

PRACTICE NOTE 10: ANNUAL REVIEW REPORT TO THE FRC 2023

INTRODUCTION

1. The Public Audit Forum (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 and Regularity of Public Sector Bodies in the United Kingdom* (PN 10).
2. PN 10 sets out how auditors of public sector bodies in England, Scotland, Northern Ireland and Wales apply auditing, quality management and ethical standards to their work on financial statements. The aim of the Practice Note is to support consistency in the application of these 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.
3. Under paragraph 58 of the FRC's [Policy on developing statements of recommended practice \(SORPs\) \(January 2021\)](#) (the FRC Policy), SORP-making bodies are required to review, on an annual basis, the SORP for which they are responsible. As a minimum, a SORP-making body shall consider:
 - (a) any implications for the SORP of new and proposed accounting, auditing or actuarial standards – any divergence should be notified to the FRC as soon as possible;
 - (b) any evidence of widespread or significant failure in the relevant industry or sector to follow any part of the guidance contained in the SORP, of which the SORP-making body is aware;
 - (c) any developments in the industry or sector which suggest that further guidance in respect of their accounting, auditing or actuarial treatment is desirable; and
 - (d) any new or emerging factors that may impact the continued need for the SORP.
4. This document is the PAF's account of the findings of its annual review for 2023 that is required to be provided to the FRC under paragraph 59 of the FRC Policy. It has been prepared by the Standing Group established by the PAF for the purpose of carrying out the PAF's functions as the SORP-making body for PN 10 (hereafter called the Standing Group).
5. Under paragraph 60 of the FRC Policy, the account shall include:
 - (a) the current membership of the standing groups, including length of service and any steps taken to periodically refresh the membership;
 - (b) details of any changes made to the governance arrangements of the SORP-making body;
 - (c) the process and actions taken by the SORP-making body to engage with stakeholder groups; and
 - (d) whether the SORP-making body proposes to revise any of the SORPs for which it is responsible in the light of the findings of its annual review.

6. In carrying out the annual review, the Standing Group has complied with the FRC *Policy* as set out below and continues to be committed to acting in accordance with it.

MEMBERSHIP OF THE STANDING GROUP

7. Each of the public audit bodies that are members of the PAF (Audit Scotland, Audit Wales, the National Audit Office and the Northern Ireland Audit Office) have nominate one representative to be a member of the Standing Group. The National Audit Office has also nominated an additional member to provide secretarial functions for the Standing Group.
8. The following list indicates the length of service of members of the Standing Group:
 - i. Representative from Audit Scotland: since March 2023
 - ii. Representative from Audit Wales: since October 2019
 - iii. Representative from the National Audit Office: since October 2019
 - iv. Representative from the Northern Ireland Audit Office: since October 2022
9. The Standing Group's terms of reference require the technical director of each respective public audit body, who make nominations to the Standing Group, to have regard to the length of service of the current members and the need for membership to be periodically refreshed.

GOVERNANCE ARRANGEMENTS OF THE STANDING GROUP

10. There have been no changes made to the governance arrangements of the SORP-making body since the establishment of its [terms of reference](#) in 2021.

ENGAGEMENT WITH STAKEHOLDER GROUPS

11. As part of the process for issuing the 2022 revision of PN 10, the PAF carried out a public consultation on the exposure draft of the revised PN 10, the results of which are available on the PAF website [here](#).
12. The Standing Group also established a 'task and finish' group made up of members of major private sector firms that carry out audits of public sector entities. Standing Group members met with these representatives to seek private sector firms' views on the PAF's proposals at various stages through the development of the 2022 revision of PN 10 prior to the public consultation. Members of the group provided comments on the draft Practice Note and engaged in wider discussions regarding matters relevant to audits of public sector entities.
13. Members of the Standing Group also regularly meet with representatives of the firms and discuss their public sector audit work. For example, in March 2023, the Standing Group's National Audit Office representative joined the NAO's Local Audit Code and Guidance team in a meeting with the firms to discuss their reflections on the PN 10 guidance on applying ISA (UK) 320 *Materiality in planning and performing an audit* in the context of local authority audits.

14. In addition, PAF members have engaged with preparers in central government regarding issues addressed by PN 10.
15. The results of these consultations have been taken into account in carrying out the annual review.

