

THE AUDITING PRACTICES BOARD

Practice Note 10

Consultation Draft

*Audit of Financial Statements of Public Sector Bodies
in the United Kingdom (Revised)*

January 2010

The Auditing Practices Board (APB) is one of the operating bodies of the Financial Reporting Council (FRC). The FRC is a unified, independent regulator with a mission of promoting confidence in corporate reporting and governance. In addition to the APB, the FRC incorporates five other operating bodies: the Accounting Standards Board, the Financial Reporting Review Panel, the Accountancy and Actuarial Discipline Board, the Board for Actuarial Standards and the Professional Oversight Board.

The APB is committed to leading the development of auditing practice in the United Kingdom and the Republic of Ireland so as to:

- Establish high standards of auditing;
- Meet the developing needs of users of financial information; and
- Ensure public confidence in the auditing process.

Further information regarding the APB's remit and processes is provided in the statement of the Scope and Authority of APB Pronouncements and on the APB website (www.frc.org.uk/apb).

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The purpose of Practice Notes issued by the Auditing Practices Board is to assist auditors in applying Auditing Standards of general application to particular circumstances and industries.

Practice Notes are persuasive rather than prescriptive. However, they are indicative of good practice. Auditors should be aware of and consider Practice Notes applicable to the engagement. Auditors who do not consider and apply the guidance included in a relevant Practice Note should be prepared to explain how the basic principles and essential procedures in APB standards have been complied with.

This Practice Note, when finalised, will replace Practice Note 10: Audit of Financial Statements of Public Sector Entities in the United Kingdom (Revised), which was issued in January 2006.

INVITATION TO COMMENT

This consultation draft is issued by the Auditing Practices Board (APB) for public comment.

Following the publication of the clarified ISAs (UK and Ireland) in October 2009, there is a need to update the APB's industry-specific Practice Notes currently in issue. The revision of Practice Note 10 primarily provides guidance for auditors on their audit procedures when applying the new ISAs (UK and Ireland). It also takes account of a small number of legal and regulatory developments affecting public sector bodies in the United Kingdom since the current Practice Note 10 (Revised) was issued in January 2006. While most of the changes to Practice Note 10 are conforming changes the APB invites comments on any aspect of the guidance.

You are invited to send written comments on the consultation draft to APB. APB would like to receive comments from those who agree with the consultation draft as well as from those who do not. Your comments will be most helpful if they refer to the relevant paragraphs and are supported by reasoning.

APB would prefer to receive letters of comment in an electronic form that facilitates 'copy and paste': these may be sent by e-mail to k.billing@frc-apb.org.uk. If this is not possible, please send letters of comment to:

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Letters of comment should be sent so as to be received no later than **9 April 2010**. All comments will be regarded as being on the public record, unless otherwise requested and will be posted to APB's website soon after receipt

PRACTICE NOTE 10

AUDIT OF FINANCIAL STATEMENTS OF PUBLIC SECTOR BODIES IN THE UNITED KINGDOM

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PREFACE

This Practice Note contains guidance on the application of auditing standards issued by the Auditing Practices Board (APB) to the audit of public sector bodies in the UK.

This Practice Note is supplementary to, and should be read in conjunction with, International Standards on Auditing (ISAs) (UK and Ireland), which apply to all audits undertaken in the UK. The Practice Note sets out the special considerations relating to the audit of public sector bodies which arise from individual ISAs (UK and Ireland) listed in the contents. The Practice Note does not provide commentary on all of the requirements in the ISAs (UK and Ireland) - 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 and Ireland) no material is included. Extracts from the ISAs (UK and Ireland) are indicated by grey shading.

This Practice Note has been prepared with advice and assistance from representatives from each of the UK national audit agencies and private sector firms who carry out public sector audit work. It is based on legislation and regulations which are in effect at XX/XX/2010. This Practice Note is not an exhaustive list of all of the obligations that public sector auditors may have under legislation.

