

## PRACTICE NOTE 10: AUDIT OF FINANCIAL STATEMENTS AND REGULARITY OF PUBLIC SECTOR BODIES IN THE UNITED KINGDOM (REVISED 2022)

### INVITATION TO COMMENT

**Deadline for response: Friday 16 September 2022**

Mae'r ddogfen hon hefyd ar gael yn Gymraeg | This document is also available in Welsh.

### INTRODUCTION

1. The Public Audit Forum (PAF)<sup>1</sup> 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 and Regularity of Public Sector Bodies in the United Kingdom* (PN 10). Under 'SORP-making body' arrangements, the 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. The PAF is now inviting comments on the accompanying exposure draft of the 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. PN 10 also provides guidance on the approach to the audit of regularity.
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. PN 10 was last revised in 2020 and there is a need to ensure the Practice Note is updated to take account of changes to International Standards on Auditing (UK) (ISAs (UK)):
  - a. ISA (UK) 240 (Revised May 2021) *The auditor's responsibilities relating to fraud in an audit of financial statements* comes into effect for audits of financial statements for periods commencing on or after 15 December 2021 (equating to the 2022-23 financial year for most public sector bodies).
  - b. ISA (UK) 315 (Revised July 2020) *Identifying and assessing the risks of material misstatement* comes into effect for audits of financial statements for periods commencing on or after 15 December 2021 (equating to the 2022-23 financial year for most public sector bodies). The existing material on this standard in the 2020 version of PN 10 has been expanded to include

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<sup>1</sup> The Forum's members are Audit Scotland, Audit Wales, the National Audit Office (NAO) and the Northern Ireland Audit Office (NIAO).

additional examples of inherent risk factors that may be particularly relevant to public sector entities.

- c. Systems of quality management in compliance with ISQM (UK) 1 *Quality management for firms that perform audits or reviews of financial statements, or other assurance or related services engagements* are required to be designed and implemented by 15 December 2022. The evaluation of the system of quality management required by paragraphs 53-54 of ISQM (UK) 1 is required to be performed within one year following 15 December 2022.
  - d. Changes have been made to the draft PN 10 (2022) to reflect the updated standards.
6. The section on ISA (UK) 320 (Revised June 2016) *Materiality in planning and performing an audit* has been expanded to include additional guidance and examples for situations applicable to public sector entities, including where the value of gross assets and/or liabilities is much higher than the value of total expenditure and income and where misstatements of lesser amounts than materiality for the financial statements as a whole could reasonably be expected to influence the decisions of users taken on the basis of the financial statements.
7. The section on ISA (UK) 570 (Revised September 2019) *Going concern* includes additional material which reiterates that, for entities for which the financial reporting framework provides for the adoption of the going concern assumption on the basis of the anticipated continuation of the provision of a service in the future:
  - a. the continued existence and funding, or otherwise, of the audited entity is not, in itself, relevant to the auditor's work on going concern; and
  - b. uncertainty regarding the future existence and/or funding of the audited entity does not create a material uncertainty related to going concern for such entities, provided that this uncertainty does not also extend to the future delivery of the services.
8. A new section has been added in Part 1 providing guidance on applying the FRC's Revised Ethical Standard 2019 in the public sector.
9. Part 2 also includes additional guidance on determining a materiality threshold for the regularity opinion.
10. Following on from this 2022 revision, the PAF intends to keep PN 10 under regular review to consider each year whether any further revisions are needed as a result of new standards and developments in auditing practice:
  - a. ISQM (UK) 2 *Engagement quality reviews* and ISA (UK) 220 (Revised July 2021) *Quality management for an audit of financial statements* are effective for periods beginning on or after 15 December 2022 (equating to audits of 2023-24 financial statements for most public sector bodies).
  - b. The FRC published the exposure draft of the revised ISA (UK) 600 *Special considerations – audits of group financial statements (including the work of component auditors)* in April 2022. It is proposed to be effective for audits of group financial statements for periods beginning on or after 15 December 2023 (equating to audits of 2024-25 financial statements for most public sector bodies).
11. Further iterations of PN 10 will respond to future changes in standards as appropriate.

## IMPACT ASSESSMENT

12. As a Practice Note is guidance to support best practice, and is not prescriptive, the 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, is in line with existing practice.

## INVITATION TO COMMENT

13. The accompanying exposure draft has two main parts:
  - Part 1: Application of auditing, quality management and ethical standards
  - Part 2: The audit of regularity
14. 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.
15. The Annex to this consultation document includes a more detailed summary of the proposed revisions to PN 10.
16. 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 the PAF to consider when finalising the proposed revisions to PN 10.
17. Comments from all interested parties are welcomed. The PAF particularly invites comments from those representing users of public sector financial statements.

