CONSULTATION DRAFT

Statement of Recommended Practice

Practice Note 10: Audit of financial statements and regularity of public sector bodies in the United Kingdom

(Revised 2024)

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

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The Financial Reporting Council's Statement on the Statement of Recommended Practice – Practice Note 10: Audit of financial statements and regularity of public sector bodies in the United Kingdom

The purpose of the Financial Reporting Council (FRC) is to serve the public interest by setting high standards of corporate governance, reporting and audit and by holding to account those responsible for delivering them. In relation to auditing standards applicable in the UK, the FRC's overriding objective is to enable users of financial statements to have confidence that they have been subject to high-quality, robust and independent audit, proportionate to the size and complexity of the entity and users' information needs. In particular industries or sectors, clarification of aspects of those standards may be needed in order for the standards to be applied in a manner that is relevant and provides useful information to the users of audit reports or other information issued by the auditor in that industry or sector.

Such clarification in connection with auditing standards is issued in the form of Statements of Recommended Practice (SORPs) by bodies recognised for this purpose by the FRC. The Public Audit Forum, comprising the four UK national audit agencies, has confirmed that it shares the FRC's aim of high-quality audit and has been recognised by the FRC for the purpose of issuing SORPs for audit of financial statements and regularity of public sector bodies in the United Kingdom.

In accordance with the FRC's *Policy on Developing Statements of Recommended Practice (SORPs)*, the FRC carried out a review of the SORP focusing on those aspects relevant to the audit of financial statements, but also including aspects relevant to the FRC's broader responsibilities where appropriate.

On the basis of its review, the FRC has concluded that the SORP has been developed in accordance with the FRC's *Policy on Developing SORPs* and does not appear to contain any fundamental points of principle that are unacceptable in the context of present auditing practices or to conflict with an auditing standard or to undermine the FRC's broader objectives.

[DATE]

Financial Reporting Council

Statement of Recommended Practice – Practice Note 10: Audit of financial statements and regularity of public sector bodies in the United Kingdom (Revised 2024)

This Statement of Recommended Practice, referred to hereafter as a Practice Note, replaces Practice Note 10: *Audit of financial statements and regularity of public sector bodies in the United Kingdom (Revised 2022)*, which was issued in November 2022.

Preface

This Practice Note contains guidance on the application of quality management, auditing and ethical standards issued by the Financial Reporting Council (FRC) to the audit of public sector bodies in the United Kingdom, as classified by the Office for National Statistics.[1]

This Practice Note is supplementary to, and is intended to be read in conjunction with, International Standards on Auditing (ISAs) (UK) and International Standards on Quality Management (ISQM) (UK), which apply to all audits undertaken in the United Kingdom. The Practice Note sets out the special considerations relating to the audit of public sector bodies which arise from individual quality control and auditing standards. It is not the intention of the Practice Note to provide step-by-step guidance on the audit of public sector bodies, so where no special considerations arise from a particular ISA (UK) or ISQM (UK), no material is included. Where this document is silent on certain aspects of the auditing requirements, users may refer to relevant auditing standards.

Entities or work complying with this SORP shall apply the auditing standards applicable at the relevant reporting date (which does not preclude early application when permitted). When the current edition of this SORP predates a change in legislation or auditing standards and a conflict is thereby created, or other developments lead to a conflict, the affected provisions of this SORP cease to have effect.

This Practice Note has been prepared by the Public Audit Forum (PAF) with advice and assistance from representatives from each of the UK national audit agencies and certain private sector firms who carry out public sector audit work. It is based on auditing standards,

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[1] Auditors are reminded that the publication of ONS decisions takes place after consideration of relevant criteria, and it may be appropriate to consider, on a case-by-case basis, evidence for the classification of an entity that may be subject to ongoing ONS consideration. Decisions are published on the ONS website: www.ons.gov.uk/economy/nationalaccounts/uksectoraccounts/datasets/publicsectorclassificationguide

legislation and regulations which were in effect at 1 September 2024. This Practice Note is not an exhaustive list of all of the obligations that public sector auditors may have under legislation.

The 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). 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.

This version of Practice Note 10 has been updated to take account of revisions to ISAs (UK) since the previous version: principally ISA (UK) 600 (Revised September 2022): *Special considerations – audits of group financial statements (including the work of component auditors)*, which took effect for audits of financial statements for periods beginning on or after 15 December 2023. Other updates have also been made to reflect the latest developments in public sector auditing practice. All auditing standards and other FRC pronouncements issued by 31 August 2024 were considered in the development of this SORP.

The FRC's Revised Ethical Standard 2024, replacing the Revised Ethical Standard 2019, will become effective on 15 December 2024. Auditors may complete engagements relating to periods commencing before December 2024 in accordance with existing ethical standards, putting in place any necessary changes in the subsequent engagement period. Therefore, guidance relating to the Revised Ethical Standard will be updated for the 2024 Standard in a future revision of PN 10.

ISA (UK) 505 (Revised October 2024): *External confirmations* will be effective for audits of financial statements for periods commencing on or after 15 December 2024. There is no specific guidance on applying ISA (UK) 505 in the current version of PN 10. Since the revised standard will not be effective for most public sector entities until their 2025-26 audits, the PAF will consider whether guidance relating to the revised standard should be included in a future revision of PN 10.

The prospective ISA (UK) 250 (Revised): *Consideration of laws and regulations in an audit of financial statements* and ISA (UK) 2X0: *Special considerations for public interest entities – communicating and reporting to an appropriate authority outside the entity*, replacing the current ISA (UK) 250 (Revised November 2019) Section A and ISA (UK) 250 (Revised November 2019) Section B, are, if adopted by the FRC, proposed to be effective for audits of financial statements beginning on or after 15 December 2024. This would mean these standards becoming effective for most public sector entities for their 2025-26 audits, and guidance relating to these standards, if adopted, will be included in a future revision of PN 10.

The PAF also maintains a watching brief on regulatory developments which may impact public sector auditors in the United Kingdom in the future, depending on decisions to be taken by UK regulators. This includes standards development projects being undertaken by the International Auditing and Assurance Standards Board (IAASB) and the International Ethics Standards Board for Accountants (IESBA).

Codes of Audit Practice issued by the national audit agencies[2] require public sector auditors to comply with auditing standards in their work on financial statements. This Practice Note applies to all public sector auditors, whether these are audit agencies or audit firms.

Part 2 of this Practice Note relates to the audit of regularity. This guidance reflects current practice across the United Kingdom in relation to auditors' work on regularity and the relevant legislative requirements and frameworks of authorities that apply to this work. In particular, PN 10 provides guidance on the work needed to support a separate opinion on regularity where one is needed.

Introduction

1 External auditors in the public sector give an independent opinion on the financial statements and may review and, where appropriate, report on aspects of the arrangements set in place by the audited body to ensure the proper conduct of its financial affairs and to manage its performance and use of resources. As such, external audit is an essential element in the process of accountability and makes an important contribution to the stewardship of public money and the corporate governance of public services.

2 Public sector auditors act and report in accordance with the mandates that govern their activities and provide the authority for the auditor to carry out and to report the results of the audit work. These mandates are embodied in legislation and, in some circumstances, set out in Codes of Audit Practice which may be established in accordance with legislation and issued by the national audit agencies.

3 The mandates of public sector auditors vary in accordance with the requirements laid down in the legislation relevant to each jurisdiction within the public sector and within each geographical area. The legislative framework governing the audit of public sector bodies UK wide and in England, Wales, Scotland and Northern Ireland is set out on websites of the individual national audit agencies.

4 These mandates establish broadly similar responsibilities for each jurisdiction in relation to:

- the financial statements;
- compliance with legislative and other authorities (sometimes referred to as "regularity"); and
- economy, efficiency and effectiveness (sometimes referred to as "performance audit", "value for money" or "use of resources").

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[2] The Codes can be found on the respective websites of the national audit agencies.

5 In some parts of the UK, English is not the primary language used by public bodies for the conduct of business including preparation of accounts, for example as a result of applying options available under the *Welsh Language Act 1993* and *Welsh Language (Wales) Measure 2011*. Where this occurs, the auditor ensures that the auditor's responsibilities under auditing standards can be properly discharged through, for example, including staff with the appropriate language skills in the engagement team and the use of translation services.

6 This Practice Note provides auditors with further guidance on the application of ISAs (UK) to the audit of financial statements, including the regularity opinion where appropriate, in the public sector. The heads of the national audit agencies in the UK have chosen to apply ISAs (UK) and follow Practice Note 10. They require auditors conducting work on their behalf to have regard to Practice Note 10 in the application of ISAs (UK) to that work.

7 Public sector auditors may also be required to review and report on other documents prepared by public bodies. Such other documents may relate to aspects of corporate governance or arrangements to secure economy, efficiency and effectiveness in the use of resources. Practice Note 10 does not provide guidance to the auditor on conducting these assignments, unless it is directly related to reporting on the audit of financial statements or regularity. The standards governing other reporting assignments in the public sector are a matter for the national audit agencies and certain regulators to determine. These may be included in a separate Code of Audit Practice.

Part 1: Application of auditing, quality management and ethical standards

1-1 A list of International Standards on Quality Management (ISQMs) (UK) and International Standards on Auditing (ISAs) (UK) is shown in the table below. This identifies those ISAs (UK) and ISQM (UK) in respect of which application guidance is included in this Practice Note and, for completeness, also shows those ISAs for which there is no need for further guidance:

Extant auditing and quality standards	**Further guidance relevant to the public sector context included in this part of PN 10**	**No further guidance relevant to the public sector context provided**

ISQM (UK) 1: Quality management for firms that perform audits or reviews of financial statements, or other assurance or related services engagements[3]	✓	
ISA (UK) 200 (Revised June 2016) (Updated May 2022): Overall objectives of the independent auditor and the conduct of an audit in accordance with International Standards on Auditing (UK)		✓
ISA (UK) 210 (Revised June 2016) (Updated May 2022): Agreeing the terms of audit engagements	✓	
ISA (UK) 220 (Revised June 2016) (Updated May 2022): Quality control for an audit of financial statements		✓
ISA (UK) 230 (Revised June 2016) (Updated May 2022): Audit documentation		✓
ISA (UK) 240 (Revised May 2021) (Updated May 2022): The auditor's responsibilities relating to fraud in an audit of financial statements[4]	✓	
ISA (UK) 250A (Revised November 2019) (Updated May 2022): Consideration of laws and regulations in an audit of financial statements	✓	
ISA (UK) 250B (Revised November 2019): The auditor's statutory right and duty to report to regulators of public interest entities and regulators of other entities in the financial sector		✓

[3] Systems of quality management in compliance with ISQM (UK) 1 are required to be designed and implemented by 15 December 2022 and 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.

[4] ISA (UK) 240 (Revised May 2021) (Updated May 2022) is effective for audits of financial statements for periods commencing on or after 15 December 2021. It replaces ISA (UK) 240 (Revised June 2016) (Updated January 2020).

ISA (UK) 260 (Revised November 2019) (Updated May 2022): Communication with those charged with governance	✓	
ISA (UK) 265 (Updated May 2022): Communicating deficiencies in internal control to those charged with governance and management		✓
ISA (UK) 300 (Revised June 2016) (Updated May 2022): Planning an audit of financial statements		✓
ISA (UK) 315 (Revised July 2020): Identifying and assessing the risks of material misstatement[5]	✓	
ISA (UK) 320 (Revised June 2016) (Updated May 2022): Materiality in planning and performing an audit	✓	
ISA (UK) 330 (Revised July 2017) (Updated May 2022): The auditor's responses to assessed risks		✓
ISA (UK) 402 (Updated May 2022): Audit considerations relating to an entity using a service organisation	✓	
ISA (UK) 450 (Revised June 2016) (Updated May 2022): Evaluation of misstatements identified during the audit		✓
ISA (UK) 500 (Updated May 2022): Audit evidence		✓
ISA (UK) 501 (Updated May 2022): Audit evidence: Specific considerations for selected items		✓
ISA (UK) 505 (Updated May 2022): External confirmations		✓
ISA (UK) 510 (Revised June 2016): Initial audit engagements: Opening balances	✓	

[5] ISA (UK) 315 (Revised July 2020) is effective for audits of financial statements for periods beginning on or after 15 December 2021. It replaces ISA (UK) 315 (Revised June 2016).

ISA (UK) 520 (Updated May 2022): Analytical procedures		✓
ISA (UK) 530 (Updated May 2022): Audit sampling		✓
ISA (UK) 540 (Revised December 2018) (Updated May 2022): Auditing accounting estimates and related disclosures	✓	
ISA (UK) 550 (Updated May 2022): Related parties	✓	
ISA (UK) 560: Subsequent events	✓	
ISA (UK) 570 (Revised September 2019) (Updated May 2022): Going concern	✓	
ISA (UK) 580 (Updated May 2022): Written representations	✓	
ISA (UK) 600 (Revised September 2022): Special considerations: Audits of group financial statements including the work of component auditors	✓	
ISA (UK) 610 (Revised June 2013) (Updated May 2022): Using the work of internal auditors	✓	
ISA (UK) 620 (Revised November 2019) (Updated May 2022): Using the work of an auditor's expert	✓	
ISA (UK) 700 (Revised November 2019) (Updated May 2022): Forming an opinion and reporting on financial statements	✓	
ISA (UK) 701 (Revised November 2019) (Updated May 2022): Communicating key audit matters in the independent auditor's report	✓	
ISA (UK) 705 (Revised June 2016): Modifications to the opinion in the independent auditor's report		✓

ISA (UK) 706 (Revised June 2016): Emphasis of matter paragraphs and other matter paragraphs in the independent auditor's report	✓	
ISA (UK) 710: Comparative information: corresponding figures and comparative financial statements		✓
ISA (UK) 720 (Revised November 2019) (Updated May 2022): The auditor's responsibilities relating to other information	✓	
ISA (UK) 800 (Revised): Special considerations – Audits of financial statements prepared in accordance with special purpose frameworks		✓
ISA (UK) 805 (Revised): Special considerations – Audits of single financial statements and specific elements, accounts or items of a financial statement		✓

1-2 The following sections of this part set out the further guidance on the application of ISQM (UK) 1 and ISAs (UK) for public sector audit. Where there are public sector considerations in the quality management and auditing standards, these have been referenced throughout this document. References to ISQM and ISAs in this Practice Note are to standards applicable in the UK. Part 2 of this Practice Note sets out guidance on the audit of regularity.

International Standard on Quality Management (UK) 1: Quality management for firms that perform audits or reviews of financial statements, or other assurance or related services engagements

1-3 The objective of the [audit organisation or] firm is to design, implement and operate a system of quality management for audits or reviews of financial statements, or other assurance or related services engagements performed by the firm, that provides the firm with reasonable assurance that:

(a) The firm and its personnel fulfil their responsibilities in accordance with professional standards and applicable legal and regulatory requirements, and conduct engagements in accordance with such standards and requirements; and

(b) Engagement reports issued by the firm or engagement partners are appropriate in the circumstances (ISQM 1, 14).

Public sector equivalent to partner and firm

1-4 [In applying ISQM (UK) 1,] "Engagement partner" and "partner" is to be read as referring to their public sector equivalents where relevant (ISQM (UK) 1, footnote 3 to paragraph 16(c)).

Requirement to withdraw from or decline to accept an engagement where the appointment is made in statute

1-5 In some circumstances, jurisdictional law or regulation may impose an obligation on the firm to accept or continue a client engagement, or in the case of the public sector, the firm may be appointed through statutory provisions (ISQM (UK) 1, A123).

1-6 The requirements of law, regulation or statute to accept or continue an engagement, as described above, may prevent a public sector auditor from withdrawing or resigning from the engagement or from declining to accept an engagement where auditing or ethical standards would otherwise have led them to do so. In most cases, statutory-appointed auditors have the authority to report publicly such matters that may otherwise have caused their withdrawal or resignation from, or declining to accept, a statutory engagement. This may be relevant, for example, to a head of one of the public audit agencies who is appointed by the legislation as an auditor of specific public sector bodies.

Quality management for contracted-out engagements

1-7 A contracted-out engagement is an engagement where, although responsibility for issuing the auditor's report remains with the statutory auditor, all or some of the audit assignment is undertaken by another firm or auditor under contract or agreement. In some cases the contractor firm or auditor provides a fully ISA (UK) compliant auditor's report to the statutory auditor. For example, the Comptroller and Auditor General contracts out audit work on some of the statutory appointments, but is still responsible for signing the audit certificate and report.

1-8 For contracted-out engagements, responsibility for quality remains with the statutory auditor. This includes:

- ensuring that the contractor auditor has sufficient personnel with the competencies, capabilities and commitment to ethical principles necessary for compliance with relevant standards;

- confirming that the contractor auditor meets the relevant ethical standards, including independence, on appointment and periodically thereafter;
- ensuring that there are policies and procedures in place to identify and resolve potential conflicts;
- considering whether an internal consultation and the appointment of an engagement quality reviewer is necessary for contracted-out engagements;
- applying the organisation-wide quality management arrangements (including, for example, the organisation's risk assessment process, governance and leadership responsibilities, relevant ethical requirements and resourcing) to contracted-out engagements;
- including contracted-out engagements within the scope of the statutory auditor's overall quality management arrangements (for example, by the person employed by the statutory auditor acting in the role of engagement partner carrying out appropriate direction, supervision and review and taking overall responsibility for managing and achieving quality; referring technical queries and judgements through the statutory auditor's formal consultation processes where appropriate; and including contracted-out audits in the scope of audits that are considered for whether they require an engagement quality review);
- reporting any deficiencies identified as a result of monitoring a contracted-out engagement to the contractor auditor undertaking the assignment; and
- establishing policies and procedures designed to provide reasonable assurance that complaints and allegations relating to quality are dealt with appropriately.

1-9 This does not absolve contractor auditors of responsibility for systems of quality management within their organisations in accordance with ISQM (UK) 1. The contractor auditor is considered to be a service provider[6] for the purpose of ISQM (UK) 1. In this context, the contractor auditor may agree to provide the statutory auditor with a report on the system of quality management within their firm (a 'service provider report') to inform the statutory auditor's understanding of the impact of using the service provider on the achievement of its quality objectives. In practice, the statutory auditor either obtains assurance over quality from its contractors or undertakes procedures to confirm that its contractors' systems of quality management are working effectively.

[6] Paragraph 16(v) of ISQM (UK) 1 defines a service provider as an individual or organization external to the firm that provides a resource that is used in the system of quality management or in the performance of engagements. Service providers exclude the firm's network, other network firms or other structures or organizations in the network.

1-10 If the contractor auditor identifies deficiencies in any of its public sector assignments that fall within the remit of the statutory auditor, these are communicated, along with the action undertaken, to the relevant statutory auditor. If the statutory auditor identifies deficiencies in the performance by the contractor auditor of any of its contracted-out assignments, the statutory auditor communicates these to the contractor auditor and determines what actions are required to address these, which may include additional work being performed by the contractor auditor.

1-11 The contractor auditor establishes policies and procedures designed to provide reasonable assurance that it deals appropriately with complaints and allegations relating to quality. These policies and procedures allow for escalation of such issues to the statutory auditor, where relevant.

Quality management for engagements on an "appointment by" basis

1-12 An assignment undertaken on an "appointment by" basis is an engagement where another firm or individual is responsible for the assignment, its performance and the issuing of the auditor's report. An example of this arrangement is the relationship between the Accounts Commission in Scotland and its appointed auditors. The guidance in this section is not relevant to engagements in England where Public Sector Audit Appointments Limited is the appointing person under the *Local Audit and Accountability Act 2014*.

1-13 Where an auditor undertakes the engagement on an "appointment by" basis and issues the auditor's report in its own name, it assumes responsibility for quality. This does not affect any statutory responsibility the national audit agency (if a national audit agency is the appointing body) has for the oversight of, or quality assurance for, those assignments undertaken on an "appointment by" basis. The responsibilities of the auditor include:

- ensuring that the engagement has sufficient personnel with the competencies, capabilities and commitment to ethical principles necessary for compliance with relevant standards;
- ensuring that the engagement meets the relevant ethical standards, including independence, on appointment and periodically thereafter;
- ensuring that there are policies and procedures in place to identify and resolve potential conflicts;
- considering whether an internal consultation is necessary for "appointment by" engagements;
- applying the firm's quality management arrangements to "appointment by" engagements;
- reporting any deficiencies identified as a result of monitoring "appointment by" engagements to the national audit agency, where appropriate; and

- establishing policies and procedures designed to provide reasonable assurance that complaints and allegations relating to quality are dealt with appropriately.