Introduction – the role of the public sector auditor

- 1 Those who are responsible for the conduct of public business and for spending public money are accountable for ensuring that this business is conducted in accordance with the law and proper standards of accounting and governance and that public money is used economically, efficiently and effectively.
- 2 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.
- 3 The standards governing the conduct and reporting of the audit of financial statements in the public sector are a matter for the national audit agencies and certain regulators to determine. However, the heads of the national audit agencies in the UK have chosen to adopt the Auditing Practices Board's engagement standards and quality control standards as the basis of their approach to the audit of financial statements. ISAs (UK and Ireland) apply to all audits of financial statements for periods ending on or after 15 December 2010.

Definitions

- 4 For the purpose of this Practice Note, the following terms are defined:
 - An **auditor** of a public sector body (a **public sector auditor**) can be:
 - a person, or persons appointed under statute or agreement (such as the Comptroller and Auditor General); or
 - a person or persons 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 (such as a firm of auditors appointed by the Audit Commission); or
 - a person or persons appointed as auditor to a body regulated by an independent regulator which has determined that this Practice Note applies (such as Monitor, the independent regulator of NHS Foundation Trusts).
 - A **national audit agency** is one of the United Kingdom public audit agencies responsible for carrying out the audit of the financial statements of public sector bodies for a public sector auditor (the National Audit Office for the Comptroller and Auditor General, Wales Audit Office for the Auditor General for 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) or for the appointment and regulation of auditors of public sector bodies (the Accounts

Commission, the Auditor General for Scotland, the Audit Commission and the Auditor General for Wales);

- **Parliament** includes the United Kingdom Parliament and the Scottish Parliament, but not the National Assembly for Wales or the Northern Ireland Assembly.
- The **public sector**¹ comprises:
 - government departments and their executive agencies;
 - the Scottish Government, Welsh Assembly Government, the Northern Ireland Executive and their sponsored and associated bodies;
 - trading funds;
 - bodies not administered as government departments but which are subject to Ministerial and departmental control, for example non-departmental public bodies (NDPBs);
 - local authorities and other local government bodies (such as police and fire authorities);
 - National Health Service bodies, including:
 - strategic health authorities, primary care trusts, NHS trusts, special health authorities and NHS Foundation Trusts in England;
 - local health boards and NHS trusts in Wales;
 - health boards and special health boards in Scotland; and
 - health boards, trusts and special agencies in Northern Ireland.
 - in Scotland, further education colleges and the water authority.

It does not include other public corporations or the nationalised industries. The first four parts of the definition can collectively be regarded as **central government**.

Responsibilities of Public Sector Auditors

- 5 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 established in accordance with legislation.

¹ There is more than one generally accepted definition of the **public sector** and the inclusion of any particular category of entities will depend on the purposes for which the definition is being applied. This is also the case with the definition of central government.

- 6 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 summarised in Appendix 2. These mandates establish broadly similar responsibilities for each jurisdiction in relation to:
- the financial statements (see paragraphs 8-9);
 - compliance with legislative and other authorities (sometimes referred to as ‘regularity’) (see paragraphs 10-15); and
 - economy, efficiency and effectiveness (sometimes referred to as ‘value for money’ or ‘use of resources’) (see paragraph 16).
- 7 In some parts of the UK, English is not the primary language used by public bodies for the conduct of business including preparation of the accounts, for example as a result of applying options available under the Welsh Language Act 1993. 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.

The financial statements

- 8 The legislative framework governing public sector bodies sets out the requirements on the public bodies in relation to the preparation of financial statements. For example, the Government Resources and Accounts Act 2000 requires government departments to prepare resource accounts for each financial year and send them within a specified period to the Comptroller and Auditor General. The Comptroller and Auditor General is required to examine the accounts with a view to reaching an opinion as to whether they present a true and fair view; to certify and issue a report on them; and to send them to HM Treasury to lay before the House of Commons.
- 9 This Practice Note provides public sector auditors with further guidance on the application of ISAs (UK and Ireland) 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 adopt Practice Note 10 as a requirement for their audits to be conducted under. The standards governing other reporting assignments in the public sector are a matter for the national audit agencies and certain regulators to determine.

