to all public sector audits and is more principles-based Removed repetition on accountability of public sector entities
Part 2: Related concepts	<ul style="list-style-type: none"> Removed reference to PAF guidance from 2001 as it might be too out of date and does not need to be referenced here Rephrased few sentences to avoid the repetition and use plain English Removed reference to Managing Public Money as it's central government specific Included laws and regulations as a related concept- ISA 250A (Part 1)
Part 2: Overview	<ul style="list-style-type: none"> Removed repetition of ISA 250 Rephrased the bullet point on testing regularity to make it applicable to all public sector audits- more principles-based Moved some parts of guidance that provide a good overview of the audit of regularity
Part 2: Understanding the entity and its environment	<ul style="list-style-type: none"> Removed guidance that is very detailed and specific to central government entities (e.g. supply)- rephrased to cover this through high-level principles rather than prescriptive rules

Part 2: Understanding the entity's internal controls	<ul style="list-style-type: none"> • Rephrased the first paragraph to avoid repetition • Removed some examples as these might have been misinterpreted as controls, e.g. guidance set out in financial memoranda • Removed part on internal audit as it is already covered in section on using the work of others
Part 2: Materiality	<ul style="list-style-type: none"> • Removed references to excess votes and replaced by a principle that certain balances or types of transactions might require a lower level of materiality depending on the interest of users of the accounts.
Part 2: Risk of material irregularity	<ul style="list-style-type: none"> • Included a reference to ISA 320 • Removed repetition (first paragraph) • Moved examples of risk factors and mitigating controls from appendix into this section
Part 2: Audit procedures	<ul style="list-style-type: none"> • Included a reference to ISA 330 • Rephrased second paragraph as assumed that controls are in place over significant risks • Aligned with ISAs in relation to sufficient and appropriate evidence and that controls need to prevent or detect and correct material irregularities • Removed guidance on Statement of Parliamentary Supply and Excess Votes as it is very specific to central government and can be covered through the rest of the guidance (does not require unique treatment)
Part 2: Areas requiring special consideration	<ul style="list-style-type: none"> • Removed reference to auditor's role to challenge government in respect of enacting legislation on new EU Directives • Fees and charges- rephrased to make it more high-level as include too much detail on reporting arrangements rather than audit • Rephrased the section on disclosures to make it relevant to all public sector auditors, not just audit of central government entities
Part 2: Written representations	<ul style="list-style-type: none"> • Rephrased slightly to refer to all public sector auditors
Part 2: Using the work of others	<ul style="list-style-type: none"> • Combined few chapters to make guidance more succinct • Simplified the guidance to make it relevant to all public sector auditors • Removed repetition and parts included already in other guidance (e.g. first paragraph, legal advice, auditor's expert) • Removed the reference to auditor asking the entity to consult with the relevant authorising bodies- it is not the auditor's role to enforce this • Added a section on group regularity opinion where consolidated bodies have a different framework of authorities
Part 2: Evaluating irregularities	<ul style="list-style-type: none"> • Removed repetition on fraud and reporting to relevant bodies and group management • Removed health specific section on unlawful expenditure- covered by principles in the rest of the section
Part 2: Risk of fraud	<ul style="list-style-type: none"> • Simplified the guidance and removed repetition • Removed description of ISA 240 and key requirements of this ISA- it's already covered in part 1 and there is no regularity specific guidance
Part 2: Regularity opinion	<ul style="list-style-type: none"> • Removed the table as it duplicates what is in legislation- auditors affected by this legislation will already be aware of the requirements and the impact on their mandate and will not need to refer to this Practice Note to guide them on this
Part 2: Reporting	<ul style="list-style-type: none"> • Removed reference to Parliamentary Committees as this is specific only to certain public sector auditors

	<ul style="list-style-type: none"> • Replaced guidance on Excess Votes and reporting on public interest in Wales with more high-level guidance applicable to all bodies • Moved few paragraphs from other sections on regularity as they covered reporting.
Appendix 1: Glossary of terms	<ul style="list-style-type: none"> • Removed several definitions as these are no longer stated in the guidance or are too generic (e.g. excess vote, entity) • Updated few definitions, e.g. on regularity and framework of authorities • Moved definitions from different sections of PN 10, e.g. introduction, application of ISAs • Added new definitions as a result of revisions to the PN 10
Other appendices	<ul style="list-style-type: none"> • 2010 version of PN 10 had two other appendices on legislative framework and risk factors in relation to regularity • The appendix on legislative framework was removed as the introduction refers to legislation and information on audit agencies and PAF websites. Users of PN 10 would already be aware what legislation specifies their mandate, local auditors have specific instruction in the Code of Audit Practice that they can refer to, if needed • The appendix on risk factors on regularity was integrated into part 2: the audit of regularity