1-14 Where an engagement is undertaken on an "appointment by" basis and the appointing body has responsibility for the oversight of, or quality assurance for, the audit assignment, the appointing body also:

- satisfies itself that the appointed auditor has sufficient personnel with the competencies, capabilities and commitment to ethical principles necessary for compliance with relevant standards;
- considers whether to apply quality management arrangements to such assignments;
- confirms whether the appointed auditor meets the relevant ethical standards, including independence, on appointment and periodically thereafter; and
- ensures that there are policies and procedures in place to identify and resolve potential conflicts.

Ethics

1-15 Auditors in the public sector may need to meet relevant ethical and propriety requirements in addition to the FRC's Ethical Standard, such as restrictions on political activities or requirements established by regulators. The *Official Secrets Acts* also cover some public sector activities. No other requirement is expected to compromise the ability of the firm or individual auditors to comply with relevant ethical requirements required by ISQM (UK) 1 and the FRC Ethical Standard.

Independence

1-16 Statutory measures may provide safeguards for the independence of public sector auditors. However, threats to independence may exist regardless of any statutory measures designed to protect it. **In achieving the quality objectives in [ISQM (UK) 1] related to independence, public sector auditors may address independence in the context of the public sector mandate and statutory measures (ISQM (UK) 1, A66).**

1-17 Listed entities as defined in paragraph 16(j) of ISQM (UK) 1 and referred to in paragraph 34 and elsewhere are not common in the public sector. However, there may be other public sector entities that are significant due to size, complexity or public interest aspects, and which consequently have a wide range of stakeholders. Therefore, there may be instances when the auditor determines, based on their quality management policies and procedures, that a public sector entity is significant for the purposes of expanded quality control procedures.

1-18 Other matters relating to independence are discussed in the section of Practice Note 10 on the FRC's Revised Ethical Standard 2019. The Standard includes considerations specific to the public sector that were previously addressed in International Standard on Quality Control (UK) 1 but are not reflected in ISQM (UK) 1.

Confidentiality

1-19 In addition to the provisions of ISQM (UK) 1 (for example, the requirement in paragraph 34-1(m) of ISQM (UK) 1 to establish policies and procedures relating to confidentiality of information), public sector auditors may have additional statutory obligations relating to confidentiality: for example, under the *Official Secrets Act 1989*.

1-20 As well as complying with applicable statutory obligations relating to confidentiality, auditors also consider whether audit work is potentially disclosable under applicable freedom of information legislation. For example, where the auditor is classified as a public authority under Schedule 1 of the *Freedom of Information Act 2000* or *Freedom of Information (Scotland) Act 2002*, legislation provides a right of access to recorded information held by that auditor.

1-21 For auditors not classified as public authorities, relevant audit legislation may permit an auditor to disclose information obtained in the course of an audit except where it would prejudice the effective performance of the auditor's functions.

1-22 The acceptance of some appointments in the public sector requires the auditor to acknowledge that their working papers may be subject to inspection by the national audit agency that appointed the auditor or that is responsible for the audit of a higher tier entity or by review agencies that have statutory rights of access to information relevant to the auditor's duties. If not bound by a specific statutory requirement (for example, freedom of information legislation), ethical considerations normally require that the national audit agency acquires the duty of confidentiality that is held by the auditor.

Engagement quality review

1-23 Although (in most cases) they do not meet the definition of listed entities or Public Interest Entities, large public sector entities may have a high public profile, which is an example given in paragraph A134 of ISQM (UK) 1 of a condition giving rise to one or more quality risk(s) for which an engagement quality review may be an appropriate response. Public sector auditors may therefore determine that an engagement quality review is an appropriate response for such engagements under paragraph 34(f)(iii) of ISQM (UK) 1.

1-24 In the public sector, a statutorily appointed auditor (for example, an Auditor General, or other suitably qualified person appointed on behalf of the Auditor General) may act in a role equivalent to that of engagement partner with overall responsibility for public sector audits. In such circumstances, where applicable, the selection of the engagement quality reviewer includes consideration of the need for independence from the audited entity and the ability of the engagement quality reviewer to provide an objective evaluation.

1-25 Auditors may also appoint engagement quality reviewers at their discretion, where considered necessary.

Individuals with responsibility and accountability for the system of quality management

1-26 In the case of the public sector, it may not be practicable to perform a performance evaluation of the individual(s) assigned ultimate responsibility and accountability for the system of quality management, or to take actions to address the results of the performance evaluation, given the nature of the individual's appointment. Nevertheless, performance evaluations may still be undertaken for other individuals in the firm who are assigned operational responsibility for aspects of the system of quality management (ISQM (UK) 1, A201).

1-27 In the national audit agencies, the individual or individuals assigned operational responsibility for the system of quality management under paragraphs 20 and 21-1 of ISQM (UK) 1 may not be eligible for appointment as a statutory auditor under the *Companies Act 2006*, since the national audit agencies' audit appointments are vested personally in the Comptroller and Auditor General, the Comptroller and Auditor General for Northern Ireland, the Auditor General for Scotland and the Auditor General for Wales. In this case, the national audit agencies comply with paragraph 21-1 of ISQM (UK) 1 by ensuring that the individual or individuals assigned operational responsibility for the system of quality management have levels of experience, knowledge, influence and authority within the national audit agency such that they are capable of fulfilling the role of engagement partner for an audit engagement as defined in ISAs (UK), which is considered to be equivalent to the levels required to achieve eligibility for appointment as a statutory auditor.

ISA (UK) 210 (Revised June 2016) (Updated May 2022): Agreeing the terms of audit engagements

1-28 The objective of the auditor is to accept or continue an audit engagement only when the basis upon which it is to be performed has been agreed, through:

(a) establishing whether the preconditions for an audit are present; and

(b) confirming that there is a common understanding between the auditor and management and, where appropriate, those charged with governance of the terms of the audit engagement (ISA (UK) 210, 3).

Agreeing the terms of public sector audit engagements

1-29 In the public sector, specific requirements may exist within the legislation governing the audit mandate; for example, the auditor may be required to report directly to a minister, the legislature or the public if the entity attempts

to limit the scope of the audit (ISA (UK) 210, A39 which relates to the requirements of ISA (UK) 210, 21).

1-30 Law or regulation governing the operations of public sector audits generally mandate the appointment of a public sector auditor and commonly set out the public sector auditor's responsibilities and powers, including the power to access an entity's records and other information. When law or regulation prescribes in sufficient detail the terms of the audit engagement, the public sector auditor may nonetheless consider that there are benefits in issuing a fuller audit engagement letter than permitted by paragraph 11 [of ISA (UK) 210] (ISA (UK) 210, A29 which relates to the requirements of ISA (UK) 210, 10–11).

1-31 With some exceptions, the statutory framework allows national audit agencies to mandate a substantial part of the scope and objectives of the audit. In other cases, an appointment letter or Code of Audit Practice issued by a national audit agency may determine the nature and scope of the audit engagement. For this reason, formal engagement letters for statutory engagements may not always be necessary. However, for audits of local bodies in England, for example where appointments have been made directly by the audited bodies under the *Local Audit and Accountability Act 2014* or for the audit of Foundation Trusts, a letter of engagement is required.

1-32 Nevertheless, it remains important that management and the auditor formally recognise their respective responsibilities. It may also be necessary, where legislation does not provide sufficient detail on the scope of the audit, to ensure that it is appropriately understood by those charged with governance. A letter of understanding may therefore be necessary.

1-33 The auditor may find it appropriate to conclude letters of understanding with the audited entity to confirm the auditor's understanding of the roles of the parties with an interest in the engagement, the requirements of the audit, the responsibilities of each party, how the responsibilities will be met, and the expectations that each party can have of the other. Such a document is not intended to be a substitute for the clarification of any uncertainties in the auditing framework that will need to be resolved with the relevant national audit agency.

1-34 In circumstances where roles, requirements and responsibilities mandated by the national audit agency are not clear or are debatable, the auditor requests that the national audit agency provides greater clarity in the terms of its appointment; auditor and audited entities do not seek to interpret the intentions behind the uncertainties without the advice of the national audit agency.

1-35 Where the auditor has not been appointed under statute, an engagement letter is required to set out the responsibilities of the auditor and the audited body. The auditor agrees the terms of engagement with the addressee of the auditor's report.

1-36 Where financial statements are laid before Parliament, either by statute or command, the auditor also considers whether HM Treasury agreement of these terms may be required.

Areas that may be covered in a letter of engagement or understanding

1-37 The auditor determines the areas that may be covered by the letter of engagement or understanding. These areas may change over time and the auditor considers developments that may be relevant to the audited body. In preparing the letter of engagement or understanding, the auditor may consider the following:

- responsibilities of the Accounting Officer or Accountable Officer, and, where relevant, those charged with governance;
- responsibilities of the auditor, with reference to the relevant legislative framework;
- the audit framework, distinguishing between statutory and non-statutory requirements. Statutory considerations might include examination in respect of regularity and Whole of Government Accounts. Non-statutory elements might include, if relevant, the involvement of other auditors and the relationship between the national audit agency and the other auditors;
- reporting responsibilities, acknowledging that there may be wider responsibilities to report to other entities, such as Parliament, or those charged with governance;
- wider auditor responsibilities, such as obligations under the *Freedom of Information Act 2000* or the *Proceeds of Crime Act 2002*;
- considering the Governance Statement;
- electronic publication of financial statements;
- value for money examinations;
- other audit related services, for example limited assurance reports and other assurance products that are closely related to the work carried out on the audit; and
- audit fees.

ISA (UK) 240 (Revised May 2021) (Updated May 2022): The auditor’s responsibilities relating to fraud in an audit of financial statements

1-38 The objectives of the auditor are:

(a) to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement due to fraud, including:

> **(i) identifying and assessing the risks of material misstatement of the financial statements due to fraud;**
>
> **(ii) obtaining sufficient appropriate audit evidence regarding the assessed risks of material misstatement due to fraud, through designing and implementing appropriate responses; and**

(b) to respond appropriately to fraud or suspected fraud identified during the audit (ISA (UK) 240, 11).

The public sector auditor's responsibilities relating to fraud

1-39 The public sector auditor's responsibilities relating to fraud may be a result of law, regulation or other authority applicable to public sector entities or separately covered by the auditor's mandate. Consequently, the public sector auditor's responsibilities may not be limited to consideration of risks of material misstatement of the financial statements, but may also include a broader responsibility to consider risks of fraud (ISA (UK) 240, A7 which relates to the requirements of ISA (UK) 240, 3).

1-40 The public sector auditor's responsibilities relating to fraud under ISA (UK) 240 are interrelated with the work that underpins the regularity opinion, where one is given (see Part 2). However, compliance with the requirements of Part 2 on the audit of regularity is not in itself sufficient to provide reasonable assurance about whether the financial statements as a whole are free from material misstatement due to fraud, as required by ISA (UK) 240.

1-41 When giving a regularity opinion on a public sector entity, the auditor's objectives include obtaining reasonable assurance about whether the financial statements as a whole are free from material irregular transactions (that is, transactions not in accordance with the framework of authorities – see paragraph 1-43) due to fraud, including identifying and assessing the risks of material irregular transactions due to fraud and obtaining sufficient appropriate audit evidence regarding the assessed risks of material irregular transactions due to fraud, through designing and implementing appropriate responses. These objectives are in addition to and complement those of ISA (UK) 240.

1-42 Fraud or suspected fraud identified during the audit of a public sector entity may include fraud that does not result in misstatement of the financial statements but does result in transactions that are not in accordance with the framework of authorities, which may have implications for the regularity opinion. The public sector auditor's responsibilities under ISA (UK) 240 to:

- determine whether law, regulation or relevant ethical requirements require them to report fraud or suspected fraud that is identified during the audit to an appropriate authority outside the entity; and
- communicate to management and/or those charged with governance, as appropriate, identified fraud or information that indicates that a fraud may exist,

extend to such fraud or suspected fraud with an impact on regularity rather than on the financial statements.

1-43 The term 'irregularities' is used in ISAs (UK) to refer to instances of non-compliance with laws and regulations, including fraud.[7] If such irregularities are identified or suspected, ISA (UK) 250A requires the auditor to carry out specified procedures and to communicate and report these to those charged with governance or others as appropriate. In the context of the regularity opinion, 'irregular transactions' refers to transactions not in accordance with the framework of authorities, as described in Part 2. The regularity opinion, if given, sets out whether there are material irregular transactions included in the financial statements.

1-44 An irregular transaction may not be an irregularity under ISAs (UK) (for example, a breach of non-statutory spending controls that are part of the framework of authorities may not be unlawful). However, it is likely that transactions relating to an irregularity under ISAs (UK) would also be irregular transactions for the purpose of the regularity opinion, since the framework of authorities includes compliance with the law (for example, a fraudulent payment would be in breach of primary legislation, which is also part of the framework of authorities).

The auditor's consideration of the risk of fraudulent financial reporting

1-45 A public sector auditor considers misstatements that may arise from fraudulent financial reporting where the audited body may manipulate its results to meet externally set targets: for example, the achievement of a statutory break-even duty by a health body or where financial results impact on achievement of objectives and/or wider performance reporting.

1-46 ISA (UK) 240 requires the auditor to evaluate, based on a presumption that there are risks of fraud in revenue recognition, which types of revenue, revenue transactions or assertions give rise to such risks, as material misstatements due to fraudulent financial reporting often result from a misstatement of revenue. The auditor may rebut this presumption: for example, if revenue is considered immaterial or where there is a single type of simple revenue transaction. However, the auditor may need to consider whether there is a risk of material misstatement due to fraud related to revenue recognition where

[7] For example, ISA (UK) 700, 29-1 requires the auditor's report to explain to what extent the audit was considered capable of detecting irregularities, including fraud.

the audited body is required to meet externally set targets. For example, within central government departments, income may be an immaterial transaction stream but could be manipulated in order to ensure that net expenditure is within the resource limits.

1-47 In the public sector, auditors typically focus their consideration of the risk of fraud and error on expenditure. As most public bodies are net spending bodies, the risk of material misstatement due to fraud related to expenditure may be greater than the risk of material misstatements due to fraud related to revenue recognition.

The auditor's consideration of the risk of fraud external to the audited entity

1-48 As well as misstatements resulting from the misappropriation of assets and misstatements resulting from fraudulent financial reporting, auditors in the public sector also consider the risk of external fraud. The risk of external fraud may be particularly high where there is an increased risk of fraudulent activity by individuals or groups outside the immediate control of the entity: for example, fraudulent benefit or prescription claims.

The auditor's responsibility for reporting suspected or actual fraud

1-49 In considering whether to report a suspected or actual instance of fraud to a proper authority, in addition to paragraph 44 of ISA (UK) 240, the public sector auditor has regard to:

- the provisions relevant to the entity that set out the responsibilities of those charged with governance for the reporting of misconduct, fraud or other irregularity; and
- the duties which the auditor may have under the terms of engagement to report to a third party.

1-50 In the public sector, requirements for reporting fraud, whether or not discovered through the audit process, may be subject to specific provisions of the audit mandate or related law, regulation or other authority (ISA (UK) 240, A69 which relates to the requirements of ISA (UK) 240, 44).

1-51 Where the public sector auditor considers that there is a duty to report instances or suspected or actual fraud to a third party, they determine the proper authority to whom they are initially expected to report. The relevant authority differs for different parts of the public sector, depending upon the terms of the engagement and statutory requirements. This is in addition to responsibilities under the *Money Laundering, Terrorist Financing and Transfer of Funds (Information on the Payer) Regulations 2017*.

ISA (UK) 250A (Revised November 2019) (Updated May 2022): Consideration of laws and regulations in an audit of financial statements

1-52 The objectives of the auditor are:

(a) to obtain sufficient appropriate audit evidence regarding compliance with the provisions of those laws and regulations generally recognised to have a direct effect on the determination of material amounts and disclosures in the financial statements;

(b) to perform specified audit procedures to help identify instances of non-compliance with other laws and regulations that may have a material effect on the financial statements; and

(c) to respond appropriately to identified or suspected non-compliance with laws and regulations identified during the audit (ISA (UK) 250A, 11).

The auditor's consideration of laws and regulations

1-53 In the public sector, there may be additional audit responsibilities with respect to the consideration of laws and regulations which may relate to the audit of financial statements or may extend to other aspects of the entity's operations (ISA (UK) 250A, A7 which relates to the requirements of ISA (UK) 250A, 3–9).

1-54 Auditors of central government and some health bodies have wider regard to laws and regulations as part of their responsibilities in respect of the audit of regularity. ISA (UK) 250A is concerned with ensuring that the auditor considers the risks of material misstatement in the financial statements due to non-compliance with laws and regulations and performs further audit procedures whose nature, timing and extent are responsive to assessed risks.

1-55 Auditors of other public sector entities (for example those required to follow a Code of Audit Practice) may be required to have a wider regard to laws and regulations than those to which ISA (UK) 250A is directly relevant. These requirements are set out in the relevant Code of Audit Practice and assign particular duties to the auditor in relation to the entity's arrangements to prevent non-compliance and to matters that come to the auditor's attention that may require consideration under ISA (UK) 250A. For example, some local auditors who are required to report on arrangements to secure value for money may, in that work, become aware of instances of non-compliance with laws and regulations.

The public sector auditor's consideration of legislation on corruption

1-56 The public sector auditor considers to whom the auditor may report suspected or actual acts of corruption, irrespective of whether, in the auditor's opinion, the consequences of the corruption could have a material effect on the financial statements. In the first instance, the auditor normally brings the matter to the attention of those charged with governance. It is then the responsibility of those charged with governance to report the matter to the proper authorities. If the auditor of an entity identifies a suspected or actual instance of corruption and if, having reported the matter to those charged with governance the auditor is unable to establish whether those charged with governance have reported the matter to the relevant third party, the auditor takes the steps set out in paragraph 43 of ISA (UK) 240.

Money laundering regulations in the public sector

1-57 Guidance on the auditor's responsibilities in relation to the UK anti-money laundering legislation when auditing and reporting on financial statements is provided in the Appendix to ISA (UK) 250A. This legislation includes the *Money Laundering, Terrorist Financing and Transfer of Funds (Information on the Payer) Regulations 2017* and the *Proceeds of Crime Act 2002*.

1-58 Under regulation 103 of the *Money Laundering, Terrorist Financing and Transfer of Funds (Information on the Payer) Regulations 2017*, various listed public authorities (including the Comptroller and Auditor General, the Auditors General for Wales and Scotland and the Comptroller and Auditor General for Northern Ireland) must, if they know or suspect or have reasonable grounds for knowing or suspecting that a person is or has engaged in money laundering or terrorist financing, as soon as reasonably practicable, inform the National Crime Agency. This report will normally be made by the audit organisation's nominated Money Laundering Reporting Officer. Such a disclosure is not to be taken to breach any restriction, however imposed, on the disclosure of information.

1-59 The auditor considers the offence of tipping off under section 333 of the 2002 Act. There is also an offence under section 342 of the 2002 Act which applies to all persons. This offence occurs where a person knows or suspects that an appropriate officer (such as an officer from the National Crime Agency) is acting (or proposing to act) in connection with a money laundering investigation which is being or about to be conducted, and makes a disclosure which is likely to prejudice the investigation or falsifies, conceals, destroys or otherwise disposes of, or causes or permits the falsification, concealment, destruction or disposal of, documents which are relevant to the investigation.

Reporting non-compliance

1-60 The public sector auditor may be obliged to report on instances of non-compliance to the legislature or other governing body or to report them in the auditor's report (ISA (UK) 250A, A34 which relates to the requirements of ISA (UK) 250A, 29).

ISA (UK) 260 (Updated May 2022): Communication with those charged with governance

1-61 The objectives of the auditor are:

(a) to communicate clearly with those charged with governance the responsibilities of the auditor in relation to the financial statement audit, and an overview of the planned scope and timing of the audit;

(b) to obtain from those charged with governance information relevant to the audit;

(c) to provide those charged with governance with timely observations arising from the audit that are significant and relevant to their responsibility to oversee the financial reporting process; and

(d) to promote effective two-way communication between the auditor and those charged with governance (ISA (UK) 260, 9).

Determining who is charged with governance in the public sector context

1-62 At the outset of the audit, the auditor determines who is charged with governance. This may include the Accounting/Accountable Officer (or equivalent) and other individuals responsible for decision-making, for example a board, scrutiny committee, Council, governing body or another group.