IMPLICATIONS OF NEW STANDARDS

16. Quality management

- i. ISA (UK) 220 (Revised July 2021) *Quality management for an audit of financial statements* is effective for audits of financial statements for periods beginning on or after 15 December 2022 (equating to the 2023-24 financial year for most public sector bodies).
- ii. ISA (UK) 220 deals with the specific responsibilities of the auditor regarding quality management at the engagement level for an audit of financial statements, and the related responsibilities of the engagement partner.
- iii. The 2022 revision of PN 10 does not include any specific guidance on applying ISA (UK) 220 in the context of public sector audits.
- iv. ISA (UK) 220 (Revised July 2021) is premised on the basis that the audit organisation adopting the standard is subject to International Standards on Quality Management (ISQMs) (UK) or to national requirements that are at least as demanding, including the design, implementation and operation of a system of quality management. The 2022 revision of PN 10 includes guidance on applying ISQM (UK) 1 to public sector audits. ISQM (UK) 2 is discussed in the following section of this report.
- v. The PAF has considered whether further guidance would be helpful in light of the amendments made within the revised ISA (UK) 220.
- vi. The PAF considers that ISA (UK) 220 (Revised July 2021) can be applied to audits of public sector bodies without further guidance beyond that already included in relation to engagement quality reviews, so does not intend to make any revisions to PN 10 in relation to this standard.

17. Engagement quality reviews

- i. ISQM (UK) 2 (Updated March 2023) *Engagement quality reviews* is effective for audits and reviews of financial statements for periods beginning on or after 15 December 2022 (equating to the 2023-24 financial year for most public sector bodies) and for other assurance related services engagements beginning on or after 15 December 2022.
- ii. ISQM (UK) 2 deals with the appointment and eligibility of the engagement quality reviewer and the engagement quality reviewer's responsibilities relating to the performance and documentation of an engagement quality review.
- iii. ISQM (UK) 2 does not change or incorporate the criteria for the circumstances under which an engagement should be subject to an engagement quality review (guidance in relation to which is already included in paragraphs 1-23 and 1-25 of the 2022 revision of PN 10), but

instead focuses on the process for appointing engagement quality reviewers, the eligibility criteria for appointment and the process of performing, documenting and concluding the engagement quality review. Paragraph 1-24 of the 2022 revision of PN 10 provides guidance on the selection of an engagement quality reviewer where a statutorily appointed auditor fulfils the role of engagement partner.

- iv. The PAF considers that ISQM (UK) 2 can be applied to audits of public sector bodies without further guidance beyond that already included in relation to engagement quality reviews, so does not intend to make any revisions to PN 10 in relation to this standard.

18. Group audits

- i. ISA (UK) 600 (Revised September 2022) *Special considerations – audits of group financial statements (including the work of component auditors)* will be effective for audits of group financial statements for periods commencing on or after 15 December 2023 (equating to the 2024-25 financial year for most public sector bodies).
- ii. Since the existing ISA (UK) 600 will remain in force for 2023-24 audits, the PAF does not plan to make any associated changes to PN 10 in 2023, but it is likely that the guidance on applying ISA (UK) 600 in the public sector will need to be revised in 2024 in line with the timetable for the adoption of the revised standard.
- iii. The PAF will prepare proposals for changes to the ISA (UK) 600 guidance in PN 10 during the lead up to the 2024-25 audit cycle. This is likely to include consideration of the following areas:
 - guidance relating to the combined financial statements of components that have no parent;
 - expectations of work to be performed by component auditors for the purpose of public sector group audits; and
 - the assurances required to be obtained by public sector group auditors over the regularity of transactions entered into by component entities.

EVIDENCE OF FAILURE TO FOLLOW SORP GUIDANCE

19. In accordance with paragraph 58(b) of the FRC *Policy*, the Standing Group has considered whether it is aware of any evidence of widespread or significant failure by auditors of public sector entities to follow any part of the guidance contained in PN 10. The Standing Group concluded that it is not aware of any such evidence.
20. In undertaking this consideration, the Standing Group has considered the results of the engagement with stakeholder groups described in paragraphs 11 to 15 above, as well as members' knowledge and experience of specific audits of public sector entities and the results of quality monitoring procedures on such audits.

SECTOR DEVELOPMENTS

21. Financial Reporting Council standards development projects

- i. The PAF is aware that the FRC is carrying out work on prospective future changes to the following standards:
 - ISA (UK) 250A *Consideration of laws and regulations in an audit of financial statements*;
 - ISA (UK) 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*;
 - the 500 series of ISAs (UK), which cover audit testing procedures;
 - the 700 series of ISAs (UK), which cover auditors' reporting requirements; and
 - the Ethical Standard.
22. Given that no prospective changes have yet been put out for consultation in relation to this work, the PAF does not anticipate that there will be any changes to take into account for the 2023-24 audit cycle.
23. The PAF will keep in view any prospective changes to these standards and consider any potential impacts of such changes on the public sector-specific guidance in PN 10. Such changes would be expected to come into effect, at the earliest, in any 2024 revision of PN 10.
24. The PAF will also consider whether to respond to any consultations issued by the FRC on new and revised standards, in line with the purpose and objectives of the Standing Group, as set out in paragraph 4 of its terms of reference.

