

Public Audit Forum (PAF) Consultation

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

Deadline for response: Friday 16 September 2022

INVITATION TO COMMENT

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?

The principles in I-88 are consistent with the ISA.

Para I-84 - references A2, but should this be to A3?

Para I-85. References A9 - but is this correct (refers to Considerations Specific to Small Entities). Should this be to A10?

What changes should be made, if any?

Example 5 should be more specific on why the auditor determined materiality for the financial statements as a whole using gross assets as a benchmark, i.e. their determination of what is important to the expected main users of the financial statements. If the day-to-day decision making focuses on I&E, why would the auditor determine materiality using gross assets?

The example indicates a higher materiality for specific accounts, property plant and equipment, and then a lower level for the majority of other account balances like income and expenditure and other assets and liabilities.

This feels out of line with the spirit of ISA (UK) 320 where the auditor sets an overall materiality level based what they consider to be material to the main users of the financial statements in the context of the organisation, and then identifies specific accounts or disclosures for which misstatements of a lesser amount than PM or TE have a reasonable possibility of influencing the economic decisions of the users of the financial statements. The ISA refers to specific circumstances of the entity, where there is

one or more particular classes of transactions, account balances or disclosures, with para A11 providing specific examples. Example 5 in the PN would be clearer if it included a specific example rather than “most or all expenditure and income transaction streams” and “assets or liabilities in respect of which management decisions are more frequently made” which indicates these are not specific circumstances.

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?

We have no comments on the section providing guidance on applying ISQM (UK) 1 in the public sector.

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?

We agree that the inherent risk factors set out in the section on ISA(UK) 315 are relevant to public sector audits and encompass common areas of inherent risk. We do, however, suggest the following refinements to some of the examples given:

- In the third bullet point under the ‘Subjectivity’ subheading we would suggest expanding the last sentence so that it reads “the extent to which public bodies recognise liabilities for possible obligations and are willing to disclose the level of detail required to meet the accounting standards” as, in our experience, there is often more sensitivity about the nature of information being included within narrative disclosures than following the prescribed accounting treatment.
- In respect of the final bullet point under ‘Subjectivity’, our experience suggests that a depreciated replacement cost valuation methodology is sometimes less subjective than a fair value or existing use value methodology. The subjectivity often arises in the choice of valuation methodology for a particular asset and whether the entity has chosen an appropriate valuation methodology for the asset. This could be made clearer in this final bullet point.
- In paragraph I-80 we would suggest adding “direction from controlling bodies” as an inherent risk factor. This is particularly relevant in local public audit, where we often see directions from the relevant government department to help manage the overall national position.
- In I-79 “Susceptibility to misstatement due to management bias or other fraud risk factors insofar as they affect inherent risk Inherent risks”, should the concept of maintaining accurate ‘ringfencing’ in large/complex organisations with multiple functions be added? Is there a risk of confusing the various pots of funds and maintaining the accurate separations, e.g. applying HRA balances to fund general fund services?

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?

We consider the guidance in Part 2 to be appropriate and sufficient to address our responsibilities in local public audit, but we are unable to comment on how appropriate, sufficient, and applicable it is to all parts of the public sector.

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?

We have no comments on the other changes. The other changes provide useful and appropriate guidance for public sector auditors.

Question 6:

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

We have not identified any other changes.

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 through 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?

No comment.