1-63 The responsibilities of those charged with governance may include, for example:

- ensuring that effective management systems appropriate for the achievement of the organisation's objectives including financial monitoring and control systems have been put in place;
- keeping proper accounts;
- ensuring internal audit is established and organised in accordance with the Public Sector Internal Audit Standards; and
- ensuring the regularity and propriety of public finances.

1-64 If the two-way communication between the auditor and those charged with governance is not adequate and the situation cannot be resolved, the public sector auditor may communicate the matter to a responsible government minister or Parliament (ISA (UK) 260, A53 which relates to the requirements of ISA (UK) 260, 22).

Communication with sponsoring bodies

1-65 Special arrangements may have developed for reporting to those charged with governance by auditors of some entities sponsored by government departments. In such cases the Accounting/Accountable Officer of the sponsor department obtains assurance that the financial and other management controls applied by the sponsored entity are adequate to ensure regularity and propriety. Reports from the auditor of the lower tier entity may assist the Accounting/Accountable Officer in obtaining such assurance. Sponsor departments may, therefore, require auditors of their arm's length bodies to:

- provide the sponsor department with copies of management letters and other relevant correspondence; and
- report significant matters arising out of the audit work to the sponsor department, including:
- failures of internal control, misconduct, fraud or other irregularity,
- occasions where the board, Chief Executive or any other official has fallen short of the high standards of financial integrity expected of those responsible for the management of public assets, or
- occasions where the entity has incurred expenditure of an extravagant or wasteful nature.

1-66 The auditors of local health bodies in England have specific responsibilities to refer certain matters to the Secretary of State or other relevant national body.

1-67 These and any other matters on which the auditor may be required to report to management are normally specified in the terms of appointment or engagement letter or Codes of Audit Practice.

Third party interest in reports to those charged with governance

1-68 In the public sector there may be a requirement to make public communications between the auditor and audited body. Even where this is not the case, third parties may seek to place reliance on a report by a public sector auditor addressed to those charged with governance. As such, auditors may need to state that the report is for use only by the audited entity to ensure that third parties who see the communication understand that it was not prepared with their use in mind.

1-69 Codes of Audit Practice applicable to local public audit in England, Northern Ireland, Scotland and Wales set out requirements relating to reporting to those charged with governance and considerations relating to defining who those charged with governance are, addressees and any relevant considerations relating to their purpose. Effective reference to relevant Codes of Audit Practice, as appropriate, in any report to those charged with governance achieves the purpose intended in the ISAs (UK).

Matters to be communicated

1-70 Law or regulation, or an agreement with the entity or additional requirements applicable to the engagement may provide for broader communication with those charged with governance. In the public sector, the auditor's mandate may provide for matters to be communicated that come to the auditor's attention as a result of other work, such as performance audits (ISA (UK) 260, A10 which relates to the requirements of ISA (UK) 260, 14).

1-71 The communication requirements relating to auditor independence that apply in the case of listed entities may also be relevant to some public sector entities (other that those that are listed, in which case the requirements are mandatory). The auditor of such bodies may consider whether this additional information would be beneficial where the audited entity has a wide range of stakeholders, as a result of their business, their size or their corporate status.

ISA (UK) 315 (Revised July 2020): Identifying and assessing the risks of material misstatement

1-72 The objective of the auditor is to identify and assess the risks of material misstatement, whether due to fraud or error, at the financial statement and assertion levels, thereby providing a basis for designing and implementing responses to the assessed risks of material misstatement (ISA (UK) 315, 11).

The entity and its environment

1-73 Ownership of a public sector entity may not have the same relevance as in the private sector because decisions related to the entity may be made outside of the entity as a result of political processes. Therefore, management may not have control over certain decisions that are made. Matters that may be relevant include understanding the ability of the entity to make unilateral decisions, and the ability of other public sector entities to control or influence the entity's mandate and strategic direction. For example, a public sector entity may be subject to laws or other directives from authorities that require it to obtain approval from parties external to the entity of its strategy and objectives prior to it implementing them. Therefore, matters related to understanding the legal structure of the entity may include applicable laws and regulations, and the classification of the entity (i.e., whether the entity is a ministry, department, agency or other type of entity) (ISA (UK) 315, A58, which relates to the requirements of ISA (UK) 315, 19(a)(i)).

1-74 Entities operating in the public sector may create and deliver value in different ways to those creating wealth for owners but will still have a 'business

model' with a specific objective. Matters public sector auditors may obtain an understanding of that are relevant to the business model of the entity, include:

- **knowledge of relevant government activities, including related programs; and**
- **program objectives and strategies, including public policy elements (ISA (UK) 315, A66, which relates to the requirements of ISA (UK) 315, 19(a)(i)).**

1-75 For the audits of public sector entities, there may be particular laws or regulations that affect the entity's operations. Such elements may be an essential consideration when obtaining an understanding of the entity and its environment (ISA (UK) 315, A72 which relates to the requirements of ISA (UK) 315, 19(a)(ii)).

1-76 For the audits of public sector entities, "management objectives" may be influenced by requirements to demonstrate public accountability and may include objectives which have their source in law, regulation or other authority (ISA (UK) 315, A67 which relates to the requirements of ISA (UK) 315, 19(a)(i)).

1-77 In addition to considering relevant measures used by a public sector entity to assess the entity's financial performance, auditors of public sector entities may also consider non-financial information such as achievement of public benefit outcomes (for example, the number of people assisted by a specific programme) (ISA (UK) 315, A81, which relates to the requirements of ISA (UK) 315, 19(a)(iii)).

Risks of material misstatement

1-78 For public sector entities, the identification of risks at the financial statement level may include consideration of matters related to the political climate, public interest and programme sensitivity (ISA (UK) 315, A200 which relates to the requirements of ISA (UK) 315, 28(a) and ISA (UK) 315, 30).

1-79 Inherent risk factors are characteristics of events or conditions that affect susceptibility to misstatement, whether due to fraud or error, of an assertion about a class of transactions, account balance or disclosure, before consideration of controls. The following are examples of inherent risk factors that may be particularly relevant to public sector entities under the five categories of inherent risk factors described in ISA (UK) 315 (auditors are not expected to document their judgements against each of the example inherent risk factors set out below; they are intended to be helpful in suggesting the types of issues that may particularly affect susceptibility to misstatement in the public sector context):

- *Complexity*

- The size and scope of a public sector entity's activities may create complexity. For example, some government departments are comparable to the largest private sector companies or groups in terms of spending, staffing and range of locations and business activities.
- Specific public sector entities may deal with highly unusual or specialised scenarios where there is limited opportunity for comparison or benchmarking. If highly specialised skills or knowledge are required to prepare or audit information in these fields, any scarcity of these skills or knowledge may affect the inherent risk associated with the related information.
- Public sector entities may also be subject to complex regulatory and oversight requirements relevant to their field.

- *Subjectivity*
  - Subjectivity may arise in a number of areas affecting public sector financial statements, including the status of arrangements, agreements, announcements and commitments in the public sector context.
  - Government has an ability not available to other sectors to act contrary to its previously announced intentions and to alter the legal position in response to events: for example, by using its command of Parliament to legislate on a particular issue.
  - However, there are also general expectations that public sector entities will act in certain ways that go beyond its strict legal and contractual obligations: for example, that government will act to alleviate the effects of adverse economic or environmental events on individuals, businesses and other public entities. These expectations are subject to political and situational considerations that are often highly subjective and may affect, for example, the extent to which public bodies recognise liabilities for probable obligations.
  - Arrangements may also be made between public sector entities that are not legally binding but by their nature would be contractual in a private sector context: for example, leasing arrangements where both the landlord and tenant are public bodies may be agreed using a memorandum setting out the terms of occupation, rather than a legal contract. This may give rise to subjectivity as to how these arrangements should be accounted for.
  - Public sector entities may hold property assets for their service potential, which, depending on the financial reporting framework, may be valued using depreciated replacement cost as a measure of current value in existing use. Such valuation methodologies may lead to subjectivity in the valuation of the property due to a lack of observable inputs or benchmarks to be used in the valuation.
- *Change*

    - Events or conditions may give rise to frequent and unpredictable change impacting a public sector entity and the environment in which it operates. For example, the objectives and responsibilities of government entities may be subject to change at short notice as a result of political developments or unexpected events and emergencies.

- *Uncertainty*
    - Examples of public sector inherent risk factors that relate specifically to accounting estimates are given in paragraph 1-110 under the ISA (UK) 540 section of Practice Note 10.

- *Susceptibility to misstatement due to management bias or other fraud risk factors insofar as they affect inherent risk*
    - 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.
    - Whereas the incentives or pressures arising in the private sector may be more focused on information about the profitability and solvency of the entity, those present in public sector entities may be to influence information on stewardship of public funds, service delivery, compliance with government requirements and policies and matters that may be politically contentious.
    - Incentives or pressures to influence financial information in public sector financial statements may relate to total expenditure and budgetary limits, particularly sensitive categories of expenditure and spending on high-profile projects or programmes.
    - Factors relevant to the susceptibility of public sector financial statements to misstatement due to fraud in the form of fraudulent financial reporting or misappropriation of assets are described in the ISA (UK) 240 section of Practice Note 10.

1-80 In addition to the five categories of inherent risk factors described in ISA (UK) 315, other inherent risk factors in public sector audits may arise from the following factors, or a combination of these:

- a closely-regulated regime (which may increase, for example, the risk of non-compliance with laws and regulations or incentives to manipulate reporting to comply with regulatory requirements);
- a wide range of stakeholders who may have disparate interests and needs as users of financial statements;

- major new legislation or expenditure programmes having been introduced;
- the possibility of a breach of Parliamentary control totals;
- an entity is likely to be wound up, reorganised, merged, sold or privatised;
- there is political pressure on an entity to complete transactions quickly; and/or
- the form of the financial statements does not reflect the underlying management and accounting processes.

1-81 Where entities are required to work to annual limits on resource or capital spending, the risk of transactions being recorded in the wrong accounting period is increased, since there is an incentivefor an entity to bring forward or delay expenditure or capital additions depending on its expected outturn against these limits. The risk of misclassification of transactions and balances is also increased, since there is an incentive to recognise items in a manner that increases outturn against limits that are underspent and reduces outturn against limits that are overspent.

1-82 When considering compliance with the applicable financial reporting framework, the public sector auditor's procedures are performed in the knowledge that entities have their own legislative framework and accounting provisions that prescribe the form and content of financial statements.

ISA (UK) 320 (Revised June 2016) (Updated May 2022): Materiality in planning and performing an audit

1-83 The objective of the auditor is to apply the concept of materiality appropriately in planning and performing the audit (ISA (UK) 320, 8).

1-84 In the case of a public sector entity, legislators and regulators are often the primary users of its financial statements. Furthermore, the financial statements may be used to make decisions other than economic decisions. The determination of materiality for the financial statements as a whole (and, if applicable, materiality level or levels for particular classes of transactions, account balances or disclosures) in an audit of the financial statements of a public sector entity is therefore influenced by law, regulation or other authority, and by the financial information needs of legislators and the public in relation to public sector programmes (ISA (UK) 320, A3 which relates to the requirements of ISA (UK) 320, 10).

1-85 In an audit of a public sector entity, total cost or net cost (expenses less revenues or expenditure less receipts) may be appropriate benchmarks for programme activities. Where a public sector entity has custody of public assets,

assets may be an appropriate benchmark (ISA (UK) 320, A10 which relates to the requirements of ISA (UK) 320, 10).

1-86 Therefore, gross expenditure or gross assets/liabilities may be more appropriate than profit or revenue as benchmarks for setting materiality for financial statements as a whole, as set out in the illustrative examples in Box 1 below.

1-87 Auditors may determine the materiality level or levels to be applied to particular 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, where appropriate in the context of the audited entity and the expectations of the users of the financial statements. There are examples given in ISAs (UK) of situations when the auditor's evaluation of what items are material may vary between different areas of the financial statements: for example, paragraph A20 of ISA (UK) 450 highlights circumstances where misclassifications between balance sheet items that do not affect the performance statement may not be considered material.

1-88 In some public sector entities, the value of gross assets and/or liabilities is much higher than the value of total expenditure and income. Depending on the circumstances, the auditor may conclude that the majority of the decisions of users of these entities' financial statements are taken based mainly on in-year transactions rather than the large asset or liabilities balances, particularly if there is little intervention to be made by the entity from year to year (for example, historic or specialised property assets or statutory pension schemes). However, users may also periodically make economic decisions based on the overall assets and liabilities (for example, decisions to re-finance infrastructure assets or transfer pension obligations). Where the audited entity has custody of significant public assets held in order to meet a strategic policy objective, their service potential is an important contributor to the entity's ability to deliver its critical services, which may make them an appropriate benchmark for setting materiality for the financial statements as a whole, in line with paragraph A10 of ISA (UK) 320. In this context, the auditor's approach to determining materiality levels reflects the various needs of users of the financial statements for different purposes. It is crucial for the auditor to exercise their professional judgement in developing this approach, tailored to the particular circumstances applicable to the audited entity and the financial information needs of users of its financial statements.

1-89 Notwithstanding the guidance and illustrative examples provided in this Practice Note, an overriding consideration is that the determination of materiality in accordance with ISA (UK) 320 is a matter in which the auditor exercises their professional judgement, drawing on their understanding of the financial information needs of users of the financial statements, which are wide ranging given the scope of the public sector's activities. Users of the financial statements of public sector entities may include the following (this is not an exhaustive list):

- legislators (members and staff of Parliament and devolved legislatures);

- individual and business taxpayers;
- current and prospective suppliers and business partners to the public sector;
- recipients of public funding, grants, benefits and loans;
- other public sector entities;
- employees and contractors of public sector entities or of suppliers and business partners to the public sector;
- current and prospective purchasers of financial instruments issued by government; and
- international agencies who have dealings with the United Kingdom.

Box 1: Illustrative examples of applying different benchmarks for setting materiality

The following illustrative examples are not prescriptive, but are demonstrations of some judgements that would generally be expected to be consistent with the requirements of ISA (UK) 320 in particular circumstances. Auditors may consider, using their professional judgement, that different approaches to setting materiality are appropriate, even in circumstances similar to those outlined.

Example 1: the main role of the entity is to provide services and the majority of expenditure relates to staff costs – the auditor considered it appropriate to use gross expenditure as a benchmark for setting materiality.

Example 2: the audited entity is the pension scheme account and majority of expenditure and income relates to the movements of the pension scheme asset – the auditor decided to use the gross assets as a benchmark for setting materiality.

Example 3: the audited entity manages government's long-term significant provisions, and the value of the liability and related movements is more significant than the value of other financial statement items – the auditor used the gross liabilities as a benchmark for setting materiality.

Example 4: the audited entity has significant non-current assets but its main role is to provide services to the public – the auditor decided that it is more appropriate to use gross expenditure as a benchmark for setting materiality to reflect the entity's role and interest of the users of the financial statements.

Example 5: the audited entity's accounts include a high-value portfolio of assets and liabilities held in order to meet a strategic public policy objective, but its day-to-day decision making focuses on other account balances, classes of transactions and disclosures – consulting the principles set out in ISA (UK) 320 and using their professional judgement and understanding of the financial information needs of users of the entity's financial statements, the auditor determined materiality for the financial statements as a whole using a benchmark based on the strategic asset or liability balances and also determined a materiality level to be applied to most or all other account balances (for example, working capital balances or actively-managed investments, where the financial information needs cover shorter-term or more granular factors than for the strategic balances), classes of transactions and 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 (no assertion is intended by the inclusion of this illustrative example that such an approach is necessarily applicable to local authority audits).

ISA (UK) 402 (Updated May 2022): Audit considerations relating to an entity using a service organisation

1-90 The objectives of the user auditor, when the user entity uses the services of a service organisation, are:

(a) to obtain an understanding of the nature and significance of the services provided by the service organisation and their effect on the user entity's internal control relevant to the audit, sufficient to identify and assess the risks of material misstatement; and

(b) to design and perform audit procedures responsive to those risks (ISA (UK) 402, 7).

Use of service organisations in the public sector

1-91 Public sector entities often use shared service providers. For example, transaction processing or payroll services may be outsourced to another entity, which could be private sector, another public sector organisation, or a joint venture between the two sectors.

1-92 Auditors consider how the audited body oversees the provider's performance and considers whether this raises the risk of misstatement. Where a national audit agency is the auditor of more than one user organisation for a service provider, the agency obtains an understanding of how each user entity is affected by the service organisation and makes individual assessments of risk and impact on the audit approach for each user entity.

Access rights to service organisations

1-93 Public sector auditors generally have broad rights of access established by legislation. However, there may be situations where such rights of access are not available, for example when the service organisation is located in a different jurisdiction. In such cases, a public sector auditor may need to obtain an

understanding of the legislation applicable in the different jurisdiction to determine whether appropriate access rights can be obtained. A public sector auditor may also obtain or ask the user entity to incorporate rights of access in any contractual arrangements between the user entity and the service organisation (ISA (UK) 402, A10 which relates to the requirements of ISA (UK) 402, 9).

1-94 ISA (UK) 402 in itself is not sufficient to secure access rights to service organisations for the public sector auditor. It is important that where such access rights are required, appropriate arrangements are made by the audited body to provide assurance to the auditor.

1-95 Public sector auditors may use another auditor to perform tests of controls or substantive procedures in relation to compliance with law, regulation or other authority (ISA (UK) 402, A11 which relates to the requirements of ISA (UK) 402, 9).

1-96 In some cases, law or regulation may require a reference to the work of a service auditor in the user auditor's report, for example, for the purposes of transparency in the public sector. In such circumstances, the user auditor may need the consent of the service auditor before making such a reference (ISA 402, A43 which relates to the requirements of ISA 402, 21).

ISA (UK) 510 (Revised June 2016): Initial audit engagements – opening balances

1-97 In conducting an initial audit engagement, the objective of the auditor with respect to opening balances is to obtain sufficient appropriate audit evidence about whether:

(a) opening balances contain misstatements that materially affect the current period's financial statements; and

(b) appropriate accounting policies reflected in the opening balances have been consistently applied in the current period's financial statements, or changes thereto are appropriately accounted for and adequately presented and disclosed in accordance with the applicable financial reporting framework (ISA (UK) 510, 3).

Opening balances in the context of a machinery of government change

1-98 ISA (UK) 510 is concerned with the opening balances for initial engagements. This can occur when the financial statements for the prior period were audited by another auditor, but is also relevant for "machinery of government changes" that transfer functions from one part of the public sector to another as a going concern.

1-99 Where opening balances are clearly identifiable from the preceding period's audited financial statements for the transferring entity the auditor adopts the requirements in paragraphs 6 and 7 of ISA (UK) 510.

1-100 Where opening balances are not clearly identifiable from the preceding period's audited financial statements for the transferring entity, but have been derived from balances contained in those statements, the auditor discusses with the auditor of the predecessor organisation whether information is available that would provide substantive evidence for the opening balances. In the absence of such evidence, the auditor carries out substantive testing on opening balances to confirm they have been brought forward appropriately in accordance with the terms of the transfer, at an appropriate valuation in line with the accounting policies of the receiving body.

1-101 Where opening balances have been calculated as part of a separate disaggregation or merger exercise, subject to a separate specific review and report by an auditor, the auditor considers the scope and outcomes of that separate review, and considers whether the conclusions can be relied on in accordance with ISA (UK) 500. Where the work from the separate specific review cannot be used, the auditor considers carrying out substantive testing on opening balances.

1-102 Where opening balances have been calculated as part of a separate disaggregation/merger exercise, but not subject to separate specific review and report, the auditor considers substantive testing on opening balances. Completeness of assets and liabilities, together with appropriate valuation can be risks in a disaggregation exercise, and engagement with the audited body occurs at an early stage.

1-103 Where, after performing the procedures described above, the auditor is unable to obtain sufficient appropriate audit evidence concerning the opening balances of the entity, the auditor considers the implications for the auditor's report.

The audit of opening balances by the incoming auditor

1-104 In the public sector, in the interests of efficiency and reducing the audit burden, the predecessor auditor is expected by the national audit agencies, relevant Codes of Audit Practice or terms of appointment to adopt a cooperative approach in dealing with enquiries and requests for information from the incoming auditor.

1-105 Arrangements to support a cooperative approach typically include enabling the incoming auditor to perform a review of the prior year audit documentation or have access to particular reports or papers that may be required rather than the transfer of all the relevant papers or data. While there is a clear expectation that auditors cooperate in support of effective handover arrangements, the incoming auditor remains responsible for meeting the requirements of ISA (UK) 510.

