

RESPONSE FROM THE PUBLIC AUDIT FORUM ON THE FRC'S CONSULTATION ON THE PROPOSED ISA (UK) 250 (REVISED) AND THE PROPOSED ISA (UK) 2X0

January 2024

INTRODUCTION

This is the Public Audit Forum's response to the invitation to comment issued by the FRC in October 2023 on its [proposed revisions to ISA \(UK\) 250 Section A and ISA \(UK\) 250 Section B](#).

The Public Audit Forum (PAF) brings together all the UK's public audit organisations to provide a focus for developmental thinking about public audit. The PAF's members are the national audit agencies of the UK: Audit Scotland, Audit Wales, the National Audit Office and the Northern Ireland Audit Office.

The PAF has the following remit:

- Develop strategic strands of work focused on the issues shared by the public audit organisations which support our common objectives of promoting high standards of governance, transparency, audit quality and financial management across the public sector.
- Support the accountability of public service delivery by exchanging experiences and methods for investigating the conduct and value for money achieved by those using public money to deliver public services be they in the private, public or third sectors.
- Be an evidence-based source of independent and objective insight and guidance to support beneficial change in the public sector by sharing insights into how public bodies can improve services.
- Enhance the efficiency, effectiveness and high standards of public audit across the public sector by active co-operation between the audit organisations, sharing knowledge and good practice on the application of audit standards and codes of practice of the auditors of bodies delivering public services.

The PAF's member agencies carry out audits of financial statements of public sector entities in central government and the devolved administrations, and apply International Standards on Auditing (UK) (ISAs (UK)) as issued by the Financial Reporting Council (including, presently, ISA (UK) 250 Sections A and B) to these engagements.

PAF member agencies would therefore expect to be users of the revised standards when they come into effect.

The PAF has been designated by the 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). PN 10 sets out how auditors of public sector bodies in the UK apply auditing, quality management and ethical standards (including ISAs (UK)) to their work on financial statements (taking into account the specific legislative and regulatory frameworks that apply to the audits of public sector bodies), and also provides guidance on the approach to the audit of regularity.

As part of this remit, the PAF would expect to consider whether guidance on applying the revised standards in the public sector should be incorporated into PN 10 when the standards come into effect.

COMMENTS ON THE CONSULTATION

The PAF supports the FRC's objective of enabling the delivery of high-quality audit and assurance work to maintain stakeholder confidence, whilst balancing the need to minimise the impact of regulatory requirements.

The PAF has reviewed the invitation to comment document and the consultation drafts of the proposed ISA (UK) 250 (Revised) *Considerations of laws and regulations in an audit of financial statements* and the proposed ISA (UK) 2X0 *Special considerations for Public Interest Entities – communicating and reporting to an appropriate authority outside the entity*.

Comments are provided in the following sections on each of the proposed standards in turn.

PROPOSED ISA (UK) 250 (REVISED)

The PAF welcomes the general principle, as applied in the proposed ISA (UK) 250 (Revised) of integrating requirements relating to the audited entity's compliance with laws and regulations more closely with the risk assessment model established by ISA (UK) 315 (Revised July 2020) *Identifying and assessing the risks of material misstatement*.

However, the PAF has concerns about the detailed requirements of the proposed revised standard, particularly in relation to:

- the increase in work effort implied by the requirement to apply the same risk assessment process to all laws and regulations, rather than the current focus on those that have a direct effect on the financial statements; and
- the interaction of the requirements of the proposed revised standard with public sector auditors' responsibilities relating to regularity.

The proposed ISA (UK) 250 (Revised) removes the distinction within ISA (UK) 250 Section A between the auditor's responsibilities and work effort in relation to the audited entity's compliance with laws and regulations which, respectively, do and do not have a direct effect on the determination of material amounts and disclosures in the financial statements. The revised standard replaces this distinction with a risk assessment process, which involves obtaining an understanding of "*regulatory factors, including those laws and regulations that are relevant to the operating aspects of the business and to an entity's ability to continue its business*", and then sets out procedures to be performed where non-compliance with such laws and regulations is identified or suspected.