Compliance with legislative and other authorities

- 10 For central government bodies, public sector auditors express an opinion on whether transactions included in the financial statements conform, where appropriate, with the legislation that authorises them; regulations issued by a body with the power to do so; Parliamentary authority; and HM Treasury authority. The requirement derives from the Exchequer and Audit Departments Act 1921 (and the Government Resources and Accounts Act 2000), whereby the

Comptroller and Auditor General has to satisfy himself that expenditure and income (money and other resources provided by Parliament, in the 2000 Act) have been applied in accordance with Parliament's intentions and conforms to governing authorities². Accordingly, he provides Parliament with an explicit, separate, opinion on the regularity of transactions included in the financial statements of central government bodies.

- 11 In Scotland, the Public Finance and Accountability (Scotland) Act 2000 requires audits of accounts for which the Auditor General is responsible to include an auditor's report that sets 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.
- 12 There is also a requirement deriving from that set out in paragraph 10 to provide an explicit opinion on regularity in relation to specified National Health Service entities in England which are to be consolidated in the financial statements of the Department of Health, and all National Health Service entities in Wales. This requirement also exists in relation to specified health and social services entities in Northern Ireland.
- 13 In other health entities and in local government there is no requirement for auditors to express an opinion on the regularity of transactions, (except in Northern Ireland where the Comptroller and Auditor General does express an opinion on the regularity of transactions for entities in the health sector). However, auditors are required by the Audit Commission's and Audit Scotland's Codes of Audit Practice and the Auditor General for Wales' Code of Audit and Inspection Practice to be alert to the question of legality and review the arrangements set in place by the audited body to ensure compliance with laws and regulations. Where unlawful transactions or events come to the auditor's attention the auditor is empowered under legislation to report to the appropriate authorities.
- 14 Where expenditure in any part of the public sector involves the application of European Union funds, the European Court of Auditors has a right to audit the final use of monies, wherever they have ultimately been spent. The Court will normally address the regularity with which funds have been applied.
- 15 This Practice Note provides public sector auditors with guidance on the audit of regularity in the section at paragraphs 268-375.

Other review and reporting assignments

- 16 Public sector auditors may also be required to review and report on other information prepared by public bodies. Practice Note 10 does not provide guidance to the auditor on conducting these other review and reporting assignments. The standards governing other review assignments in the public

² In Wales, the equivalent authority comes from section 97(6) of the Government of Wales Act 1998. In Northern Ireland, it comes from the Exchequer and Audit Act (Northern Ireland) 1921, the Northern Ireland Act 1998, the Government Resources and Accounts Act (Northern Ireland) 2001 and the Audit and Accountability (Northern Ireland) Order 2003.

sector are a matter for the national audit agencies or certain regulators to determine. Such other information on which public sector auditors may be required to review and report may include aspects of their corporate governance or on their arrangements to secure economy, efficiency and effectiveness in the use of resources, including:

- **performance information.** The Audit Commission Act 1998, the Public Audit (Wales) Act 2004 and the Local Government (Scotland) Act 1973 require the Audit Commission's, the Auditor General for Wales's and the Accounts Commission's appointed auditors to obtain satisfaction that, where appropriate, the body has made the necessary arrangements for collecting, recording and publishing specified performance information. In practice, an Audit Commission appointed auditor's responsibilities in relation to performance information derive from the auditor's general responsibility to obtain satisfaction that the audited body has put in place proper arrangements to secure economy, efficiency and effectiveness in their use of resources, which are defined in the Codes of Audit Practice to include arrangements to ensure data quality. In central government, there is no statutory requirement for public sector auditors to review and report on non-financial performance information published by departments, agencies and non-departmental public bodies or the adequacy of supporting systems. Public sector auditors may nevertheless be invited to carry out an assignment to review Executive Agency or NDPB performance indicators where the Minister responsible decides this is required. The Comptroller and Auditor General was invited by Government in 2002 to review the adequacy of data systems supporting Departments Public Service Agreement targets.
- **grant claims.** Public bodies in receipt of government grants may be required to provide assurance about the extent to which a grant claim or return has been prepared in accordance with the requirements of the government entity and that the figures presented are properly supported and fairly presented. Auditors of local government and NHS bodies (excluding NHS Foundation Trusts) in England may examine and report on audited bodies' government grant claims and returns in accordance with a framework prescribed by the Audit Commission. In carrying out this work, auditors in England act as agents of the Audit Commission. In Wales, a similar arrangement applies to the whole of the devolved public sector under the Public Audit (Wales) Act 2004. In Northern Ireland, article 25 of the Local Government (Northern Ireland) Order 2005 governs these arrangements. In Scotland similar arrangements apply.
- **corporate governance.** Public sector auditors are required to review and report on the corporate governance statements that public sector bodies are required to include with their financial statements.
- **economy, efficiency and effectiveness.** The nature of the auditor's responsibilities varies between different parts of the public sector. The National Audit Act 1983 empowers the Comptroller and Auditor General to carry out examinations into the economy, efficiency and effectiveness with which Departments have used their resources in discharging their functions.