1-106 In the public sector, there may be legal or regulatory limitations on the information that the current auditor can obtain from a predecessor auditor. For

example, if a public sector entity that has previously been audited by a statutorily appointed auditor (for example, an Auditor General, or other suitably qualified person appointed on behalf of the Auditor General) is privatised, the amount of access to working papers or other information that the statutorily appointed auditor can provide a newly-appointed auditor that is in the private sector may be constrained by privacy or secrecy laws or regulations. In situations where such communications are constrained, audit evidence may need to be obtained through other means and, if sufficient appropriate audit evidence cannot be obtained, consideration is given to the effect on the auditor's opinion (ISA (UK) 510, A1 which relates to the requirements of ISA (UK) 510, 6).

1-107 If the statutorily appointed auditor outsources an audit of a public sector entity to a private sector audit firm, and the statutorily appointed auditor appoints an audit firm other than the firm that audited the financial statements of the public sector entity in the prior period, this is not usually regarded as a change in auditors for the statutorily appointed auditor. Depending on the nature of the outsourcing arrangement, however, the audit engagement may be considered an initial audit engagement from the perspective of the private sector auditor in fulfilling their responsibilities, and therefore [ISA (UK) 510] applies (ISA (UK) 510, A2 which relates to the requirements of ISA (UK) 510, 6).

ISA (UK) 540 (Revised December 2018) (Updated May 2022): Auditing accounting estimates and related disclosures

1-108 The objective of the auditor is to obtain sufficient appropriate audit evidence about whether accounting estimates and related disclosures in the financial statements are reasonable in the context of the applicable financial reporting framework (ISA (UK) 540, 11).

The risk of management bias in accounting estimates in the public sector

1-109 In the public sector, factors outside of the scope of the financial reporting framework can have a significant influence on management's estimates. For example, central government departments adhere to HM Treasury budgetary controls, so estimates in the financial statements can be influenced by the impact they have on departmental expenditure limits or the administration budget. In the health sector, statutory limits or targets can similarly influence management decisions.

1-110 Auditors obtain an understanding of these influences, some of which come from elsewhere within a departmental or sector group, when considering the appropriateness of accounting estimates and the assumptions applied by management.

Inherent risk factors relevant to accounting estimates in the public sector

1-111 Inherent risk factors that may be relevant to accounting estimates prepared by public sector entities include, but are not limited to:

- a very high degree of estimation uncertainty caused by the need to project forecasts far into the future, such as for provisions related to the disposal of nuclear waste or liabilities relating to defined benefit pension schemes;
- areas where the related skills or knowledge are highly specialised or rare or where there may be a lack of available comparators for estimates that are unique to the public sector, such as the valuation of important public assets or liabilities relating to the cost of carrying out public functions, including property valuations;
- the existence of possible constructive obligations created by political statements or past practice of carrying out actions that may be expected of public authorities but are not required by law; and
- general political uncertainty and the possibility of future changes in public policy having an impact on the assumptions used to prepare accounting estimates.

The use of third-party estimates in the financial statements

1-112 Some public sector entities are reliant on accounting estimates provided by other entities within the public sector. The auditor understands how these estimates have been derived, and may need to communicate with the auditors of the entities compiling the accounting estimates on which the public sector body relies.

The use of external information sources

1-113 Paragraphs A127-A129 of ISA (UK) 540, along with paragraph A31 of ISA (UK) 500, set out the auditor's considerations on the reliability of information from an external information source[8] .

1-114 In the public sector, such an external information source may be another body that is part of, or controlled by, the same government. For example, the Office for National Statistics and the Office for Budget Responsibility provide information that is suitable for use by a broad range of users. Where the public sector auditor considers that the

[8] External information sources are defined in ISA (UK) 500, 5(cA).

objectivity of an external information source may be reduced by political influence over both the audited entity and the external information source, the auditor considers whether additional procedures are necessary to corroborate the information from the external source.

Non-current assets in the public sector

1-115 Public sector entities may have significant holdings of specialised assets (for example, hospitals, schools, bridges or rail and road networks) for which there are no readily available and reliable sources of information for purposes of measurement at fair value or other current value bases, or a combination of both. Often specialised assets held do not generate cash flows and do not have an active market. Measurement at fair value therefore ordinarily requires estimation and may be complex; the methods employed may be different from more common techniques such as the estimation of future cash flows.

ISA (UK) 550 (Updated May 2022): Related parties

1-116 The objectives of the auditor are:

(a) Irrespective of whether the applicable financial reporting framework establishes related party requirements, to obtain an understanding of related party relationships and transactions sufficient to be able:

(i) to recognize fraud risk factors, if any, arising from related party relationships and transactions that are relevant to the identification and assessment of the risks of material misstatement due to fraud; and

(ii) to conclude, based on the audit evidence obtained, whether the financial statements, insofar as they are affected by those relationships and transactions:

- **achieve fair presentation (for fair presentation frameworks); or**
- **are not misleading (for compliance frameworks); and**

(b) in addition, where the applicable financial reporting framework establishes related party requirements, to obtain sufficient appropriate audit evidence about whether related party relationships and transactions have been appropriately identified, accounted for and disclosed in the financial statements in accordance with the framework (ISA (UK) 550, 9).

Public sector specific considerations with regard to related party transactions

1-117 The public sector auditor's responsibilities regarding related party relationships and transactions may be affected by the audit mandate, or by

obligations on public sector entities arising from law, regulation or other authority. Consequently, the public sector auditor's responsibilities may not be limited to addressing the risks of material misstatement associated with related party relationships and transactions, but may also include a broader responsibility to address the risks of non-compliance with law, regulation and other authority governing public sector bodies that lay down specific requirements in the conduct of business with related parties. Further, the public sector auditor may need to have regard to public sector financial reporting requirements for related party relationships and transactions that may differ from those in the private sector (ISA (UK) 550, A8 which relates to the requirements of ISA (UK) 550, 11).

1-118 Financial reporting frameworks establish specific accounting and disclosure requirements for related party relationships, transactions and balances to enable users of the financial statements to understand their nature and actual or potential effects on the financial statements. In particular, the audited body may need to consider the definition of a related party in respect of public sector bodies. A public sector body is not automatically a related party to another public sector body due to its classification. The related parties of public sector entities are subject to specific restrictions on the nature and scope of the relationships that they can enter into with the entity, which prescribe practices that might be permissible in relationships outside the public sector.

1-119 The auditor has a responsibility to perform audit procedures to identify, assess and respond to the risks of material misstatement arising from the entity's failure to appropriately account for or disclose related party relationships, transactions or balances in accordance with the requirements of the financial reporting framework.

ISA (UK) 560: Subsequent events

1-120 The objectives of the auditor are:

(a) to obtain sufficient appropriate audit evidence about whether events occurring between the date of the financial statements and the date of the auditor's report that require adjustment of, or disclosure in, the financial statements are appropriately reflected in those financial statements in accordance with the applicable financial reporting framework; and

(b) to respond appropriately to facts that become known to the auditor after the date of the auditor's report, that, had they been known to the auditor at that date, may have caused the auditor to amend the auditor's report (ISA (UK) 560, 4).

Additional considerations with regard to subsequent events in the public sector

1-121 In the public sector, the auditor may read the official records of relevant proceedings of the legislature and inquire about matters addressed in proceedings for which official records are not yet available (ISA (UK) 560, A10 which relates to the requirements of ISA (UK) 560, 7).

1-122 In addition to giving audit opinions on the financial statements, auditors of certain local government and health entities may be required to:

- discharge certain statutory responsibilities and duties; and
- issue a certificate confirming that the audit and all related responsibilities and duties have been completed in accordance with the legislation.

1-123 The issue of the audit completion certificate marks the end of the exercise of the auditor's powers and duties in respect of that statutory audit.

1-124 Fulfilling the auditor's other statutory responsibilities and duties may lead to a significant delay between when the auditor has obtained sufficient appropriate audit evidence to provide the opinion on the financial statements and when the auditor is in a position to issue the audit completion certificate.

1-125 In such circumstances, the auditor assesses whether the actions the auditor expects to take in discharge of those additional statutory responsibilities and duties could give rise to matters that could have a material effect on the financial statements. If the auditor believes that discharge of those statutory responsibilities and duties are likely to give rise to matters that would have a material effect on the financial statements, the auditor does not provide an opinion on the financial statements until after those additional steps have been completed.

1-126 An opinion given on the financial statements of a local government or health entity in advance of the issue of the audit completion certificate is:

- the final opinion on the financial statements for the purposes of compliance with ISAs (UK); and
- issued to coincide with the proposed date of issue of the financial statements by the audit committee.

1-127 If the auditor has not issued an audit completion certificate on the prior year audit then an audit completion certificate is not issued on the current year audit until the audit completion certificate in relation to the prior year has been issued.

Determining the relevant dates

1-128 The financial reporting framework may specify the date on which the financial statements are considered to be authorised for issue. For example, HM Treasury's *Financial Reporting Manual* states that for central government entities this date is normally the same as the date of the certificate of the Comptroller and Auditor General. This date is relevant, for example, for entities applying International Accounting Standard 10 *Events after the reporting period*, where such events occur between the end of the reporting period and the date the financial statements are authorised for issue.

1-129 The date that the financial statements are issued is relevant to the requirements on the auditor under ISA (UK) 560.

1-130 **In the case of the public sector, the date the financial statements are issued may be the date the audited financial statements and the auditor's report thereon are presented to the legislature or otherwise made public (ISA (UK) 560, A5 which relates to the requirements of ISA (UK) 560, 5).** This means that for entities such as local government bodies that do not present their accounts to a legislature, the date the financial statements are issued is the date the audited financial statements and the auditor's report are made public.

1-131 The financial statements of central government entities are considered to be issued on the following dates:

Central government entities where the financial statements are laid in one or both of the Houses of Parliament	Date the financial statements are laid before the House(s).
Welsh Government and its sponsored and related public bodies, and NHS Wales entities	Date the financial statements are laid before the Welsh Parliament.
Central government entities in Scotland	Date the financial statements are laid before the Scottish Parliament.
Central government and health entities in Northern Ireland	Date the financial statements are laid before the Northern Ireland Assembly.
Central government entities where the financial statements are laid before multiple legislatures, where the laying takes place on different dates	Date of laying before the first legislature where the financial statements are laid.

1-132 In central government, the financial statements of most reporting entities are generally laid before: the House of Commons; the House of Lords; both of these Houses of Parliament; the Welsh Parliament; the Northern Ireland Assembly or the Scottish Parliament. However, for certain entities, usually arm's length public bodies, the financial statements may also be considered by an intermediate body (often a board, trustees or equivalent) before being formally laid before Parliament, either by the intermediate body, by the Secretary of State of the department responsible for the entity, or by HM Treasury. Where such a reporting hierarchy exists, the auditor considers subsequent events that the auditor becomes aware of and that occur from the date of the auditor's report until the date on which the financial statements are laid before the Parliament or the Assembly.

1-133 The financial statements of some central government entities are not formally laid before the Houses of Parliament but may be deposited in the libraries of the House of Commons and House of Lords by the sponsor department. Because the financial statements of these entities are not formally laid before Parliament, the auditor only considers subsequent events that occur up to the date on which the financial statements are issued. Otherwise, the auditor of a central government entity follows the requirements of ISA (UK) 560 for subsequent events occurring between the dates of issue and of laying before the Parliament or the Assembly.

Facts which become known to the auditor after the date of the auditor's report but before the financial statements are issued

1-134 After the date of the auditor's report, an auditor has no obligation to perform audit procedures regarding those financial statements. Accordingly, after this date, there is no requirement for the auditor to seek out information that may have implications for the audit opinion that has already been given.

1-135 If, after the date of the auditor's report but before the date the financial statements are issued, a fact becomes known to the auditor that, had it been known to the auditor at the date of the auditor's report, may have caused the auditor to amend the auditor's report:

- Paragraphs 10 to 13 of ISA (UK) 560 require the auditor to perform further procedures; and
- If, after completing such further procedures, the auditor concludes that there is relevant information that would have impacted the opinion on the financial statements, the auditor refers to such matters in the audit completion certificate.

1-136 If those charged with governance decide not to amend the financial statements, where the auditor believes that they need to be revised, the auditor considers taking appropriate steps on a timely basis to prevent reliance on the auditor's report:

- if the financial statements are considered by an intermediate body before being despatched to the Secretary of State of the sponsor department and before being laid before Parliament, the auditor considers making a statement to that body, depending on the auditor's relationship with the intermediate body as may be set out in the auditor's terms of engagement, and in the light of any legal advice on the auditor's position; and
- if there is no intermediate body, and the entity has despatched the financial statements to the Secretary of State of the sponsor department but they have yet to be laid before

Parliament, then subject to any legal advice on the auditor's position, the auditor considers reporting the auditor's concerns to the department. If the content of the auditor's letter of appointment is based on the guidance issued by HM Treasury, the auditor normally has right of access to report to the department any matters of importance arising out of the auditor's work.

1-137 In the public sector, the actions taken in accordance with paragraph 13 [of ISA (UK) 560] when management does not amend the financial statements may also include reporting separately to the legislature, or other relevant body in the reporting hierarchy, on the implications of the subsequent event for the financial statements and the auditor's report (ISA (UK) 560, A14 which relates to the requirements of ISA (UK) 560, 13).

1-138 Where the financial statements are produced by an entity which is audited by the Comptroller and Auditor General, the auditor has the possibility of reporting separately to Parliament on the implications of the subsequent event for the financial statements and the auditor's report. Similar arrangements enable the Auditor General for Wales to report separately to the Welsh Parliament, the Auditor General for Scotland to report to the Scottish Parliament and the Comptroller and Auditor General for Northern Ireland to report to the Northern Ireland Assembly. For local government or health entities the issue of the audit completion certificate marks the closure of the audit and the end of the exercise of the auditor's powers.

1-139 Where the subsequent event occurred after the date of the auditor's report, the auditor may, in addition to seeking legal advice, discuss the matter with the entity's Chief Executive and with the sponsor department to establish whether it might be possible to withdraw the auditor's report before the financial statements are laid before the Parliament or the Assembly.

Facts which become known after the financial statements have been issued

1-140 In some jurisdictions, entities in the public sector may be prohibited from issuing amended financial statements by law or regulation. In such circumstances, the appropriate course of action for the auditor may be to report to the appropriate statutory body (ISA (UK) 560, A17 which relates to the requirements of ISA (UK) 560, 15).

1-141 In the public sector, the issue of the auditor's statutory audit opinion marks the end of the audit and, for some public sector audit engagements, once the financial statements have been issued they cannot be revised and the auditor's report cannot be re-issued. If a matter that needs to be drawn to the attention of stakeholders arises once the financial statements have been issued and it is not possible to re-issue the audit opinion, the auditor has other mechanisms available for making a public statement. For example, in the central government sector the relevant Auditor General can report to Parliament/Assembly or local auditors or the Controller of Audit in Scotland or the Auditor General for Wales can consider the issue of a public interest report.

ISA (UK) 570 (Revised September 2019) (Updated May 2022): Going concern

1-142 The objectives of the auditor are:

(a) to obtain sufficient appropriate audit evidence regarding, and conclude on:

- **whether a material uncertainty related to going concern exists; and**
- **the appropriateness of management's use of the going concern basis of accounting in the preparation of the financial statements; and**

(b) to report in accordance with [ISA (UK) 570] (ISA (UK) 570, 9-1).

Key principles

1-143 This section of Practice Note 10 provides guidance on the application of ISA (UK) 570 for public sector entities that is based on the following principles:

a) The approach to going concern is fully compliant with ISAs (UK).

b) Nevertheless, in many (but not all) public sector entities, the use of the going concern basis of accounting is not a matter of significant focus of the auditor's time and resources because the applicable financial reporting frameworks envisage that the going concern basis for accounting will apply where the entity's services will continue to be delivered by the public sector. In such cases, a material uncertainty related to going concern is unlikely to exist.

c) Because of this, a straightforward and standardised approach to compliance with ISA (UK) 570 will often be appropriate for entities of the type referred to in (b).

d) Even where the financial reporting framework does not include provisions of the kind referred to in (b), the fact that public sector entities are likely to be able to draw upon government assistance in realising their assets and settling their liabilities means that the going concern basis of accounting may (but will not always) be more likely to apply than for private sector entities in a comparable financial position. The auditor reflects these circumstances in the conclusions they draw on going concern for the purpose of the auditor's report.

e) For many public sector entities, the financial sustainability of the reporting entity and the services it provides is more likely to be of significant public interest than the application of the going concern basis of accounting. These matters are not directly relevant to the auditor's opinion, but the auditor may wish to use additional reporting powers to draw the user's attention to financial sustainability concerns.

Going concern in the public sector

1-144 In the public sector, management's use of the going concern basis of accounting may be driven by the requirements of the financial reporting framework rather than the financial sustainability of the reporting entity. Where the auditor considers that the use of the going concern basis of accounting is appropriate, but there are nevertheless significant financial sustainability issues to bring to the attention of the user of the accounts, the auditor uses those reporting powers that are considered appropriate in the circumstances. This reporting may not result in a modification to the auditor's report. The following guidance on ISA (UK) 570 deals principally with going concern rather than financial sustainability reporting.

1-145 The application guidance in ISA (UK) 570 gives the following examples of going concern issues that may arise in the public sector. **They include, but are not limited to, situations where public sector entities operate on a for-profit basis, where government support may be reduced or withdrawn, or in the case of privatisation. Events or conditions that may cast significant doubt on an entity's ability to continue as a going concern in the public sector may include situations where the public sector entity lacks funding for its continued existence or when policy decisions are made that affect the services provided by the public sector entity (ISA (UK) 570, A2 which relates to the requirements of ISA (UK) 570, 2).**

1-146 Auditors report by exception on the robustness of management's assessment and adequacy of disclosures in respect of the emerging and principal risks facing the entity, as well as reporting on material uncertainty in respect of going concern in a separate section of the auditor's report.

Sector-specific guidance

1-147 In addition to the requirements of ISAs (UK) and this Practice Note, the public sector auditor has regard to guidance issued by relevant authorities on the audit of going concern, which may include illustrative examples, where such guidance pertains to the audited entity's particular sector or circumstances. For example, auditors of local authorities and local NHS bodies have regard to guidance notes issued in accordance with the *Local Audit and Accountability Act 2014*[9].

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[9] Supplementary Guidance Note (SGN) 01 *Going concern – auditor's responsibilities for local public bodies* issued by the National Audit Office in September 2021 is a relevant source of guidance for local auditors in England for the purpose of this paragraph.

Planning the approach to going concern

1-148 In the first instance, the auditor determines a proportionate approach to going concern based on the audited entity's circumstances and the applicable financial reporting framework.

1-149 The financial reporting framework may provide that anticipated continuation of the provision of a service in the future will be presumed to provide sufficient evidence to prepare the financial statements on a going concern basis. For example, HM Treasury's *Financial Reporting Manual* includes such a provision. The presence or absence of such a provision determines the extent of the auditor's procedures on going concern.

1-150 If the financial reporting framework provides for the adoption of the going concern basis of accounting on the basis of the anticipated continuation of the provision of a service in the future, the auditor applies the continued provision of service approach set out in this section of Practice Note 10 (the sections titled 'Continued provision of service approach – risk assessment procedures' and 'Continued provision of service approach – evaluating management's assessment').

1-151 If the financial reporting framework does not provide for the adoption of the going concern basis of accounting on the basis of the anticipated continuation of the provision of a service in the future, the auditor applies ISA (UK) 570, taking into account the remainder of the ISA (UK) 570 section of Practice Note 10.

1-152 The financial reporting frameworks that include these provisions do so to reflect the particular circumstances applying to public sector entities. In the public sector, entities may have a deficit of income over expenditure or an excess of liabilities over assets. However, the operational existence of a public sector entity will not always cease, or its scale of operations be subject to a forced reduction, as a result of an inability to finance its operations or its net liabilities. The reasons for this are:

- local government entities are statutory bodies that are required to maintain delivery of functions essential to the local communities, are themselves revenue-raising bodies and may have the possibility, on application, of recovering losses over a period;
- there is a general assumption that no part of the NHS will be allowed to cease operations other than by deliberate closure by central government, announced in advance. Legislation is in place under which the liabilities of NHS trusts are transferred to another public entity if the trust is closed; and
- government departments can act to avoid financial failures by individual entities in central government and other parts of the public sector and thus secure continuation of the delivery of public services.