25. Audit evidence

- i. The International Auditing and Assurance Standards Board (IAASB) issued an exposure draft of a revised version of ISA 500 *Audit evidence* in October 2022, with final approval currently targeted for June 2024. The proposed changes include the following:
 - Clarifying the purpose and scope of the standard and explaining its relationship with other standards. This includes clarifying that ISA 500 is a "reference framework" for auditors when making judgments about audit evidence throughout the audit.
 - An enhanced principles-based approach to considering the relevance and reliability of information intended to be used as audit evidence, given the variety of information available to an auditor, and the various sources of such information.
 - Clarification of the notion of sufficient appropriate audit evidence and evaluating whether sufficient appropriate audit evidence has been obtained.
 - Modernising the standard to be adaptable to the current business and audit environment, including recognising the increasing use of technology by the entity and the auditor.
 - More emphasis on exercising professional scepticism.
- ii. The current version of PN 10 does not include specific guidance on applying ISA (UK) 500 in the public sector. If and when the FRC adopts revisions to the UK version of the standard as a result of the IAASB project, the PAF will consider whether how these changes may be

applied to public sector audits and whether it would be appropriate to include additional guidance in PN 10.

26. Going concern

- i. The IAASB approved an exposure draft of a revised version of ISA 570 *Going concern* in March 2023, which will be issued for public consultation in early May 2023. The proposed changes include the following:
 - Defining the term “material uncertainty (related to going concern)” and providing clarity for other terminology used in the standard
 - Changing the commencement date of the period of management’s assessment of an entity’s ability to continue as a going concern to at least twelve months from the date of approval of the financial statements.
 - Strengthening requirements that:
 - drive the auditor to obtain information that is relevant to the timely identification of events or conditions that may cast significant doubt on the entity’s ability to continue as a going concern; and
 - require a more robust evaluation of management’s assessment, including evaluating the method, assumptions and data used by management.
 - New requirements when management’s plans for future actions include financial support by third parties or related parties for the auditor to evaluate the intent and ability of those parties to maintain or provide the necessary financial support.
 - Enhancing requirements and application material to enable a more robust exercise of professional scepticism when performing audit procedures.
 - Emphasising how information from sources external to the entity may be leveraged.
 - Modernising the standard for the impact of technology.
 - Strengthening the requirements for timely, two-way communications with those charged with governance and including new requirements for communication with appropriate external parties.
 - Enhancing transparency about going concern in the auditor’s report.
- ii. The guidance in PN 10 on applying ISA (UK) 570 in the public sector was extensively revised and updated in the 2020 revision, with minor additional clarifications in the 2022 revision. If and when the FRC adopts revisions to the UK version of the standard as a result of the IAASB project, the PAF will consider whether how these changes may be applied to public sector audits and whether it would be appropriate to include additional guidance in PN 10.

27. Sustainability reporting

- i. In its July 2022 comment letter on the International Sustainability Standards Board’s exposure drafts on sustainability- and climate-related disclosures, the IAASB committed to its next steps in developing a bespoke assurance standard for sustainability reporting, starting by bringing together relevant ISAs, International Standards on Assurance Engagements (ISAEs) and guidance, and supplementing and enhancing these to address specifically assurance on sustainability reporting.
- ii. The PAF will review any prospective changes in assurance standards relating to sustainability reporting as they are proposed and consider the implications for auditors of public sector

entities, including whether guidance on applying such standards to audits of public sector entities could usefully be included in a future version of PN 10.

NEW OR EMERGING FACTORS

28. The Standing Group is not aware of any new or emerging factors that may impact the continued need for the SORP.
29. There continues to be a need for guidance for auditors to apply ISAs (UK) and ethical and quality management standards in the public sector, given the specialised nature of public sector financial statement audit and the fact that these standards are designed primarily for private sector entities.
30. There is additionally no other primary source of guidance covering the audit of regularity other than PN 10.

REVISIONS TO PN 10

31. The PAF does not intend immediately to revise the 2022 version of PN 10 as a result of the 2023 annual review.
32. However, in order to incorporate guidance relevant to new standards taking effect for the 2024-25 financial year in the public sector – including ISA (UK) 600 (Revised September 2022) *Special considerations – audits of group financial statements (including the work of component auditors)* – the PAF intends to work on a revised version of PN 10 to be issued for consultation in early 2024.