The Government of Wales Acts 1998 and 2006, together with the Public Audit (Wales) Act 2004 provide the Auditor General for Wales with similar powers as does the Audit (Northern Ireland) Order 1987 and the Northern Ireland Act 1998 for the Comptroller and the Auditor General for Northern Ireland and the Public Finance and Accountability (Scotland) Act 2000 for the Auditor General for Scotland. Under the Local Government (Scotland) Act 1973 the Accounts Commission appointed auditor is required to obtain satisfaction that the audited body has made proper arrangements for securing best value and is complying with its duties with regard to community planning. Under the Audit Commission Act 1998, an Audit Commission appointed auditor is required to obtain satisfaction that the audited body has made proper arrangements for securing economy, efficiency and effectiveness in its use of resources. The Public Audit (Wales) Act 2004 contains a similar requirement for local government auditors appointed by the Auditor General in Wales and the Health and Social Care (Community Health and Standards) Act 2003 contains a similar requirement for auditors of NHS Foundation Trusts. In Northern Ireland, Article 26 of the Local Government (Northern Ireland) Order 2005 gives local government auditors a role in relation to economy, efficiency and effectiveness.

- **standards of financial conduct.** Public sector auditors are required to review and, where appropriate, to report, on issues relating to standards of financial conduct in public bodies and aspects of the arrangements set in place by the audited body to ensure the proper conduct of its financial affairs. In central government, the Comptroller and Auditor General has regard to and reports to Parliament on matters of propriety. The Auditor General for Wales, the Comptroller and Auditor General for Northern Ireland and the Auditor General for Scotland have a similar responsibility. In local government and the National Health Service in England and the health service in Northern Ireland the auditor's work on propriety is covered both by the auditor's work on the accounts, and as part of the auditor's work in relation to the use of resources, specifically in relation to arrangements to safeguard the financial standing of the audited body and arrangements to ensure that the audited body's affairs are managed in accordance with proper standards of conduct and to prevent and detect fraud and corruption.

The conduct of assignments undertaken by public sector auditors

- 17 The standards governing the conduct and reporting of the audit of financial statements in the public sector are a matter for the national audit agencies and certain regulators to determine. However, the heads of the national audit agencies in the UK have chosen to adopt the Auditing Practices Board's engagement standards and quality control standards as the basis of their approach to the audit of financial statements. Where appropriate this is embodied in codes of audit practice which also deal with other responsibilities. For example, the Audit Commission Act 1998 requires the Commission to prepare and keep under review a Code of Audit Practice prescribing the way in which auditors are to carry out their functions. The Code embodies the Commission's view of best professional practice with respect to the standards, procedures and techniques to be adopted by auditors in discharging their functions, and as such serves to define the scope and form of local authority and

health entity audits, reflecting the statutory requirements and the wider aims and objectives of the audits of local government and health bodies. Audit Scotland issues a single non-statutory Code of Audit Practice approved by the Accounts Commission and the Auditor General for Scotland that covers the whole of the public sector in Scotland. The Auditor General for Wales has issued a Code of Audit and Inspection Practice under section 16 of the Public Audit (Wales) Act 2004 for local government appointed auditors. This has been extended on a non-statutory basis to cover the whole of the Welsh public sector and includes Value for Money audit and 'Local Government Measure' work. A statutory Code of Audit Practice also exists for local government auditors in Northern Ireland. Where an independent regulator prescribes the way in which auditors are to carry out their functions, possibly in an Audit Code, the auditor follows these requirements.