Continued provision of service approach – risk assessment procedures and related activities

1-153 The auditor performs risk assessment procedures over going concern as required by paragraphs 10-1 and 10-2 of ISA (UK) 570. The auditor obtains an understanding of the following with respect to going concern: the entity and its environment; the applicable financial reporting framework; and the entity's system of internal control.

1-154 The considerations in paragraph A4-1 of ISA (UK) 570[10] would in most cases be expected to apply to a public entity 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.

1-155 If the auditor applies the continued provision of service approach to going concern, performing the risk assessment procedures required by ISA (UK) 570 involves the auditor obtaining sufficient evidence to conclude that:

a) the nature of the entity means that, notwithstanding any intention to liquidate the entity or cease its operations in their current form, it will continue to be appropriate to adopt the going concern basis of accounting because, in such an event, services it performs can be expected to continue to be delivered by related public authorities and preparing the financial statements on a going concern basis will still provide a faithful representation of the items in the financial statements;

b) the financial reporting framework permits the entity to prepare its financial statements on the basis of the presumption set out under (a) above; and

c) the entity's system of internal control to identify events or conditions relevant to going concern is proportionate to the low risk that a material uncertainty related to going concern exists.

1-156 However, if the auditor's risk assessment concludes that it may be inappropriate to assume that the services being performed by the entity will continue to be performed for the foreseeable future, the auditor ceases to apply the continued provision of service

[10] The nature, timing and extent of the auditor's risk assessment procedures to obtain the understanding required in paragraphs 10-1 to 10-2 of ISA (UK) 570 may depend on the extent to which individual matter(s) apply in the circumstances. Accordingly, some considerations about the nature and extent of oversight and governance the entity has in place may be less relevant or not applicable. Furthermore, management's method to assess the entity's ability to continue as a going concern may be uncomplicated because the business is affected to a lesser degree by events and conditions that, individually or collectively, may cast significant doubt on the entity's ability to continue as a going concern. In such circumstances, the auditor's risk assessment procedures are likely to be less extensive. (ISA (UK) 570, A4-1).

approach and reverts to alternative procedures to fulfil the requirements of ISA (UK) 570, taking into account the remainder of the ISA (UK) 570 section of Practice Note 10.

1-157 The risk assessment set out in this section is based on a consideration of whether the services provided by the audited entity will continue to be delivered. Those services might, in future, be delivered by the same entity, by another public sector entity or entities, or outside of the public sector. The continued existence and funding, or otherwise, of the audited entity is not, in itself, relevant to the auditor's risk assessment procedures over going concern 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. The auditor performs these risk assessment procedures in the knowledge that 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.

Continued provision of service approach – evaluating management's assessment

1-158 In the public sector, management may not always make a detailed or explicit going concern assessment because of the apparent straightforwardness of the going concern assessment in cases such as those described above. However, the auditor is still required to perform procedures to evaluate management's assessment of going concern (ISA (UK) 570, 12-1 to 12.3).

1-159 Paragraph A8-1 of ISA (UK) 570[11] sets out considerations that may apply to 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.

1-160 Notwithstanding this, although the auditor may conclude without a detailed analysis by management, paragraph 10-3 of ISA (UK) 570 requires the auditor to make a request to

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[11] It is not the auditor's responsibility to rectify the lack of analysis by management. In some circumstances, however, the lack of detailed analysis by management to support its assessment may not prevent the auditor from concluding whether management's use of the going concern basis of accounting is appropriate in the circumstances. In this case, the auditor's evaluation of the appropriateness of management's assessment may be made without performing detailed evaluation procedures if the auditor's other audit procedures are sufficient to enable the auditor to conclude whether management's use of the going concern basis of accounting in the preparation of the financial statements is appropriate in the circumstances (ISA (UK) 570, A8-1).

management that they perform an assessment of the entity's ability to continue as a going concern where they have not done so.

1-161 When performing the procedures required by paragraph 12-2 of ISA (UK) 570, where the auditor plans to perform less extensive risk assessment procedures over going concern in accordance with the approach set out in this section of Practice Note 10, the auditor's evaluation of:

- management's method to assess the entity's ability to continue as a going concern (12-2(a));
- the relevance and reliability of the underlying data (12-2(b)); and
- the appropriateness of the underlying assumptions (12-2(c))

may comprise the auditor obtaining sufficient evidence of the following matters to conclude that:

a) either:
    - (where management has made a simple assessment of the entity's ability to continue as a going concern): management's assessment is clearly appropriate in the circumstances; or
    - (where management has made no assessment despite a request under paragraph 10-3 of ISA (UK) 570): the auditor is able to conclude in the absence of detailed analysis by management in accordance with paragraph A8-1 of ISA (UK) 570; and
b) either:
    - (where management has made a simple assessment of the entity's ability to continue as a going concern): no underlying data exists because management's assessment is not based on quantitative factors; or
    - (where management has made no assessment despite a request under paragraph 10-3 of ISA (UK) 570): there are no underlying data or assumptions to assess because management has not made its own assessment; and
c) an appropriate underlying assumption is made that, because of the nature of the entity, notwithstanding any intention to liquidate the entity or cease its operations in their current form, services the entity performs can be expected to continue to be delivered by related public authorities and preparing the financial statements on a going concern basis will still provide a faithful representation of the items in the financial statements; and
d) the financial reporting framework permits the entity to prepare its financial statements on the basis of the presumption set out under (c) above.

1-162 However, if the auditor is unable to obtain sufficient evidence to support the assumption that the services being performed by the entity will continue to be performed for the foreseeable future, and is therefore unable to draw the conclusions outlined in the preceding paragraph, the auditor ceases to apply the continued provision of service approach and reverts to alternative procedures to fulfil the requirements of ISA (UK) 570, taking into account the remainder of the ISA (UK) 570 section of Practice Note 10.

1-163 For audited 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, the auditor's conclusions regarding management's assessment, as set out in this section, are concerned with whether the services provided by the audited entity will continue to be delivered. Management's assessment – and the auditor's evaluation thereof – need not address any uncertainty over the continued existence and funding, or otherwise, of such an entity, provided that this uncertainty does not also extend to the future delivery of the services.

1-164 In making judgements in the evaluation of management's assessment, the auditor has regard to the considerations in the section below titled 'The auditor's responsibilities for the consideration of the appropriateness of the going concern basis'.

The auditor's responsibilities for the consideration of the appropriateness of the going concern basis

1-165 In forming a view on the entity's ability to continue its operations, the public sector auditor's consideration of going concern covers two separate, but sometimes overlapping, factors:

- the risk associated with changes in policy direction; and
- operational or business risk.

1-166 The auditor ascertains whether the Parliament/Assembly has a known intention to abolish, transfer or privatise the activities of the audited entity.

1-167 When the auditor becomes aware of information which indicates that the Parliament/Assembly has made, or plans to make, a decision which is likely to impact on the entity's continued operational existence, the auditor first establishes whether the entity's operational activities are likely to be transferred elsewhere in the public sector. If they are, irrespective of whether the entity will continue to operate, the going concern basis of preparation of the financial statements is likely to remain appropriate. If they are not to be transferred within the public sector, then in considering the going concern assumption, the auditor may decide to request that the audited entity secures from the relevant department or executive body a letter of financial support, confirming that the entity continues to have financial backing to utilise its assets and meet liabilities as they fall due. The decision to obtain evidence of support takes into account other results of the management's or the auditor's assessment of going concern, for example the assessment of forecasts, available resources and material uncertainties.

1-168 Some public sector bodies may have a statutory duty to break even. The existence of such a requirement may influence the scope and nature of audit procedures; for example, it may be appropriate to consider the financial performance of the entity, including the effectiveness of financial recovery plans. Failing to break-even does not in itself indicate a going concern issue.

1-169 Given that a key consideration in the public sector is the Parliament's/Assembly's intention, in some cases the public sector auditor may consider requesting that the entity secures direct confirmation from the department or executive body responsible for providing financial backing to the entity that there are no plans that would be likely to impact on the entity's continued operational existence. In such circumstances, a representation provided by the Accounting/Accountable Officer or responsible financial officer of the entity that financial backing will continue to be received may not be sufficient as meaningful assurance over the future of an entity. This is because the representation could be based upon presumption of knowledge of facts about the intentions of the financial backer that might not be possessed by the entity or judgements about future conditions for support that the entity is not capable of making.

1-170 Where there are indications that the entity may cease operations and the auditor judges that the going concern basis is appropriate for the preparation of a public sector entity's financial statements substantially on the basis of third-party confirmations received from the department or executive body responsible for providing financial backing, the auditor considers whether this is a matter of such significance that the confirmations are referred to in the financial statements and in the auditor's report as being relevant to a proper understanding of the basis of the auditor's opinion. Even where it is not deemed necessary to refer to the confirmations in the financial statements, if the auditor is required to report under paragraph 21-1(d) of ISA (UK) 570[12], the auditor may consider it appropriate to refer to the use of the confirmations as audit evidence in the auditor's report when describing the procedures that have been performed in respect of the going concern assumption.

1-171 If no appropriate representations or confirmations can be obtained, the auditor considers whether there is a material uncertainty that requires a separate section under the heading 'Material Uncertainty Related to Going Concern' in the auditor's report.

Consideration of the foreseeable future

1-172 Decisions to abolish, transfer or privatise the functions of public sector bodies are inherently subject to political uncertainty; for example changes of government or ministerial positions. However, it is rare that the future cannot be predicted with some certainty for

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[12] See the section below titled 'Reference in the auditor's report to going concern'.

the period up to one year from the date of approval of the financial statements. Political decisions, in particular transfers of functions between different entities, can often be as, or even more uncertain than those completely unforeseeable risks faced by all private sector companies, of which neither the directors nor the auditor could be aware.

Circumstances where the going concern basis is in doubt

1-173 Cessation is most likely to result from a legislative change or a decision made by Parliament/Assembly. A decision may be taken to:

- wind-up and dissolve an entity in its entirety, where central government determines that the entity's functions are no longer required;
- wind-up and dissolve all or part of an entity, but transfer some or all of its functions to another entity in the same sector or another sector;
- merge the entity, or some part of it, with another in the same sector; or
- privatise an entity, or some part of it, where the government decides that certain functions would be better delivered by the private sector.

1-174 In each of these cases the operational existence of all or part of the entity ceases, but only in the case of dissolution without any continuation of operations would the going concern basis cease clearly to be appropriate. In the other cases the auditor considers the basis on which the activities are transferred, from the viewpoint of the entity that is relinquishing the assets and liabilities at the accounting date.

1-175 In the public sector it is not uncommon for statutory bodies to give guarantees which, if called upon, cannot be met by the resources currently available to the organisation. In such circumstances, the auditor considers whether the disclosures made by management in respect of going concern are adequate and whether the matter needs to be referred to in the auditor's report.

1-176 Where a central government entity operates at arm's length from government, particularly in a trading capacity, the auditor may determine that a deficit of income over expenditure or an excess of liabilities over assets undermines the going concern assumption.

Public sector auditors' responsibilities for reviewing and reporting upon an entity's arrangements for securing value for money

1-177 Auditing frameworks may require public sector auditors to review and report upon the entity's arrangements for securing value for money and in such cases it may be appropriate for auditors to consider how the entity ensures that it is able to maintain the sustainability of its services and finances. But, where auditors identify concerns about an entity's general financial health, or its arrangements for maintaining the sustainability of its services and finances, this does not necessarily cast doubt upon the entity's ability to continue to prepare its financial statements on a going concern basis.

References in the auditor's report to going concern

1-178 For the bodies specified in paragraph 21-1(d) of ISA (UK) 570[13], the section of the auditor's report titled 'Conclusions relating to Going Concern' includes an explanation of how the auditor evaluated management's assessment of the entity's ability to continue as a going concern and, where relevant, key observations arising with respect to that evaluation. Where the auditor's conclusions are based on the considerations set out in this section of Practice Note 10, such as a necessity for the service provided by the public sector entity to continue to be delivered in some form, the auditor makes reference to these considerations in the 'Conclusions relating to Going Concern' section of the auditor's report.

1-179 Where the situation relating to the public sector entity's going concern status is complex, or there are significant concerns with respect to the financial sustainability of the services being delivered, the auditor considers using any additional reporting powers to report further on these considerations.

1-180 In preparing the auditor's report, the auditor considers whether it would be beneficial to include an explanation of conclusions relating to going concern that clearly articulates the meaning of the concept of going concern as covered by the auditor's work. This section of the auditor's report, if included, might include an explanation that the conclusions given do not amount to assurance regarding the entity's current or future financial sustainability.

1-181 If the auditor disclaims their opinion on the financial statements, even if the auditor is able to apply the continued provision of service approach to going concern, as described earlier in the ISA (UK) 570 section of this Practice Note, the auditor does not report under paragraph 21-1 of ISA (UK) 570 within a 'Conclusions relating to Going Concern' section of the auditor's report, because the auditor is unable to obtain sufficient appropriate audit evidence to conclude that the going concern basis of accounting is appropriate.

1-182 Additional considerations relevant to the content of the auditor's report are set out in the sections above titled 'The auditor's responsibilities for the consideration of the appropriateness of the going concern basis' and 'Going concern where public sector entities prepare financial statements on a cash basis'.

[13] These entities, as specified in paragraph 21-1(d) of ISA (UK) 570, are public interest entities, other listed entities, entities that are required, and those that choose voluntarily, to report on how they have applied the UK Corporate Governance Code, and other entities subject to the governance requirements of the *Companies (Miscellaneous Reporting) Regulations 2018*.

ISA (UK) 580 (Updated May 2022): Written representations

1-183 The objectives of the auditor are:

(a) to obtain written representations from management and, where appropriate, those charged with governance that they believe that they have fulfilled their responsibility for the preparation of the financial statements and for the completeness of the information provided to the auditor;

(b) to support other audit evidence relevant to the financial statements or specific assertions in the financial statements by means of written representations if determined necessary by the auditor or required by other ISAs (UK); and

(c) to respond appropriately to written representations provided by management and, where appropriate, those charged with governance, or if management or, where appropriate, those charged with governance do not provide the written representations requested by the auditor (ISA (UK) 580, 6).

Identifying who is competent to give written representation in the public sector

1-184 The auditor takes care to ensure that representations are only accepted from those competent to give them, such that:

- acknowledgement of the responsibilities of "directors" for the financial statements is made by those in whom the responsibilities are vested; and
- management representations on matters material to the financial statements are made by persons who have knowledge of the facts or who are authorised to make the judgement or express the opinion.

1-185 In central government and health entities, representations will usually be obtained from the Accounting Officer or the Accountable Officer. At local government bodies, the responsible finance officer has statutory responsibility for the proper administration of the entity's financial affairs. The auditor of a local government entity may therefore obtain representations from the responsible finance officer.

The content of written representations in the public sector

1-186 The mandates for audits of the financial statements of public sector entities may be broader than those of other entities. As a result, the premise, relating to management's responsibilities, on which an audit of the financial statements of a public sector entity is conducted may give rise to additional written representations. These may include written representations confirming that transactions and events have been carried out in accordance with law, regulation or other authority (ISA 580, A9 which relates to the requirements of ISA 580, 10–11).

ISA (UK) 600 (Revised September 2022): Special considerations – audits of group financial statements (including the work of component auditors)

1-187 The objectives of the auditor are to:

(a) with respect to the acceptance and continuance of the group audit engagement, determine whether sufficient appropriate audit evidence can reasonably be expected to be obtained to provide a basis for forming an opinion on the group financial statements;

(b) identify and assess the risks of material misstatement of the group financial statements, whether due to fraud or error, and plan and perform further audit procedures to appropriately respond to those assessed risks;

(c) be sufficiently and appropriately involved in the work of component auditors throughout the group audit, including communicating clearly about the scope and timing of their work, and evaluating the results of that work; and

(d) evaluate whether sufficient appropriate audit evidence has been obtained from the audit procedures performed, including with respect to the work performed by component auditors, as a basis for forming an opinion on the group financial statements.In certain parts of the public sector, where the responsibilities of principal and other auditors are governed by statutory provisions, these override the provisions of ISA (UK) 600 (ISA (UK) 600, A1-1 which relates to the requirements of ISA (UK) 600, 1).

1-188 In the public sector, the option of declining or withdrawing from an engagement may not be available to the auditor due to the nature of the mandate or public interest considerations. In these circumstances, ISA (UK) 600 still applies to the group audit, and the effect of the group engagement team's inability to obtain sufficient appropriate audit evidence is considered in terms of ISA (UK) 705.

1-189 Groups are common in certain parts of the public sector. For example, central government in the United Kingdom issues consolidated financial statements for government departments and Whole of Government Accounts. Individual public sector entities may have shares or ownership in companies.

1-190 Auditors are reminded of the specific public sector interpretations in respect of preparation of the group accounts and a definition of control. These may be included in the applicable financial reporting framework, such as HM Treasury's *Financial Reporting Manual* for central government entities. Based on that information, the auditor assesses whether the audited entity should produce group financial statements and which entities should be consolidated.

Combined financial statements with a large number of individually immaterial components that are material in aggregate

1-191 Public entities may prepare combined financial statements which include the financial information prepared by a large number of components whose financial information is individually immaterial, and over which significant classes of transactions, account balances and disclosures are disaggregated, but whose financial information is material in aggregate to the group financial statements. The auditor of the combined financial statements applies ISA (UK) 600 to the audit of such combined financial statements, which are group financial statements for the purpose of paragraphs 2 and 14(k) of ISA (UK) 600, in that they include the financial information of more than one entity or business unit through a consolidation process.

1-192 Paragraphs A128 to A130 of ISA (UK) 600 provide application guidance which is relevant to the circumstances envisaged by the preceding paragraph. Where there is a degree of homogeneity between all the components or between specific sets of components (for example, the group contains many entities which operate under a common legal framework or business model, or perform a common set of public functions, and/or there is a degree of standardisation between these), it may be possible to identify and assess risks of material misstatement of the group financial statements by considering these components or sets of components on an aggregated basis in the context of group performance materiality.

1-193 In the scenario described in the previous paragraph (large consolidations with a degree of homogeneity between components or sets of components), in cases where it is necessary to perform audit procedures at selected components, as described in paragraph A130 of ISA (UK) 600, the auditor may use the audit sampling principles in ISA (UK) 530 to inform their professional judgement regarding the determination of the components at which audit procedures are to be performed.

1-194 For example, the group engagement team for a sector consolidation may conclude that procedures to address the risks of material misstatement of the group financial statements can be performed on a statistical sample of components which has been selected to be representative of a defined set of components. The population to be sampled from may consist, for example, of a category of components which are each the same legal class of entity, or which each perform the same specific public function. A sample of these components can then be selected and procedures performed over the sample which (possibly in combination with a further set of audit procedures performed centrally) provide a reasonable basis for the auditor to draw conclusions about the population of components from which the sample was selected.

1-195 In the context of the type of audit described in this section, the auditor interprets those charged with governance of the group (as defined in paragraph 10(a) of ISA (UK) 260) as referring to the person(s) or organisation(s) with responsibility for overseeing the financial reporting process relating to the combined financial statements. This group may have responsibility for overseeing the strategic direction and obligations related to the accountability of the sector to which the financial information included in the combined financial statements relates.

1-196 The interpretation described in the preceding paragraph (for the purpose of identifying those charged with governance of the group in the audit of combined financial statements of components that have no parent) may also be relevant to the identification of those charged with governance in the context of other types of group audit, where this is open to interpretation.

ISA (UK) 610 (Revised June 2013) (Updated May 2022): Using the work of internal auditors

1-197 The objectives of the external auditor, where the entity has an internal audit function and the external auditor expects to use the work of the function to modify the nature or timing, or reduce the extent, of audit procedures to be performed directly by the external auditor, or to use internal auditors to provide direct assistance, are:

(a) to determine whether the work of the internal audit function or direct assistance from internal auditors can be used, and if so, in which areas and to what extent;

and having made that determination:

(b) if using the work of the internal audit function, to determine whether that work is adequate for purposes of the audit; and

(c) if using internal auditors to provide direct assistance, to appropriately direct, supervise and review their work. (ISA (UK) 610, 13).

Using the work of internal audit in relation to the auditor's other responsibilities.

1-198 The auditor may have responsibilities to review the systems of internal control, in addition to the audit of financial statements, for example to provide a negative assurance on the Governance Statement. The work of internal audit may be assessed for such purposes, even if the auditor considers that it may not be possible or desirable to use its work in specific areas for the purpose of the external audit of the financial statements.

1-199 The work of internal audit may also be considered in relation to the auditor's other responsibilities. Where matters come to the auditor's attention relating to the work of internal audit, these findings are properly reviewed in accordance with ISA (UK) 610 for their potential impact on the audit of the financial statements.