The PAF's view is that requiring a risk assessment to be carried out for all laws and regulations that are relevant to the operating aspects of the business and to an entity's ability to continue its business, where this does not lead to a risk of material misstatement to the financial statements beyond disclosure of the non-compliance, would represent a prohibitively significant increase in work effort for many public sector audits.

Audited entities in the public sector are often subject to a very large volume of legal and regulatory requirements, the bulk of which relate to how audited entities must carry out their public functions and do not directly affect the risks of material misstatement of the financial statements. The local government sector includes numerous authorities which have a wide range of public functions and many distinct laws and regulations governing how these functions are performed, with these requirements emanating from both central legislation and local regulations such as byelaws. Other public sector entities such as central government and devolved administrations, as well as NHS bodies, may also be in a similar position.

There are also a number of instances, particularly within central government and the devolved administrations, where audited entities themselves are involved in drafting and/or performing functions in relation to laws and regulations – in these cases, such laws and regulations would be relevant to the business but may be highly unlikely to result in material misstatement of the financial statements, depending on the entity's operating context.

Because the proposed revised standard requires an understanding of laws and regulations relevant to audited entities' operations and the continuation of their business, the auditor would be required to perform the procedures described in paragraphs 19 to 30 of the consultation draft in relation to all information concerning instances of non-compliance or suspected non-compliance with all these legal and regulatory requirements, even where the risk of material misstatement would not directly impact on transactions or account balances within the financial statements but would be restricted to a disclosure of the non-compliance.

The PAF does not consider that requiring such detailed procedures for all laws and regulations relevant to the audited entity is necessary in order to identify the laws and regulations for which there is a realistic prospect that non-compliance would have a material effect on the financial statements. The PAF does not agree that the current distinction between different categories of laws and regulations prevents auditors from identifying risks of material misstatement.

The majority of audit reports issued by PAF member agencies give two distinct opinions on audited entities' financial statements:

- 'True and fair' opinion: this provides reasonable assurance that the financial statements are free from material misstatement and have been properly prepared.
- 'Regularity' opinion: this provides reasonable assurance that, in all material respects, the transactions recorded in the financial statements are in accordance with the applicable framework of authorities.

The matters in scope of the current ISA (UK) 250 Section A and the proposed ISA (UK) 250 (Revised) are primarily concerned with the 'true and fair' opinion, as this is the opinion given under the ISAs (UK). However, the auditor's responsibilities to obtain reasonable assurance over the following matters are interrelated and there is some overlap between the work involved:

- that the financial statements are free from material misstatement as a result of non-compliance with laws and regulations; and
- that the transactions recorded in the financial statements are in accordance with the applicable framework of authorities.

Public sector auditors' responsibilities in relation to the regularity opinion (which are described in detail in Part 2 of PN 10) already meet the expectations of users of the financial statements that auditors will provide assurance over material compliance with applicable frameworks of authorities. This mechanism is well established and understood by the key stakeholders of public sector entities. **The PAF does not consider that substantial additional requirements in relation to laws and regulations would add value to this existing accountability mechanism.**

There is also a potential risk that the proposed revised standard will create confusion about public sector auditors' interrelated responsibilities in respect of audited entities' compliance with, respectively, laws and regulations and the specific frameworks of authorities in scope of the regularity opinion. If implemented as drafted, the PAF would be required to provide significant additional guidance in Part 2 of PN 10 to help auditors of public sector entities to navigate these responsibilities.

PROPOSED ISA (UK) 2X0

The PAF welcomes the proposed ISA (UK) 2X0, noting that this would streamline the existing requirements within the current ISA (UK) 250 Section B for auditors of Public Interest Entities in relation to duties to report and instances where the auditor may determine that reporting an action is appropriate or it is otherwise in the public interest to report.

The PAF considers that the requirements in the proposed standard are proportionate and scalable. The PAF considers that these requirements will result in identification by the auditor of matters which may require outside responses by the auditor where they become aware of information which may require outside reporting and ensure that the auditor responds appropriately to such matters.

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