International Standard on Quality Control (UK and Ireland) 1

Objective

The objective of the firm is to establish and maintain a system of quality control to provide it with reasonable assurance that:

- (a) The firm and its personnel comply with professional standards and applicable legal and regulatory requirements; and
- (b) Reports issued by the firm or engagement partners are appropriate in the circumstances. (Paragraph 11)

Definitions

18 In the context of the audit of public sector entities the following clarification of terms used in ISQC (UK and Ireland) 1 is relevant:

- “firm” is taken as a general reference to the organisation, including the national audit agencies, of which the auditor is a partner or employee; and
- “engagement partner” is the nominated senior individual within the firm responsible for that engagement and its performance. Where an auditor general or equivalent is personally responsible for issuing the audit report, the engagement partner may be another individual who is responsible for delivering the engagement to the auditor general, or equivalent, in accordance with the ISAs (UK and Ireland).

19 In addition, for the purposes of this standard, the following definitions apply:

- Contracted-out engagement is where responsibility for issuing the audit report remains with the national audit agency, but all or some of the audit assignment is undertaken by another firm or auditor under contract or agreement;
- An assignment undertaken on an “appointment by” basis is where another firm or individual is responsible for the assignment, its performance and the issuing of the audit report. An example of this arrangement is the relationship between the Audit Commission and its appointed auditors.

Leadership

20 Overall responsibility for the system of quality control within a public sector audit organisation remains with the head of the organisation (the Auditor General or statutory board). The organisation establishes policies and procedures such that any person or persons assigned operational responsibility for the organisation’s system of quality control by the Auditor General or statutory board has the appropriate experience and ability, and the necessary authority, to assume that responsibility.

- 21 For contracted-out engagements, where the national audit agency retains responsibility for issuing the audit report, responsibility for quality across all engagements remains with the national audit agency. However, this does not absolve the contractor of responsibility for systems of quality control within that organisation in accordance with ISQC (UK and Ireland) 1. In practice, this may involve the national audit agency obtaining assurances over quality from the contractor, and may involve the national audit agency undertaking procedures to confirm that the systems of quality control are working effectively.
- 22 Where an audit organisation undertakes the engagement on appointment by, and issues the audit report in its own name, responsibility for the system of quality control rests with that audit organisation. This does not affect any statutory responsibility the national audit agency has for oversight or quality assurance for assignments undertaken on its behalf.

Ethics

- 23 The heads of the national audit agencies have chosen to adopt the Auditing Practices Board's Ethical Standards. National audit agencies may also have additional ethical and propriety standards, such as restrictions on political activities or requirements contained in the Audit Commission's 'Statement of Independence'. The Official Secrets Act also covers some public sector activities. Compliance with these additional requirements does not compromise the ability of the firm or individual auditors to comply with relevant professional ethical requirements required by ISQC (UK and Ireland) 1.
- 24 For contracted out audits, or those undertaken on an "appointment by" basis, the national audit agency confirms that the other firm meets the relevant ethical standards, including independence, on appointment and periodically thereafter, and that there are policies and procedures in place to identify and resolve potential conflicts.

Acceptance and Continuance of Client Relationships and Specific Engagements

- 25 In the public sector, where the auditor is appointed under statute, the auditor cannot decline or withdraw from the engagement. However, in most cases public sector auditors have the statutory authority to report publicly matters that may otherwise have caused withdrawal from the engagement. For example, in the central government sector such matters can be reported to Parliament.
- 26 Firms therefore establish policies and procedures equivalent to those envisaged within ISQC (UK and Ireland) 1 for acceptance and continuance of both client relationships and specific engagements in accordance with ISA (UK and Ireland) 220.

Human Resources

- 27 Where an engagement is contracted out by, or undertaken on an "appointment by" basis, the national audit agency ensures that the other auditor has sufficient personnel with the competencies, capabilities and commitment to ethical principles necessary for compliance with ISQC (UK and Ireland) 1.