ISA (UK) 620 (Revised November 2019) (Updated May 2022): Using the work of an auditor's expert

1-200 The objectives of the auditor are:

(a) to determine whether to use the work of an auditor's expert; and

(b) if using the work of an auditor's expert, to determine whether that work is adequate for the auditor's purposes (ISA (UK) 620, 5).

1-201 In the public sector, there may be circumstances (in addition to those described in ISA (UK) 620), where the auditor is required to use the work of an auditor's expert. For example, for the audit of specialist or complex accounting estimates, the auditor may need to appoint an expert to obtain understanding of the estimation process. Another example is when one auditor appoints an expert to provide assurance to a number of auditors, for example in respect of professional valuation of properties or a pension scheme.

1-202 In addition to their role assisting the auditor in obtaining evidence for the purpose of the audit opinion, auditor's experts may also provide information and expertise which the auditor can use in discharging their wider responsibilities for public audit. For example, the auditor may request insights from the auditor's expert regarding improvements the audited entity might make to its financial management. The auditor may then use this information in their communication with management and those charged with governance and/or in their wider reporting.

ISA (UK) 700 (Revised November 2019) (Updated May 2022): Forming an opinion and reporting on financial statements

1-203 The objectives of the auditor are:

(a) to form an opinion on the financial statements based on an evaluation of the conclusions drawn from the audit evidence obtained; and

(b) to express clearly that opinion through a written report (ISA (UK) 700, 6).

1-204 The section of this guidance on extended auditor's reporting reflects the fact that some public sector auditors report under ISA (UK) 701.

Addressee of the auditor's report in the public sector

1-205 ISA (UK) 700 requires the title of an auditor's report to identify the person or persons to whom it is addressed. This is normally the person or persons on whose behalf the audit is undertaken and will vary across the public sector, depending upon the relevant auditing framework.

Reports by contracted-out auditors to national audit agencies

1-206 Where an audit is carried out on a "contracted-out" basis then the contract between the firm and the audit agency may specify that the firm issues an auditor's report to the audit agency. Under these circumstances this is outside of the scope of ISA (UK) 700 and the reporting arrangements will be defined by the contract between the firm and the audit agency. The report the firm issues to the audit agency reflects the scope of the engagement under the terms of the contract.

The requirement to certify that the audit has been completed in the public sector

1-207 For certain entities there is a requirement to certify that the audit has been carried out or to certify that the audit has been completed. The former is a fundamental part of the audit opinion as required by the legislation for specific public bodies and is incorporated into the wording of the introductory paragraph to the auditor's report. The latter is a wider responsibility for auditors of local government in England and Wales and health entities in England and its link with the opinion on the financial statements needs to be understood. Auditors may refer to the separate guidance on this issue that is published by the relevant national audit agency.

Reference to the basis for the audit in the public sector auditor's report

1-208 Where the requirement to audit an entity's financial statements is provided for under statute, the auditor refers to the relevant Act of Parliament and accounts direction when identifying the financial statements have been audited. The relevant Act of Parliament and accounts direction will vary across the public sector.

Implications of the prescribed wording of the audit opinion on compliance with International Standards on Auditing (UK)

1-209 Although most public sector financial statements require an opinion as to whether the financial statements give a true and fair view, some auditing frameworks requires an opinion as to whether the financial statements present fairly or properly present the entity's transactions or balances. Whichever wording is used will not have an impact on the extent to which the auditor observes the requirements of auditing standards.

Extended auditor reporting

1-210 **Listed entities are not common in the public sector. However, public sector entities may be significant due to size, complexity or public interest aspects. In such cases, an auditor of a public sector entity may be required by law or regulation or may otherwise decide to communicate key audit matters in the**

auditor's report (ISA (UK) 700, A43 which relates to the requirements of ISA (UK) 700, 31).

1-211 **Auditors of public sector entities may also have the ability pursuant to law or regulation to report publicly on certain matters, either in the auditor's report or in a supplementary report, which may include information that is consistent with the objectives of ISA (UK) 701. In such circumstances, the auditor may need to tailor certain aspects of the communication of key audit matters in the auditor's report required by ISA (UK) 701 or include a reference in the auditor's report to a description of the matter in the supplementary report (ISA (UK) 700, A75 which relates to the requirements of ISA (UK) 700, 50).**

1-212 Extended auditor's reporting requirements including key audit matters (as determined by ISA (UK) 701)[14] apply in the public sector, where the audited body is required by the regulator or voluntarily chooses to adopt the UK Corporate Governance Code. While many public sector bodies do not meet these criteria, the auditor may consider it appropriate to include this information required by ISA (UK) 701 in the auditor's report or issue a separate report for additional openness and transparency or where required by relevant Codes of Audit Practice or equivalent.

1-213 Some public sector auditors may have additional statutory powers and responsibilities to report on matters of interest to the relevant Parliament, Assembly or regulator. This may include, for example, background information on the basis for the audit opinion, inadequate financial control or propriety issues.

Matters to be reported by exception in the public sector

1-214 The *Companies Act 2006* requires company auditors to report on certain matters by exception, including where:

- adequate accounting records have not been kept, or returns adequate for the audit have not been received from branches not visited during the audit; or
- the financial statements are not in agreement with the accounting records or returns; or
- they have not received all of the information and explanations they require for their audit.

1-215 Public sector auditors report on these matters by exception, as set out in the terms of the engagement.

[14] ISA (UK) 701 is effective for audits of financial statements for periods commencing on or after 17 June 2016. Early application is permitted.

Explanation of the extent to which the audit was considered capable of detecting irregularities, including fraud

1-216 Paragraph 29-1 of ISA (UK) 700 requires the auditor's report to explain to what extent the audit was considered capable of detecting irregularities, including fraud. As described in paragraph 1-43 of this Practice Note, the term ‘irregularities’ is used in ISAs (UK) to refer to instances of non-compliance with laws and regulations, including fraud. In the context of the regularity opinion, ‘irregular transactions’ refers to transactions not in accordance with the framework of authorities, as described in Part 2. As described in paragraph 1-44, an irregular transaction may not be an irregularity under ISAs (UK), although any irregularities detected may involve irregular transactions.

ISA (UK) 701 (Revised November 2019) (Updated May 2022): Communicating key audit matters in the independent auditor’s report

1-217 The objectives of the auditor are to determine key audit matters and, having formed an opinion on the financial statements, communicate those matters by describing them in the auditor’s report (ISA (UK) 701, 7).

1-218 Where the auditor of a public sector entity gives an opinion covering the regularity or value for money of transactions in the financial statements and is required or chooses to communicate key audit matters in the auditor’s report under ISA (UK) 701, the auditor considers whether to report on key audit matters related to regularity or value for money as appropriate.

ISA (UK) 706 (Revised June 2016): Emphasis of matter paragraphs and other matter paragraphs in the independent auditor’s report

1-219 The objective of the auditor, having formed an opinion on the financial statements, is to draw users’ attention, when in the auditor’s judgement it is necessary to do so, by way of clear additional communication in the auditor’s report, to:

(a) a matter, although appropriately presented or disclosed in the financial statements, that is of such importance that it is fundamental to users’ understanding of the financial statements; or

(b) as appropriate, any other matter that is relevant to users’ understanding of the audit, the auditor’s responsibilities or the auditor’s report (ISA (UK) 706, 6).

1-220 In the public sector withdrawal from the audit may not always be possible. Where this option is preferential, but not available, the auditor may also consider it necessary to include an Other Matter paragraph in the auditor's report or to report relevant matters to the appropriate statutory body.

ISA (UK) 720 (Revised November 2019) (Updated May 2022): The auditor's responsibilities relating to other information

1-221 The objectives of the auditor, having read the other information, are:

(a) to consider whether there is a material inconsistency between the other information and the financial statements;

(b) to consider whether there is a material inconsistency between the other information and the auditor's knowledge obtained in the audit;

(c) to respond appropriately when the auditor identifies that such material inconsistencies appear to exist, or when the auditor otherwise becomes aware that other information appears to be materially misstated;

(d) where required by law or regulation, to form an opinion on whether the information given in the other information is consistent with the financial statements and the auditor's knowledge obtained in the audit; and

(e) to report in accordance with [ISA (UK) 720] (ISA (UK) 720, 11).

The auditor's responsibilities relating to the annual report

1-222 Many public sector entities are required to include an annual report in the same documents as the financial statements. For the most part, entities are required to incorporate the elements of the *Companies Act* Strategic and Directors' Report within this additional material. The terms of engagement for the national audit agency also normally require an opinion to be made on the consistency of that material with the financial statements audited. As the material may be dispersed within other surrounding information published with the accounts, it is important for the auditor's report to identify what is covered by the consistency opinion.

1-223 In addition to this consistency opinion, ISA (UK) 720 requires the auditor to read all information published with the financial statements, which includes all material covered by the consistency opinion. Again, the auditor's report clarifies what content has been read.

1-224 By agreement with the relevant bodies where necessary, some public sector auditors report where the Governance Statement does not reflect compliance with the relevant guidance. The auditor's responsibility in respect of the Governance Statement is to consider the statement. This review is not to provide assurance on the statement, but to:

- consider the completeness of the disclosures in meeting the reporting requirements;
- identify whether the disclosures are misleading; and
- identify any inconsistencies between the disclosures and the information that the auditor is aware of from audit work.

1-225 Requirements for publishing other information alongside financial statements varies depending on the nature of the entity's operations and the reporting requirements. Typically, they may include a statement setting out the responsibilities of the Accounting/Accountable Officer or equivalent and a corporate governance statement.

1-226 The reporting framework may include a requirement that the other information presented is 'fair, balanced and understandable'.[15] An example of a reporting framework with such a requirement is HM Treasury's *Financial Reporting Manual* for central government entities. In this case, if the auditor identifies that any aspects of the other information are not presented in a fair, balanced or understandable manner, the auditor considers the implications for the report. The auditor considers whether the information is presented in a way that would be understandable to a wide range of potential users with varying levels of expertise.

Reporting to the legislature

1-227 In the public sector, withdrawal from the engagement may not be possible. In such cases, the auditor may issue a report to the legislature providing details of the matter or may take other appropriate actions (ISA (UK) 720, A47 which relates to the requirements of ISA (UK) 720, 18).

Statutory other information

1-228 Public sector annual reports and accounts may include information that is treated as statutory other information due to specific statutory reporting responsibilities or the terms of the engagement. For example, HM Treasury's *Financial Reporting Manual* provides for auditors to provide an opinion on particular disclosures in the Accountability Report and for this information to be clearly identified as audited. The auditor makes a positive statement in the auditor's report in respect of this information in accordance with paragraph A58-1 of ISA (UK) 700 and carries out appropriate procedures in respect of the information.

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[15] The requirement for reporting to be 'fair, balanced and understandable' originates in the *UK Corporate Governance Code*. See the *Code* issued in July 2018 here: https://www.frc.org.uk/getattachment/88bd8c45-50ea-4841-95b0-d2f4f48069a2/2018-UK-Corporate-Governance-Code-FINAL.pdf

Revised Ethical Standard 2019

Overarching principles

1-229 The firm, its partners and all staff shall behave with integrity and objectivity in all professional and business activities and relationships (Revised Ethical Standard 2019, A1).

1-230 In relation to each engagement, the firm, and each covered person, shall ensure (in the case of a covered person, insofar as they are able to do so) that the firm and each covered person is free from conditions and relationships which would make it probable that an objective, reasonable and informed third party would conclude the independence of the firm or any covered person is compromised (Revised Ethical Standard 2019, A2).

Loan staff assignments

1-231 A firm shall not enter into an agreement with an entity relevant to an engagement, or with the affiliates of such an entity, to provide any partner or employee to work for a temporary period as if that individual were an employee of any such entity or its affiliates. An exception applies: in respect of staff employed by a UK national audit agency, in a role with no management responsibilities; when the role to be filled in an entity relevant to an engagement has no line management or management responsibilities; for a period of no longer than three months (or no longer than six months for a staff member from a national audit agency employed on a training contract); and where the service to be provided would not be prohibited by the Ethical Standard (Revised Ethical Standard 2019, 2.36)

Partners and engagement team members joining an entity relevant to an engagement

1-232 In the circumstances covered by paragraph 2.45 [of the Revised Ethical Standard 2019][16], where the responsibility for the engagement is assigned by

[16] Paragraph 2.45 of the Revised Ethical Standard 2019 relates to circumstances where a partner, or another person (including a person whose services are at the disposal or under the control of the firm) who is personally approved as a statutory auditor as described in paragraph 2.40 of the Standard, is appointed as a director, a member of the audit committee or body performing equivalent functions, or to a key management position with an entity relevant to an engagement, having previously been a covered person:

legislation or regulation and the auditor cannot resign from the engagement (e.g. for certain public sector bodies) the firm shall apply alternative safeguards to reduce threats to integrity or objectivity to a level where independence would not be compromised (Revised Ethical Standard 2019, 2.46).

Long association with engagements and with entities relevant to engagements

1-233 Where partners and staff in senior positions have a long association or extensive and/ or regular involvement with an entity relevant to the engagement, the firm shall assess the threats to integrity, objectivity and independence of the firm and covered persons and shall:

• apply safeguards to reduce the threats to a level where independence would not be compromised; and

• disclose the engagements previously undertaken by the firm for an entity relevant to the engagement to those charged with governance and, where applicable, any other persons or entities the firm is instructed to advise.

Where appropriate safeguards cannot be applied, the firm shall not accept the engagement, shall resign from the engagement or not stand for reappointment, as appropriate. Where the responsibility for the engagement is assigned by legislation or regulation and the firm cannot resign from the engagement (e.g. in the case of certain public sector bodies) the firm shall apply alternative safeguards (Revised Ethical Standard 2019, 3.1).

1-234 In the public sector, legislation may establish the appointments and terms of office of the auditor with engagement partner responsibility. As a result, it may not be possible to comply strictly with the engagement partner rotation requirements envisaged for listed entities. Nonetheless, for public sector entities considered significant, the auditor establishes policies and procedures to promote compliance with the spirit of rotation of engagement partner responsibility.

(a) in the case of a partner, at any time during the two years prior to such appointment; or

(b) in the case of another person, at any time during the year prior to such appointment,

and requires that the firm shall resign from the engagement where possible under applicable law or regulation and not accept another engagement for the entity for a specified period.

Fees

1-235 Paragraphs 4.23 to 4.34 [of the Revised Ethical Standard 2019][17] do not apply to engagements of entities where the responsibility for the engagement is assigned by legislation and the firm cannot resign from the engagement, irrespective of considerations of economic dependence (e.g. for certain public sector bodies) (Revised Ethical Standard 2019, 4.22).

[17] Paragraphs 4.23 and 4.24 of the Revised Ethical Standard 2019 relate to circumstances where:

- it is expected that the total fees for services receivable from a public interest entity or other listed entity and its subsidiaries relevant to a recurring engagement by the firm will regularly exceed 10% of the annual fee income of the firm; or
- it is expected that the total fees for services receivable from a non-listed entity that is not a public interest entity and its subsidiaries relevant to a recurring engagement by the firm will regularly exceed 15% of the annual fee income of the firm,

and require that the firm shall not act as the provider of the engagement for that entity and shall either resign or not stand for reappointment, as appropriate.

Part 2: The audit of regularity

Introduction

2-1 This part of the Practice Note sets out guidance on public sector auditors' considerations of regularity and related matters. It covers:

- understanding the concept of regularity:
- how regularity relates to other concepts including propriety and compliance with laws and regulations;
- the audit of regularity – an overview;
- understanding the entity and its environment;
- understanding the entity's internal controls;
- materiality for the audit of regularity;
- assessing the risk of material irregular transactions;
- planning and performing audit procedures;
- areas requiring special consideration;
- written representations;
- using the work of others;
- evaluating irregular transactions;
- the risk of fraud in the audit of regularity;
- regularity opinion on financial statements; and
- other reporting on regularity.

2-2 Public sector auditors may have statutory powers and responsibilities in relation to how audited bodies use public funds. Some of these responsibilities may be discharged through the audit of regularity, where required by legislation. The audit of regularity is related to the audit of financial statements and so it is covered by this Practice Note. Auditors may also be required to report in respect of propriety or the economy, efficiency and effectiveness (value for money) of the use of public funds. These are not covered by this Practice Note and the auditors may instead refer to the specific legislative framework and other guidance; for example, Codes of Audit Practice developed by a relevant audit agency.

2-3 This part of the Practice Note focuses on the audit of regularity to provide a reasonable assurance opinion. Some public sector entities may require limited or other assurance engagements as part of funding obligations or grant conditions set by other public sector bodies. Guidance on such engagements is not included in this Practice Note and the auditors instead consult other relevant information on engagements of this type. For example, academy trusts and college corporations in England are required to commission external auditors, as reporting accountants, to perform an annual review of regularity (which, in this case, is a type of a limited assurance engagement) as part of their funding conditions. The auditors may refer to the relevant framework document (e.g. an accounts direction or a tripartite agreement) and other professional guidance (such as the ICAEW technical release on regularity reporting for academies or International Standard on Assurance Engagements (ISAE) 3000) for further information about other assurance engagements in respect of regularity.

Understanding the concept of regularity

2-4 Regularity is the concept that transactions that are reflected in the financial statements of an audited entity must be in accordance with the relevant framework of authorities.

2-5 Frameworks of authorities are external frameworks, specific to the audited entity, with which the audited entity's transactions must conform. These frameworks are set up by bodies able to issue and/or enforce the authorities for that entity and might include, for example:

- authorising legislation;
- regulations issued under governing legislation;
- parliamentary authorities (including budgetary laws, for example budget estimates voted by the relevant Parliament/Assembly); and
- government or related authorities (for example *Managing Public Money*[18] issued by HM Treasury).

2-6 The concept of regularity reflects concerns of the users of the public sector accounts that public money raised is used only for the purposes intended by relevant framework of authorities. The preparation of financial statements by public bodies is an important means by which they are held accountable for the use of public funds.

2-7 For the audit of central government (or equivalent) and some health bodies, there is an explicit statutory requirement on the auditor to provide an additional audit opinion on whether, in all material respects, expenditure and income (payments and receipts) have been applied for the purposes intended by Parliament, where applicable and conform with the

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[18] *Managing Public Money* provides guidance on how to handle public funds and sets out the regularity framework for central government in the UK. The document can be found on the following website: www.gov.uk/government/publications/managing-public-money

authorities which govern them. The auditor can adopt an integrated audit approach covering the audit of the financial statements and supplemented by additional testing of regularity, where necessary.

How regularity relates to other concepts including propriety and compliance with laws and regulations

2-8 Whereas regularity is concerned with compliance with a relevant framework of authorities, propriety is concerned more with standards of conduct, behaviour and corporate governance. It includes matters such as fairness, integrity, the avoidance of personal profit from public business, even-handedness in the appointment of staff, open competition in the letting of contracts and the avoidance of waste and extravagance.

2-9 Propriety is not readily susceptible to objective verification and, as such, is not expressly covered in the opinion on financial statements. When issues of propriety come to light in the course of the audit of financial statements, the auditor considers whether and, if so, how they may be reported.

2-10 Propriety might be part of the wider statutory role of the auditor or might fall within the terms of the audit engagement. For example, in Scotland, the *Public Finance and Accountability (Scotland) Act 2000* requires audits of accounts for which the Auditor General is responsible to include auditor's reports that set out findings on whether the expenditure and receipts shown in the account were incurred or applied in accordance with relevant statutory provisions and with any applicable guidance (whether as to propriety or otherwise) issued by Scottish Ministers.

2-11 As part of the audit of regularity, the auditor assesses the audited body's compliance with relevant laws and regulations. This consideration feeds into work performed by the auditor under ISA (UK) 250A. The guidance on the application of this ISA (UK) can be found in Part 1 of this Practice Note.

2-11A Paragraphs 1-40 to 1-44 of Part 1 of Practice Note 10 set out how the concept of regularity interacts with the auditor's responsibilities relating to fraud under ISA (UK) 240, including fraud that may have implications for the regularity opinion, along with matters relating to the terminology of 'irregularities'. The risk of fraud in the audit of regularity is also addressed in paragraphs 2-79 to 2-82 in Part 2 of Practice Note 10.

