

## Public Sector Audit Appointments Ltd - Response to the Public Audit Forum (PAF) Consultation on PN10, Audit of Financial Statements of Public Sector Bodies in the UK (revised)

PSAA Ltd welcomes the opportunity to respond to the APB's consultation on 'Practice Note 10 – Audit of Financial Statements of Public Sector Bodies in the UK (revised)'.

PSAA is specified as an appointing person under the provisions of the Local Audit and Accountability Act 2014, with responsibility for appointing auditors to eligible English principal authorities (local authorities, local police bodies, fire authorities and other local government bodies) that have chosen to opt into our national auditor appointment scheme. At 31 March 2022, 467 of the 476 eligible bodies (98%) had opted into PSAA's national auditor appointment arrangements for 2021/22. Our next appointing period covers the audits of 2023/24 to 2027/28, and 470 out of 475 eligible bodies (99%) have opted in. We are well placed to comment on issues concerning bodies opted into our scheme where appropriate.

Our response to the previous PN10 consultation in 2020 welcomed the PAF's commitment to more regular reviews. Given the turbulent state of local audit and audit in general, we are pleased to note that the PAF is following through on that commitment.

We note that the FRC stated in its 'position paper' (in July 2022) that '*Building on the success of Practice Note 10 for the Central Government Sector, by consulting on proposals for a specific practice note for local public audit in England*' is a priority for its local audit role. Whilst we welcome the consideration of a Local Audit specific PN, we encourage the PAF to make clear when it issues this updated version of PN 10 that it applies to Local Audit in order to avoid any perception that it covers only Central Government.

We also encourage the PAF to consider whether it would be appropriate alongside the revised PN10 to provide observations and/or guidance on the timeliness of audits. Whilst the timeliness issue has manifested most starkly in English local government audit, there are signs of stress elsewhere in the audit environment, and there is a risk to the reputation of public audit in general.

**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?**

We welcome the addition of example 5 (page 35) in particular, as we believe that it has the potential to enable local government auditors to tailor their audit programmes more to the sector's circumstances. The example recognises that auditors need the flexibility to adapt their approach to materiality at bodies that are revenue driven but asset heavy, especially where significant elements of those assets are held to provide public services rather than for commercial reasons. A singular revenue driven materiality level can be viewed as overly sensitive when applied to capital balances, resulting in changes in capital figures that are labelled as material (and therefore must be made to avoid a modified opinion) but actually are likely to have limited relevance/impact for the user. It is particularly frustrating for local

government as the practical impact of the 'material' changes is limited by statutory design of the accounting framework itself (eg statutory overrides). The primary interest of local taxpayers and users of the body's services (who are arguably by default the closest proxy for shareholders) is the underlying financing of the authority's expenditure.

We stress that we recognise the importance of proportionate audit consideration of all balance sheet items. Rather, we believe that example 5 is very much in line with DLUHC's statement in its Spring Update (May 2021);

*'...we also want the new system leader, as well as existing stakeholders, to look at whether there are opportunities to reduce some of the accounting and audit requirements where these relate to areas of less risk to local bodies. The intention would be to ensure that local authority accounts and the statutory audit are proportionate, noting that they need to be consolidated into the Whole of Government Accounts, prepared in accordance with International Financial reporting Standards, and meeting the necessary standards of reporting and scrutiny.'*

*Paragraph 56 - Local authority financial reporting and external audit: Spring update*

It is important that if example 5 is included in the updated PN10, then the auditors and the regulators and other users, such as HMT for WGA purposes, agree how the new flexibility can be applied in order to give the auditors confidence that they can apply a more flexible approach without incurring undue regulatory risk. In this context it may be helpful if there is a narrative alongside example 5 that sets out how the PAF envisages that it could be applied in practice. It is also important that there is a plan as to how audited bodies will be informed of the change and the impact it will have on their preparations for their audit.

**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 note that the consultation states that detailed guidance on ISQM will follow in a future version of PN10. For this version it would be helpful to clarify the ISQM position in respect of appointments made by PSAA as the Appointing Person, either within or alongside the existing 'appointments by' section. Firms that we appoint have the responsibility for implementing the ISQM requirements, but unlike the national audit agency examples used, PSAA does not oversee audit quality.

**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 welcome the additional consideration given to the public sector environment. The consultation rightly recognises that

*'Incentives or pressures may exist in public sector entities that are not present in other sectors (or present to a lesser extent) that create susceptibility to intentional or unintentional failure by management to maintain neutrality in preparing information.'*

In our view it would be appropriate for PN10 also to recognise that incentives or pressures that may exist in other sectors may not be present in public sector entities. The auditor's risk assessment should be properly tailored for the sector under consideration. The second bullet on page 32 of the consultation recognises that private sector may be more focused on

profitability/solvency, but this is less compelling than stressing that public sector bodies may be less focused on these areas – for example in local government the body has little or no incentive to inflate or deflate the value of assets due to the impact of different valuations being limited or eliminated by statutory overrides. There is a danger that in the absence of clear recognition of this in PN 10 then a public sector auditor may consider that there is a regulatory need to apply both private and public sector risk factors, whereas the auditor should be able to tailor their assessment in full to the individual body's circumstances.

**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?**

No comment

**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?**

No comment

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

No comment

**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