## CONSULTATION QUESTIONS

**Question 1:** This version of Practice Note 10 includes changes to the section on ISA (UK) 320 (Revised June 2016) *Materiality in planning and performing an audit* concerning the determination of materiality for the financial statements as a whole and the materiality level(s) to be applied to specific classes of transactions, account balances or disclosures for which misstatements of lesser amounts than materiality for the financial statements as a whole could reasonably be expected to influence the decisions of users taken on the basis of the financial statements. Further guidance is also provided in Part 2 on the determination of a separate materiality threshold for the regularity opinion. **Do you consider the revised draft provides appropriate and useful guidance on applying materiality to the audit of public sector financial statements and regularity? What changes should be made, if any?**

**Question 2:** The previous section on ISQC (UK) 1 has been replaced by guidance on applying ISQM (UK) 1 in the public sector, including for contracted-out audits. **Does this section provide appropriate and useful guidance on quality management arrangements for statutory and contractor auditors of public sector entities? What changes should be made, if any?**

**Question 3:** The section on ISA (UK) 315 includes additional examples of inherent risk factors that may be particularly relevant to public sector entities. **Are these example inherent risk factors relevant to public sector audits and do they encompass the common areas of inherent risk that are particular to public sector entities?**

**Question 4:** The section on the audit of regularity reflects existing practice in the public sector. **Do you consider that the guidance in Part 2: 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:** The consultation draft includes other changes, as outlined in the Annex below. **Do the other changes that have been proposed contribute to the objective of providing useful and appropriate guidance for public sector auditors? If not, how could these be improved?**

**Question 6:** **Are there any other changes you believe would be appropriate? If so, what changes would you like to see made and why?**

**Question 7:** The Auditor General for Wales and the Wales Audit Office are required to comply with Welsh Language Standards that provide for the Welsh language not to be treated less favourably to the English language in Wales and for individuals to be able to access public services in Wales though the Welsh or English languages. **Do you consider there to be anything in this consultation draft that undermines these requirements? Do you consider there is any revision that could be made to support the use of the Welsh language?**

## COMMENTING ON THE PROPOSALS

18. 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](mailto:PracticeNote10@public-audit-forum.org.uk)

or

[NodynYmarfer10@public-audit-forum.org.uk](mailto:NodynYmarfer10@public-audit-forum.org.uk)

19. Responses should be sent so as to be received **no later than 5pm on Friday 16 September 2022**. All comments will be regarded as being on the public record unless otherwise requested. The PAF intends to publish the text of responses to this consultation, including the names of the organisations or individuals submitting responses, on its website, <https://www.public-audit-forum.org.uk/>.
20. Consultation responses may be provided in either English or Welsh.

## ANNEX: SUMMARY OF CHANGES FROM 2020 VERSION

| Section       | Updates   |
|---------------|---|
| General       | <p>Removed some paragraphs that are verbatim quotations of material from ISAs (UK).</p> <p>Minor typographical and formatting changes.</p> <p>Paragraph numbering has been updated.</p>   |
| Contents page | Updated for other content changes.  |
| Preface       | Amended commentary on the updates made since the previous revision of PN 10.  |
| <b>Part I</b> |   |
| Name          | Name of Part I changed to 'Application of auditing, quality management and ethical standards'.  |
| ISQM (UK) I   | <p>Amended previous material on ISQC (UK) I to reflect the replacement standard, ISQM (UK) I.</p> <p>Added guidance on how contracted-out engagements are included in quality management arrangements.</p> <p>Clarified that contractor auditors are 'service providers' under ISQM (UK) I and suggested contractor auditors provide statutory auditors with a service provider report on their system of quality management.</p> <p>Made more definitive the existing reference that statutory auditor "may" obtain assurance over quality from contractors.</p> <p>Added guidance on actions to be taken by a statutory auditor where they identify deficiencies in the contractor auditor's work.</p> <p>Amended guidance on determining whether an engagement quality review is an appropriate response to quality risks for large public sector entities with a high public profile.</p> <p>Added guidance on the application for national audit agencies of requirements for those ultimately and operationally responsible for the system of quality management.</p> |
| ISA (UK) 240  | <p>Amended material to reflect the May 2021 revision of the standard.</p> <p>Added guidance on the interaction between fraud and regularity responsibilities and terminology.</p>   |
| ISA (UK) 315  | <p>Amended material to reflect the July 2020 revision of the standard.</p> <p>Added examples of inherent risk factors that may be particularly relevant to public sector entities.</p> <p>Extended existing guidance on the situation where entities are required to work to annual limits on resources to cover additionally capital spending and misclassification risks.</p>   |
| ISA (UK) 320  | Expanded the guidance and illustrative examples on determining the materiality level or levels to be applied to particular classes of transactions, account balances or disclosures for which misstatements of lesser amounts than  |

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|---|---|
|   | <p>materiality for the financial statements as a whole could reasonably be expected to influence the decisions of users taken on the basis of the financial statements.</p> <p>Highlighted the presence of examples in ISAs (UK) of situations when the auditor's evaluation of what items are material may vary between different areas of the financial statements.</p> <p>Added commentary on the situation where public sector entities have gross assets and/or liabilities whose value is much higher than the value of total expenditure and income.</p> |
| ISA (UK) 570                            | <p>Added paragraphs clarifying that, for auditors applying the 'continued provision of service approach, risk assessment procedures and evaluation of management's assessment on going concern are based on the continued delivery of services, not on the continued existence and funding of the audited entity.</p> <p>Clarified that uncertainty regarding the future existence and or funding of the audited entity that does not extend to future delivery of services does not create a material uncertainty related to going concern.</p>                |
| ISA (UK) 600                            | <p>Added the option to apply the existing guidance on identifying those charged with governance for combined financial statements of components with no parent to other types of group audit where the identity of those charged with governance is unclear.</p>  |
| Revised Ethical Standard 2019           | <p>Added a new section at the end of Part I on the FRC Revised Ethical Standard 2019.</p>   |
| <b>Part 2</b>                           |   |
| Materiality for the audit of regularity | <p>Added examples of situations when the auditor may, depending on their professional judgement, determine a different materiality threshold for the audit of regularity from that for the financial statements as a whole.</p>   |