The audit of regularity – an overview

2-12 The auditor's approach to the audit of the regularity of transactions in the financial statements of public sector entities is similar to the audit approach set out in ISA (UK) 250A *Consideration of laws and regulations in an audit of financial statements*. It can be summarised as:

- obtaining a sufficient understanding of the framework of authorities that are specific to the entity. The auditor obtains a broad understanding that is sufficient to enable identification of transactions or events that may have a significant effect on the regularity of transactions in the financial statements. The auditor also considers the systems and procedures in place to ensure compliance with the framework of authorities. The auditor obtains an understanding of the internal control environment to enable a preliminary assessment of controls which mitigate the risk of material irregular transactions;

- obtaining sufficient appropriate evidence to obtain assurance over regularity. Taking into account materiality, the auditor performs audit procedures on transactions through a combination of tests of controls and substantive procedures. Audit procedures can be integrated with those relating to the audit of the financial statements; and

- reporting on regularity through a separate and explicit opinion on regularity or separate reports on regularity issues.

2-13 In certain parts of the public sector, the principles and procedures applied to obtain sufficient appropriate evidence to support an opinion on the regularity are similar to those applied to the audit of the financial statements. Thus, in forming an opinion on regularity, the auditor seeks to provide reasonable assurance that the financial statements are free from material irregular transactions. For example, the auditor sets a materiality threshold for the regularity opinion in a similar manner as for the opinion on financial statements, applying the guidance in ISA (UK) 320 and the accompanying guidance in the ISA (UK) 320 section of Practice Note 10. The materiality threshold for regularity may, but will not necessarily, be the same as that for the financial statements. Qualitative considerations of materiality apply in a similar manner to the regularity opinion as for the opinion on financial statements, but different qualitative considerations may be relevant to the two distinct opinions, depending on the circumstances pertaining to the reporting entity.

2-14 There may, however, be particular considerations in respect of the auditor's assessment of materiality, risk and the design of audit procedures in relation to regularity that are set out in this Practice Note. In addition to these considerations, the auditor may have particular regard to the regularity of receipts, the disclosure of transactions in accordance with relevant framework of authorities, and securing management representations.

2-15 The auditor, in the audit of regularity, is expected to comply with the Financial Reporting Council's ethical, auditing and quality management standards and the guidance set out in this Practice Note.

Understanding the entity and its environment

2-16 An auditor in the public sector has, or obtains an understanding of the framework of authorities governing the audited body and its activities which is sufficient to enable identification of events, transactions and practices which may have a material effect on the regularity of transactions in the financial statements.

2-17 The extent of the auditor's work in relation to obtaining a sufficient understanding of the regulatory framework will depend on the complexity of the laws and regulations. In complex regulatory environments, the auditor considers the translation of the framework of authorities into relevant rules and procedures used by the audited entity.

2-18 In all regards, the audited entity retains the responsibility for ensuring the regularity of its transactions and for disclosing these transactions in the financial statements. However, the auditor has a responsibility for understanding the framework of authorities and cannot wholly rely on management representations about the framework, as the auditor's opinion on regularity is based on evidence of compliance with the framework of authorities, rather than on evidence of compliance with the entity's understanding of the framework.

2-19 The auditor can identify the framework of authorities from a number of sources, including:

- a framework document or accounts direction, where issued under the authorising legislation;
- previous experience with the entity or similar entities;
- review of legislation and regulations governing the audited body;
- discussions with the staff employed by the entity (finance officers, internal audit, policy and legal branches); or
- documents produced by the entity (for example: minutes of board and other principal committee meetings; correspondence and minutes of meetings with relevant authorising bodies; prior years' financial and annual reports; budgets; internal management reports; management policy manuals; manuals of accounting and internal control; and scheme control plans).

2-20 In considering the framework of authorities, the auditor distinguishes between those authorities which are specific to the entity and provide specific direct authority for its financial transactions and those laws and regulations which provide the general framework within which it conducts its activities.

2-21 Laws and regulations that fall within the general framework include, for example, those relating to health and safety, environmental protection and employment. While non-compliance with those laws and regulations that provide the general legal framework would not affect the auditor's opinion on the regularity of transactions, some of these may be relevant to the auditor's assessment of compliance with laws and regulations under ISA (UK) 250 Section A.

2-22 Understanding the framework of authorities and using this information appropriately will assist the auditor in developing the audit plan and in identifying potential material irregular transactions in the financial statements, for example, from new and complex legislation or from a misinterpretation of legislation and its scope. The auditor's understanding of the authorities includes knowledge of the reasons for the legislation and its objectives as this will aid the auditor's understanding of any secondary legislation or subsidiary regulations. The nature and complexity of the relevant legislation and other authorities has an impact on the extent of the auditor's work on regularity.

The framework of authorities included in the auditor's report

2-23 A transaction is regular if it is in accordance with the framework of authorities. If it is not in accordance with the framework of authorities then it is not regular. The authorities that are within the scope of the auditor's regularity opinion may be determined by the legislation under which the auditor is appointed. Where the auditor gives a regularity opinion that is not required by legislation, the auditor may use a similar form of opinion to that which is normally given for audits where that auditor is appointed by statute, and the scope of the regularity opinion will be determined by the form of words used in the report. For example:

- Where the Comptroller and Auditor General is required to give a regularity opinion under Section 6 of the *Government Resources and Accounts Act 2000*, the report will be on whether money provided by Parliament has been expended for the purposes intended by Parliament, resources authorised by Parliament to be used have been used for the purposes in relation to which the use was authorised and the financial transactions are in accordance with any relevant authority. Parliament expresses its intentions through primary and secondary legislation and so these clearly form part of the framework of authorities. In addition, through long-standing convention HM Treasury has a role in setting rules for Government departments' spending[19], which means that guidance issued by the Treasury is a relevant authority. Other authorities may also be relevant authorities and the auditor considers which authorities are relevant for the purpose of the regularity opinion (see paragraph **2-24** below). For regularity opinions given by the Comptroller and Auditor General otherwise than under the *Government Resources and Accounts Act 2000*, the form of opinion will typically follow this pattern and so similar considerations will apply when considering what forms part of the framework of authorities.

- Where the Auditor General for Scotland, or a person appointed by the Auditor General, gives a regularity opinion under Section 22 of the *Public Finance and Accountability (Scotland) Act 2000*, the report will be on whether the transactions in the account were in accordance with any applicable enactments and guidance issued by the Scottish Ministers, the Budget (Scotland) Act covering the financial year and sections 4

[19] See https://publications.parliament.uk/pa/ld201213/ldselect/ldconst/165/16505.htm for further discussion on this point.

to 7 of the *Public Finance and Accountability (Scotland) Act 2000* and the sums paid out of the Scottish Consolidated Fund for the purpose of meeting the expenditure shown in the financial statements were applied in accordance with section 65 of the *Scotland Act 1998*. The legislation referred to specifically forms part of the framework of authorities. The auditor additionally considers which of the Scottish Ministers' guidance is applicable for the purpose of the regularity opinion (see paragraph **2-24** below).

2-24 Some authorities (such as legislation) are explicitly cited within the wording of the regularity opinion. In other cases, the form of opinion refers to 'relevant' or 'applicable' authorities and in this case the auditor determines which authorities are in scope of the opinion. When considering these matters, the auditor may adopt the principle that an authority is relevant or applicable if the Parliament/Assembly or other body to which the auditor's report is addressed would consider that that authority is relevant or applicable to the audited entity's financial transactions.

Understanding the entity's internal controls

2-25 In planning the audit of regularity, the auditor considers how the entity's management complies with the framework and where relevant, addresses the risk of material irregular transactions through controls. This involves an assessment of the general control environment at the entity level and control procedures relating to individual transaction streams that are designed to prevent or detect and correct material irregular transactions.

2-26 As part of the auditor's review of the control environment, the auditor considers the general control framework for ensuring regularity, including:

- the entity's organisational structure and the extent to which the responsibility for ensuring regularity is delegated;
- methods of ensuring regularity and accountability where the responsibility for it is delegated;
- the results of any relevant internal audit work which covers controls over compliance with laws and regulations or regularity; and
- the entity's corporate governance arrangements, insofar as the arrangements address compliance with regulations, in particular the work carried out by the entity to support the corporate governance statements, and the auditor's own work in reviewing the statements.

2-27 Controls and procedures which the audited body operates to ensure regularity of individual transaction streams may include, for example:

- application of desk instructions for staff which translate statutory requirements into a set of operating procedures;

- monitoring of compliance with financial memoranda; or
- receipt of reports on compliance from auditors of other entities.

2-28 It is sometimes necessary for the auditor to consider major or new legislation affecting the financial transactions or to consider whether regulations are appropriately translated into relevant rules and procedures. The auditor's work on legislation or regulations need only focus on those authorities that are relevant to the entity's financial transactions, such as those that govern the powers of the entity to make payments or receive money, or set out the value of such payments or receipts. It is not concerned with administrative rules or regulations that are not directly linked to financial transactions.

2-29 The auditor's consideration of the translation of framework of authorities may involve reviewing the legislation to identify the provisions that authorise activities and reviewing the process for their translation and interpretation in subsidiary regulations and guidelines. It may also extend to the process for translation of those regulations into working manuals or other key documentation. In conducting this review the auditor pays particular attention to the statutory regulations which govern, for example:

- the powers of relevant bodies to determine the rules and procedures;
- the controls to be operated by the entity responsible for the administration of a scheme;
- the eligibility of beneficiaries to receive grants or other kinds of financial support under a scheme;
- the calculation of grants or any other payments; and
- the setting of fees and charges and other revenues.

2-30 In considering relevant rules and procedures relating to schemes, the auditor also identifies those controls that are designed to prevent or detect and correct material irregular transactions.

2-31 Where the volume of laws or regulations is significant, entities may have systems for the design and monitoring of procedures and controls to ensure that they are appropriate and meet legislative requirements.

2-32 The auditor remains alert for significant problems encountered by the audited body relating to the interpretation of new and existing legislation or the application of regulations and the impact on the audit.

Materiality for the audit of regularity

2-33 The concept of materiality applies to the audit of regularity. The auditor is required to obtain sufficient appropriate evidence that the audited body has complied with the relevant framework of authorities "in all material respects". This explicitly recognises the fact that the auditor cannot detect all occurrences of irregular transactions through the audit work. Materiality affects both the way in which the auditor plans the audit work on regularity and evaluates and reports the results of that work.

2-34 The auditor follows ISA (UK) 320 when determining the materiality in the context of regularity. However, the materiality threshold for the audit of regularity may be different to the materiality for the financial statements as a whole.

2-34A 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 include where:

- the audited entity makes payments to individuals or other bodies that are of significantly greater public interest than the administrative functions of the entity itself;
- the benchmark used to determine materiality for the financial statements as a whole has increased significantly (for example, due to an expansion of the audited entity's operations) but there remains user interest in the regularity of transactions at a more granular level;
- aspects of the audited entity's framework of authorities and/or regulatory oversight regime indicate that quantitatively small non-compliance with the framework of authorities would be perceived more seriously than would be apparent from assessing the amounts against materiality for the financial statements as a whole; or
- the benchmark used to determine materiality for the financial statements as a whole is based on assets or liabilities and these amounts are out of proportion to the expenditure and income transactions that are subject to the regularity opinion.

2-34B The auditor's assessment of what is material is a matter of judgement and includes both quantitative and qualitative considerations. This is because the users might have an interest in breaches of authority even where the sums of money involved may be small in relation to the overall expenditure in the financial statements.

2-35 This might mean that certain classes of transactions, account balances or disclosures need to be considered against a threshold lower than the materiality level. For example, in the context of regularity in central government in the United Kingdom, the auditor may consider material items including, but not limited to: any expenditure incurred in excess of the amounts authorised by Parliament; any expenditure on senior remuneration incurred without appropriate approvals; and any expenditure on activities that constitute tax avoidance.

2-36 The auditor remains alert to the nature of irregular transactions and considers their significance having regard to the interest of the users of the financial statements in the matter.

2-37 The determination of materiality in the public sector is influenced by legislative and regulatory requirements, and by the financial information needs of legislators and the public in relation to public sector programmes. The list of matters will vary from audited body to audited body, however considerations may include:

- the need for openness and transparency, for example senior staff or board members' remuneration;
- public expectations and public interest which might deem separate disclosure necessary; and
- the context in which a matter appears, for example if the matter is also subject to compliance with the framework of authorities, legislation or regulations.

Assessing the risk of material irregular transactions

2-38 The auditor considers the risks of material irregular transactions through the process of obtaining an understanding of the entity, its environment and its internal controls.

2-39 To assess the inherent risk of a material irregular transactions occurring, the auditor uses judgement and prior experience and knowledge of the entity and its environment to evaluate a range of factors, for example:

- the complexity of the regulations;
- the introduction of major new legislation or regulations changes in existing ones;
- services and programmes delivered through third parties; and
- payments and receipts made on the basis of claims or declarations.

2-40 The auditor considers the controls which mitigate the risk that material irregular transaction could occur in an account balance or class of transactions and would not be prevented, or detected and corrected on a timely basis by the accounting and control systems. Where the auditor expects to be able to rely on the operation of internal controls to reduce the extent of substantive procedures relating to regularity, the auditor assesses the design and implementation of those controls and plans and performs tests of their effectiveness.

2-41 Examples of areas of risk and possible mitigating controls in relation to regularity are summarised as follows.

Risk	Description	Mitigating Controls

Complexity of regulations	The more complex the regulations the greater the risk of error. This may occur either through a misunderstanding or misinterpretation of the regulation or through an error in application.	Formal procedures for the translation of statutory requirements into operating instructions. Formal control plans prepared and monitored by scheme managers. Review of scheme control plans and operating manuals by internal audit or some other independent audit function.
New legislation	New legislation may require the introduction of new administrative and control procedures. This may result in errors in either the design or operation of controls required to ensure regularity.	The controls identified above involving formal procedures for the translation of statutory requirements into scheme rules. Formal control plans and the independent review of operating instructions and control plans will also apply where schemes are introduced following new legislation.
Services and programmes delivered through third parties	Where programmes are administered by agents, departments lose a degree of direct control and may have to rely on agents to ensure compliance with authorities.	Formal agreements between the entity and the agent defining control procedures to be applied in the administration of services. Management control and monitoring of third-party activities. Inspection visits by internal audit to third parties to review systems and

		procedures, including those relevant to regularity. Independent assurance report on, or certification of, payments and receipts by the third parties' reporting accountant or auditor. Established criteria for making claims, clearly set out in departmental instructions and guidance to claimants.
Payments and receipts made on the basis of claims or declarations	An entity's ability to confirm compliance with authorities may be restricted where, for example, criteria specified for receipt of grant are not subject to direct verification.	Standard requirements for documentation evidencing entitlement to be submitted in support of claims. (This may be a condition of payment of grant or a requirement once the activity supported by the grant has been completed). Physical inspection of claimants' records etc., to confirm eligibility. Procedures for assessing the financial standing of claimants before awarding a grant and for monitoring continuing solvency. Independent assurance report on, or certification of, the application of grant by reporting accountant or external auditor.

2-42 The auditor considers the significance of the identified risks of material irregular transactions in determining the nature, timing and extent of substantive procedures required to reduce audit risk to an acceptable level. As part of the risk assessment, the auditor determines which of the risks identified require special audit consideration.

Planning and performing audit procedures

2-43 The nature, timing and extent of the audit procedures is dependent on the complexity of the framework of authorities. For example, where an entity pays grants that are subject to specific restrictions in the grant agreement, the auditor plans and performs adequate procedures to obtain assurance that the grant receiving entity complied with these restrictions.

2-44 Audit procedures designed to obtain assurance over the regularity of transactions are usually based on a combination of tests of controls and substantive procedures. The auditor performs these in line with ISA (UK) 330.

2-45 For tests of controls, the auditor determines whether the controls are adequately designed and implemented and are operating effectively to prevent or detect and correct material irregular transactions. If the auditor concludes that the controls are not effective, the auditor will not obtain assurance from them.

2-46 For substantive procedures, the auditor confirms that financial transactions conform to framework of authorities, the range and scope being dependent on identified risks of material irregular transactions and the extent to which evidence from tests of control provides audit assurance.

2-47 Where the auditor obtains satisfactory evidence as to the operating effectiveness of the entity's controls in relation to regularity, the auditor may seek to reduce the extent of substantive procedures. The auditor may also have regard to work carried out on the auditor's review of the Governance Statement.

2-48 Evidence in relation to regularity can be gathered as part of an integrated approach with the audit of financial statements. The auditor considers whether the audit evidence available is sufficient and appropriate to obtain assurance over regularity of transactions.

2-49 Analytical procedures on their own are unlikely to provide the auditor with sufficient appropriate evidence in support of regularity. They may nevertheless, assist the auditor in assessing whether amounts recorded in financial statements are consistent with expectations. For example, where allowances under a scheme are subject to a maximum value and the number of recipients is known the auditor may use analytical procedures to identify whether the permitted maximum may have been breached.

2-50 The auditor may carry out specific audit procedures to identify activities and transactions that are not in accordance with the framework of authorities. These tests might involve:

- the review of financial statements and any specific legislation;
- the review of the entity's management accounts to identify any unusual transaction streams or account balances or any incorrect analysis of transactions; and
- the substantive testing of transactions and account balances.

Areas requiring special consideration

2-51 The auditor may encounter difficulties obtaining audit evidence regarding certain aspects of regularity, for instance eligibility for grants. Ideally, the auditor requires direct evidence to satisfy the objective of the test. Where this is not available, the auditor considers how the entity satisfied itself as to regularity. This may be through the work of a separate inspection function or by receiving advice or assurance from an independent third party.

2-52 Rather than pay grants directly to the recipients intended by relevant framework of authorities, public sector bodies may fund other bodies to administer a scheme. Where this is the case, the auditor of the body may assess the arrangements put in place by the body to ensure proper accountability for such grants. This includes consideration of any work undertaken by the auditor of the other body on the regularity of expenditure.

2-53 An auditor engaged in the examination of expenditure on schemes funded by the European Union considers the compliance of transactions with the relevant European legislation and the impact of any non-compliance on the audit of regularity. In particular, the auditor obtains an understanding of the consistency of any regulations established in the UK with the provisions in the governing European Council or Commission Regulation and that these provisions are properly translated into instructions and procedures.

2-54 The auditor also remains alert to any legal actions that challenge the provisions of national or delegated legislation implementing European legislation by making enquiries of the entity and obtaining representations.

2-55 The auditor takes into account particular considerations when auditing the regularity of fees and charges levied by public sector entities, for example:

- reviewing the relevant primary legislation to confirm that it provides appropriate authority for the audited body to levy fees and charges for the services concerned;
- confirming that fee orders and other types of Statutory Instrument issued under the governing legislation are in accordance with those authorities; and
- confirming that the relevant legislation provides the appropriate authority for the receipts to be applied in aid of expenditure and not used to generate surplus (set up on a cost recovery basis).

2-56 As well as determining the authorities for levying fees and charges, the auditor also confirms that receipts are properly utilised and disclosed in the financial statements as authorised in the appropriate legislation.

2-57 Depending on the financial reporting framework, there may be additional requirements for disclosures in the financial statements in respect of regularity. In particular, the audited body may be required to disclose any non-compliance with frameworks of authorities. Taking into account materiality, the auditor considers the implications of lack of or inadequate disclosure on the audit opinion on regularity and the need to present a separate report on the matter to a relevant authority.

Written representations

2-58 Audit evidence on regularity is gathered from the audit procedures. However, the auditor may also seek representations from management (for example, Accounting Officers or Accountable Officers) on the discharge of their responsibility for the regularity of transactions. This is particularly important in areas, such as benefit and grant schemes, where direct evidence may not be available to the auditor.

2-59 Management is normally expected to provide a formal statement on the discharge of their responsibility each year. Where this statement is included in the financial statements, the auditor makes reference to the statement or discloses, in the responsibilities section of the auditor's report, the fact that the statement is not included or is not comprehensive in setting out management's responsibilities. The length and formality of management representations on regularity do not influence the scope of the auditor's procedures in obtaining evidence to support the regularity opinion.

Using the work of others

2-60 The auditor may wish to use the work of the internal auditor to obtain sufficient appropriate evidence in support of regularity. Where the auditor considers internal audit work, the auditor applies ISA (UK) 610. In particular, the auditor is prohibited from the direct use of internal audit staff as part of the engagement team.

2-61 The auditor may seek to use the work of the auditor of another entity. The auditor may encounter the work of another auditor, for example where the entity:

- consolidates or summarises the financial statements of other bodies;
- has paid a grant to another entity; or
- has contracted out services to a service organisation.

2-62 Where the entity prepares group financial statements, the auditor of a group determines how to obtain sufficient appropriate evidence over regularity of the group's transactions. Where the auditor of a group wishes to use the work of a component auditor in the audit of regularity, the auditor follows the standards and guidance in ISA (UK) 600.

2-63 Frameworks of authorities are specific to each entity and the fact that an entity is consolidated does not result in that entity having to apply their parent entity's framework of authorities. For example, a public sector body may not have a specific framework of authorities. Therefore, the component may not require the audit of regularity for the purpose of a group regularity opinion, except for fraud considerations. However, where a consolidated entity has a framework of authorities but was not subject to the audit of regularity, the group auditor may carry out audit procedures (or instruct a component auditor to do so) to obtain assurance over regularity of the component's transactions.

2-64 The group auditor obtains representations from the component auditor as to that auditor's independence from the entity and their compliance with the relevant auditing and ethical requirements. This also applies if the group auditor uses audited financial statements, signed by the component auditor, which contain a specific opinion on regularity.

2-65 Where a public sector entity has paid a grant to another entity, it will usually establish controls designed to ensure that the recipient complies with the grant conditions. The management might specify in the financial memoranda or grant conditions to receive an auditor's report or certificate on regularity.

2-66 The auditor may need to examine the application of grants paid to other entities through, for example:

- examination of the evidence available in the principal entity, including reports by their own internal audit function;
- using the work of the other entity's external auditor;
- consideration of the work of the other entity's internal audit function; and
- direct access to the other entity and performance of appropriate audit procedures.

2-67 The auditor may use the certificate and reports issued by the auditor of the grant recipient by:

- confirming that the instructions issued to that auditor address the regularity considerations satisfactorily;
- agreeing the scope; and
- reviewing the results of the quality control review.

2-68 Where the auditor of a public sector entity does not have a right of access to the other entity or other sources to obtain sufficient appropriate evidence, an auditor considers whether there is a limitation on the scope of the audit in accordance with ISA (UK) 705.

2-69 Where another auditor is required to provide a report or certificate on regularity to the principal entity, it is often the case that this is done a considerable time after the financial period being audited. The auditor ensures that only the evidence available to the principal entity relating to the reporting period is used. Where this is not possible, or if the principal and other entities have different year end dates, then the principal auditor may have to perform additional procedures, including the exercise of inspection rights, where appropriate.

2-70 Where the public sector entity has contracted-out services to a service organisation, the need to access that organisation and/or their auditor depends on the nature of the services provided, the information available at the principal entity, and the terms of engagement of the other auditor.

2-71 Where a public sector auditor is considering the need to obtain legal opinions concerning the interpretation of statutes or regulations the auditor follows the standards and guidance in ISA (UK) 620.

2-72 When determining whether to seek legal advice on a matter of regularity, the auditor considers:

- the materiality of the matter in the context of the financial statements;
- the risk of irregular transactions based on the nature and complexity of the framework of authorities; and
- the availability of other relevant audit evidence, in particular whether the entity has sought its own legal advice.

2-73 Usually where there is doubt about the regularity of transactions, management may seek clarification on the legal position. Where the entity is unwilling to seek legal advice or where the auditor has concerns about the legal advice given to the entity, the auditor may wish to seek a separate legal opinion.

2-74 Where the auditor is uncertain about the regularity of expenditure in relation to the framework of authorities other than legislation, the auditor first determines whether the entity sought clarification or, where necessary, obtained the appropriate authorisation from the relevant bodies. The auditor may also seek advice directly from the relevant authority. In these circumstances, the auditor follows similar steps to those the auditor would take when seeking legal advice.

Evaluating irregular transactions

2-75 Where non-compliance with regulations is suspected or discovered, the auditor considers the wider implications for the audit opinion on regularity. This will also include consideration of the implications for the auditor's assessment of risks and controls in relation to material irregular transactions and the extent of assurance that the auditor can obtain from the overall control environment and representations from management.

2-76 The auditor considers the nature and extent of any non-compliance and, in particular, whether it arises from a fundamental misinterpretation of legislation or a misapplication of rules.

2-77 Cases of non-compliance with regulations may be reported to management of the entity to allow corrective action to be taken, for example, by recovering overpayments of grant. Where it is not possible for the entity to take corrective action, the management may disclose the non-compliance in the financial statements by outlining the circumstances surrounding the breach of regulations and the possible extent of irregular transactions. Even where a breach of regularity is disclosed, the auditor considers the implications for the audit opinion on regularity and the need to present a separate report on the matter to the relevant authority. In doing so, the auditor considers the materiality of the matter at issue.

2-78 If the entity's management does not accept the auditor's opinion that the relevant transactions are not in compliance with the appropriate authorities, then the auditor may:

- communicate in a report to the appropriate level of management or those charged with governance the findings from the auditor's investigations into the circumstances surrounding the suspected irregular transactions and the conclusions drawn therefrom;
- consider whether the matter is one which management is required to report to the relevant authority or group management and if so, request in writing that management notify them;
- report directly to the relevant authority or group management if management are required to do so and the auditor is unable to establish whether management have complied with the requirement; and
- consider modifying the opinion on regularity.

The risk of fraud in the audit of regularity

2-79 A particular transaction can be determined as fraudulent only through the applicable legal framework. However, the auditor often encounters situations where there is suspicion of fraud, identified by management, internal audit, third parties or the auditor. Although the auditor does not have the authority to determine whether or not a fraud has actually occurred, the auditor considers whether, in the auditor's opinion, the transactions concerned are in compliance with the relevant framework of authorities.

2-80 Fraudulent transactions are always irregular regardless of the manner or extent of disclosure in the financial statements since they are without proper authority. The auditor considers the impact of suspected or proven fraudulent transactions on the audit opinion, taking into account the materiality of the irregular transactions.

2-81 For the purpose of auditing regularity, fraudulent financial reporting is not itself irregular, although it may disguise underlying irregular transactions. However, misappropriation of assets is irregular and the risk of material misappropriation of assets due to fraud is considered for both the risk of management override and the audit of regularity.

2-82 While ISA (UK) 240 is not written to address the audit of regularity, in some instances compliance with its requirements may be used to gain assurance over regularity, for example by:

- evaluating whether unusual or unexpected relationships that have been identified through analytical procedures are indicative of material irregular transactions due to fraud;
- testing the appropriateness of journal entries; and
- considering the rationale for significant transactions undertaken outside the normal course of business.

Regularity opinion

2-83 For the audit of central government (or equivalent) and some health bodies, the auditor provides an opinion on the regularity of transactions. The opinion would normally be included within the audit certificate or report. It may be included next to the true and fair opinion on the financial statements or within a separate section of the report entitled "The audit of regularity" or as appropriate. The form of words used in the regularity opinion relate to the statutory requirements or the scope of the engagement agreed with the audited body. The wording is also accompanied by:

- disclosure of management's responsibilities in relation to regularity in the statement of responsibilities and a reference to the disclosure in the responsibilities section of the auditor's report; or, full disclosure in the responsibilities section; and
- inclusion of the overall work performed with regard to regularity in the scope of the basis of opinion section of the auditor's report.

2-84 If the auditor modifies the audit opinion on regularity, the auditor applies the principles of ISA (UK) 705.

2-85 Where the auditor concludes that material financial transactions do not comply with the relevant framework of authorities, the auditor qualifies the regularity opinion, stating that the audited body complies with a relevant framework of authorities, except for the non-compliance identified. Where the impact of the non-compliance on the financial statements is pervasive, the auditor issues an adverse opinion on regularity.

2-86 Where the auditor is unable to obtain sufficient evidence to reach an opinion, the auditor qualifies the regularity opinion as a limitation of scope or, if pervasive, the auditor issues a disclaimer.

2-86A Where the auditor disclaims their opinion on the financial statements, the auditor also disclaims their opinion on regularity. This is because, if the possible effects on the financial statements of undetected misstatements, if any, could be both material and pervasive or it is otherwise not possible to form an opinion on the financial statements (as implied by a disclaimer of the opinion on financial statements), then the auditor does not have sufficient assurance over the nature of the transactions entered into by the audited entity. The circumstances leading to such a situation would necessarily imply a lack of sufficient assurance to address the risks that a material level of such transactions could be irregular. Furthermore, a set of circumstances which lead the auditor to conclude that they are unable to form an opinion on the financial statements would be highly likely to involve an elevated level of engagement risk such that the auditor would have insufficient confidence that sufficient appropriate audit evidence had been obtained to provide a basis for an opinion on regularity.

2-87 A qualified opinion on regularity does not in itself lead to a qualification of the truth and fairness, fair presentation or proper presentation opinion on the financial statements. However, the auditor considers whether the matter is properly disclosed in the financial statements and whether it is so pervasive as to make the financial statements misleading.

Other reporting on regularity

2-88 In certain parts of the public sector, the auditor may be required to provide separate reports, other than through audit opinions, on issues of regularity. The auditor may be required to report matters relating to regularity to third parties, for example a component auditor reporting to the group's management or reporting to a regulator such as the Charity Commission. The form and scope of these reports may be determined by the third party as part of a specific condition of the grant or subsidy and will be subject to specific instructions to the auditor. In other entities, the auditor may be required to submit a more general report on the entities' compliance with regulations, determined by the auditor's terms of engagement.

2-89 The auditor may also have statutory powers to issue a public interest report on any regularity or propriety matter which comes to the auditor's attention in the course of the audit in order that it is considered by the entity concerned or brought to the attention of the public.

2-90 In certain parts of the public sector, the auditor considers the need for a separate report where the audit opinion is modified as a consequence of material irregular transactions. The purpose of a separate report is to provide the users of the financial statements with a detailed explanation of the basis for qualification and support the relevant authority in holding the audited entity to account. This is linked to guidance on additional reporting responsibilities in Part 1 of this Practice Note (ISA (UK) 700).

2-91 The auditor may in some cases identify irregular transactions during the course of the audit which are not material to the financial statements but which need, in the auditor's judgement, to be drawn to the attention of the addressees of the auditor's report. An example of this may be where expenditure in previous years is retrospectively deemed to be irregular by virtue of a legal challenge to the interpretation of legislation.

Appendix One – Glossary of terms

Accountable Officer(1) – members of the staff of the Scottish Administration designated by the Principal Accountable Officer with responsibility for parts of the Administration, bodies or office holders as regards signing the accounts of the entity and ensuring the propriety and regularity of its finances.

Accountable Officer(2) – the officer (directed as the Chief Executive) responsible for the propriety and regularity of the public finances of health entities, and for the keeping of proper records, as set out in the Accountable Officers' Memorandum issued by the Department of Health or Chief Executive, NHS Wales. In Northern Ireland, the Accountable Officers' Memorandum is issued by the Department of Health.

Accounting Officer – usually the permanent head or senior full-time official of a central government entity or an NHS Foundation Trust, appointed or designated as the Accounting Officer for that entity and with a personal responsibility for, among other things, signing of the financial statements, ensuring that proper financial procedures are followed and accounting records maintained, ensuring that public funds and assets are properly managed and safeguarded and all relevant financial considerations, including issues on propriety, regularity or value for money are taken into account.

Accounts Commission – the independent body with statutory responsibilities for securing the audit of local government entities in Scotland, and to assist such entities in achieving best value. In relation to the audit of the financial statements, the Commission is responsible for appointing auditors, setting the required standards for its appointed auditors and regulating the quality of audits.

Accounts Direction – the document issued by HM Treasury or the Secretary of State of a parent or sponsor department, or by Welsh Ministers or Scottish Ministers which sets out the accounting and disclosure requirements to be applied in preparing the entity's financial statements. In Northern Ireland, the Department of Finance is responsible for issuing accounts directions for central government departments and executive agencies while normally the sponsoring department is empowered to direct the form of accounts for non-departmental public bodies and health service entities, with the consent of the Department of Finance.

"Appointment By" Basis Engagement – an engagement where another firm or individual is responsible for the assignment, its performance and the issuing of the auditor's report.

Assembly – the Northern Ireland Assembly.

Audit Scotland – national audit agency which supports both the Accounts Commission and the Auditor General for Scotland in carrying out their work.

Audit Wales – the trademark of two legal entities: the Auditor General for Wales and the Wales Audit Office.

Auditor of a public sector body (a public sector auditor) – a person, or persons appointed under statute or agreement; or appointed by, employed by or acting as the agent of a national audit agency, a secretary of state or a government department acting under statute or by agreement; or appointed as auditor to a body regulated by an independent regulator which has determined that this Practice Note applies.

Auditor General for Scotland – the individual responsible for authorising the issue of public funds from the Scottish Consolidated Fund to government departments and other public sector bodies; for examining or ensuring the examination of parliamentary accounts (which includes determining whether sums paid out of the Fund have been paid out and applied in accordance with statute), and certifying and reporting on them; for carrying out or ensuring the carrying out of examinations into the economy, efficiency and effectiveness with which the Scottish Ministers and the Lord Advocate have used their resources in discharging their functions; and for carrying out or ensuring the carrying out of examinations into the economy, efficiency and effectiveness with which other persons determined under Scottish legislation to whom sums are paid out of the Fund have used those sums in discharging their functions.

Auditor General for Wales – the individual responsible for examining and certifying the accounts of the Welsh Government, its sponsored and other related public bodies, Welsh local government bodies and NHS Wales entities. The Auditor General for Wales is responsible for authorising the issue of public funds from the Welsh Consolidated Fund to Welsh Ministers and other public sector bodies. The Auditor General is also responsible for carrying out value for money work at those bodies.

Auditor's report – any auditor's report expressing an opinion on the truth and fairness, fair presentation or proper presentation of financial statements and, in specified cases, on the regularity of the financial transactions included in them and any other legal and regulatory requirements. In central government, the auditor's report may also be referred to as a Certificate.

Central government entities – defined as government departments and their executive agencies, any entity which operates as a trading fund (a government department, part of a department or an executive agency) and arm's length bodies. For the purposes of this Practice Note, central government does not include National Health Service bodies, local authorities, public corporations, academy trusts, college corporations or nationalised industries.

Certificate(1) – the title of an auditor's report containing the opinion of the Comptroller and Auditor General, the Auditor General for Wales or the Comptroller and Auditor General for Northern Ireland on financial statements audited under statute where there is a statutory requirement for the examination to be certified, usually on the resource and other accounts produced by government departments (and on accounts produced by health entities in Wales and Northern Ireland). Use of the word "certificate" clearly differentiates the auditor's report from any other report of the Comptroller and Auditor General, the Auditor General for Wales and the Comptroller and Auditor General for Northern Ireland.

Certificate(2) – the declaration by auditors under the *Local Audit and Accountability Act 2014* that the audit of a local government or health entity has been completed in accordance with the Act. The certificate is normally, but not necessarily, incorporated in the auditor's report. A similar certificate is issued by local government auditors in Wales under the *Public Audit (Wales) Act 2004* and by local government auditors in Northern Ireland under the *Local Government (Northern Ireland) Order 2005*.

Chief Executive – the title applied to the senior official of a public sector body, accountable for the management and operations of that agency.

Code of Audit Practice – any document identified as such, issued by a national audit agency or the relevant head of that agency, that prescribes the way in which the auditor is to carry out their functions in respect of the audits of specified entities, embodying what the national audit agency considers to be the best professional practice with respect to the standards, procedures and techniques to be adopted by the auditor.

Comptroller and Auditor General (the C&AG) – the head of the National Audit Office. As Comptroller, the C&AG's duties are to authorise the issue by HM Treasury of public funds from the Consolidated Fund and National Loans Fund to government departments and others; as Auditor General, the C&AG certifies the accounts of all central government departments and some other public bodies, and carries out value-for-money examinations.

Comptroller and Auditor General for Northern Ireland – the individual responsible for authorising the issue of public funds to Northern Ireland departments and other public sector bodies, for carrying out the audit of the financial statements of Northern Ireland central government and health entities (which includes satisfying themselves that expenditure and income have been applied in accordance with the Assembly's intentions and conforms to governing authorities) and for examining the economy, efficiency and effectiveness with which Northern Ireland central government entities have discharged their functions.

Contractor auditor – An auditor who has been engaged to undertake all or some of an auditor assignment on behalf of the statutory auditor under a contract or agreement.

Contracted-out engagement – An engagement where, although responsibility for issuing the auditor's report remains with the statutory auditor, all or some of the audit assignment is undertaken by another firm or auditor under contract or agreement.

Corruption – the offering, giving, soliciting or acceptance of any inducement or reward that may influence the actions taken by an entity, its members or its officers.

Firm – sole practitioner, partnership, limited liability partnership, or corporation or other entity of professional accountants engaged in the provision of engagements. In the public sector context, firm can also mean a national audit agency and local auditors.

Framework of Authorities – external frameworks, specific to the audited entity, with which the audited entity's transactions must conform. These frameworks are set up by bodies able to issue and/or enforce the authorities for that entity and might include, for example: authorising legislation; regulations issued under governing legislation; Parliamentary authorities (including budgetary laws); government or related authorities.

Government Departments – these represent the top tier of central government, or equivalent, in each country. Parliament/Assembly provides money annually to each department to spend for purposes that are specified in Supply Estimates/Budget Act or equivalent. Each government department is headed by an Accounting Officer who is responsible to Parliament for the application and expenditure of the funds provided in the Supply Estimates.

Grant – payments made by departments to outside bodies to reimburse expenditure on agreed items or functions.

Health entities – individual corporate entities that are part of the National Health Service but do not form part of a department or are constituted as executive agencies, arm's length bodies or public corporations. Includes NHS foundation trusts, NHS trusts and clinical commissioning groups. In Wales, health entities are NHS Trusts and Local Health Boards. In Northern Ireland health entities are Health and Social Services Boards, Trusts and Special Agencies.

Legislation – Acts of Parliament and delegated or subordinate legislation including, for example, Welsh Measures, Statutory Instruments, or Rules and Orders issued by Ministers and submitted to Parliament. The term legislation also includes Regulations, Directives and Decisions issued by the European Council of Ministers and the European Commission.

Local auditors – Auditors of local public sector entities in England, such as local government bodies, appointed under the *Local Audit and Accountability Act 2014*.

National audit agency – one of the United Kingdom public audit agencies responsible for carrying out the audit of the financial statements of public sector bodies (the National Audit Office for the Comptroller and Auditor General, Audit Wales, Audit Scotland for the Auditor General for Scotland and the Accounts Commission, and the Northern Ireland Audit Office for the Comptroller and Auditor General for Northern Ireland) and/or responsible for the appointment and regulation of auditors of public sector bodies.

National Audit Office (NAO) – national audit agency which supports the Comptroller and Auditor General (the C&AG) in scrutinising public spending for Parliament.

Northern Ireland Audit Office (NIAO) – national audit agency which supports the Comptroller and Auditor General for Northern Ireland in fulfilling their responsibilities.

Other responsibilities – any function, other than the audit of the financial statements and the giving of an opinion on regularity, that public sector auditors take on whether as a result of statutory prescriptions or direction by the relevant national audit agency.

Parliament – the United Kingdom Parliament, the Scottish Parliament and the Welsh Parliament, but not the Northern Ireland Assembly.

Performance audit – work performed by the auditor in relation to the economy, efficiency and effectiveness of use of public funds. It may be also referred to as "value for money" work.

Public Audit Forum (PAF) – a consultative and advisory forum of the four national audit agencies in the UK designed to provide a focus for developmental thinking about public audit.

Public sector bodies – include bodies designated as public sector by the Office for National Statistics: government departments and their executive agencies; the Scottish Government, Welsh Government, the Northern Ireland Executive and their sponsored and associated bodies; trading funds; arm's length bodies; local authorities and other local government bodies; National Health Service bodies; in Scotland, further education colleges and the water authority. It does not include other public corporations or the nationalised industries.

Regularity – a concept that transactions that are reflected in the financial statements of an audited entity must be in accordance with the relevant framework of authorities.

Responsible financial officer – the officer appointed by a local government entity to be responsible for the proper administration of its financial affairs.

Sponsor department – normally the department through which Parliamentary funding and accountability is conducted for arm's-length bodies.

Statutory auditor – The auditor appointed to perform an engagement by statute. In this Practice Note the term statutory auditor is not used in the sense in which this is used in the Audit Directive and Regulation and related frameworks.

Tier – any level in a series of entities through which a grant is passed down from Parliament to the intended recipients. Top tier entities are usually government departments. Lower tier entities comprise agencies, arm's-length bodies and non-central government sector organisations

Wales Audit Office – national audit agency constituted as a statutory board, which employs staff, secures and utilises other resources, including additional expertise from private sector accountancy firms, to enable the Auditor General for Wales to carry out his functions.