Engagement performance

- 28 For contracted-out audits, the national audit agency remains responsible for engagement performance. This does not affect the contractor's responsibility for its engagement performance. Both the national audit agency and the contractor undertake their own consideration of whether internal consultation and the appointment of an engagement quality control reviewer are necessary. The fact that either has undertaken, or chosen not to implement, this process does not absolve the other from considering the need for such procedures in accordance with ISQC (UK and Ireland) 1. Equally, a review by the engagement partner within the national audit agency does not constitute an independent engagement quality control review for the purposes of ISQC (UK and Ireland) 1.
- 29 ISQC (UK and Ireland) 1 requires the appointment of an engagement quality control reviewer for listed companies, but acknowledges that certain public sector entities may be of sufficient significance to warrant performance of such a review. Each firm establishes a policy for determining which assignments are subject to an engagement quality control review, taking into account the complexity of the organisation, public interest issues, and other relevant factors determined corporately, for example whether a modification to the audit report is expected.

Monitoring

- 30 Each firm implements quality control monitoring policies and procedures. Where contractors perform assignments on a contracted-out basis, the national audit agency ensures that the quality control monitoring system includes those assignments. The national audit agency may also apply quality monitoring arrangements to assignments undertaken on an "appointment by" basis.
- 31 A firm undertaking an assignment on a contracted-out basis, or on appointment, ensures that their quality control monitoring system includes such assignments.
- 32 Where deficiencies are identified as a result of monitoring an assignment undertaken on a contracted-out basis or on an "appointment by" basis, these deficiencies are reported to the firm undertaking the assignment. Equally, if the contractor identifies deficiencies in any of its public sector assignments that fall within the remit of the national audit agency, these are communicated, along with the action undertaken, to the relevant national audit agency.
- 33 Each firm establishes policies and procedures designed to provide it with 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 national audit agency, where relevant.

Completion of the Assembly of Final Engagement Files

The firm shall establish policies and procedures for engagement teams to complete the assembly of final engagement files on a timely basis after the engagement reports have been finalised. (Paragraph 45)

- 34 The application material to ISQC (UK and Ireland) 1 states that the assembly of the final audit file would ordinarily not be more than 60 days after the date of the auditor's report. In the public sector the requirement to lay the account before Parliament and the existence of the Parliamentary summer recess may require these files to be held open for a longer period. In these circumstances the auditor still ensures that all audit documentation to support the audit opinion is held on the file on a timely basis and documents the reasons why the file is held open.

Confidentiality, Safe Custody, Integrity, Accessibility and Retrievability of Engagement Documentation

The firm shall establish policies and procedures designed to maintain the confidentiality, safe custody, integrity, accessibility and retrievability of engagement documentation. (Paragraph 46)

- 35 Although public sector auditors apply the provisions of ISQC (UK and Ireland) 1 in full, auditors may also have additional statutory obligations relating to confidentiality. For example, when carrying out central government assignments auditors are aware of, and comply with, any applicable provisions of the Official Secrets Act 1989. Auditors of local government and health entities (excluding NHS Foundation Trusts) in England are bound by the requirements for confidentiality contained in section 49 of the Audit Commission Act 1998 and auditors of local government entities in Wales are bound by the provisions of Section 54 of the Public Audit (Wales) Act 2004. Auditors of NHS Foundation Trusts are bound by the same requirements, set out in section 8 of schedule 10 to the National Health Service Act 2006.
- 36 The acceptance of most appointments in the public sector requires the auditor to acknowledge that the auditor's 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 and 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, ethical considerations normally entail that the national audit agency acquires the duty of confidentiality that is held by the auditor.
- 37 Whilst the auditor is expected to comply with statutory obligations relating to confidentiality, the auditor is also aware that the audit work may be potentially disclosable under the Freedom of Information Act 2000 and the Freedom of Information (Scotland) Act 2002.
- 38 The Freedom of Information Act 2000 and the Freedom of Information (Scotland) Act 2002 provide a statutory right of access to recorded information held by public authorities. Auditors appointed by the Audit Commission or the Auditor General for Wales are not public authorities for the purposes of the Freedom of Information Act 2000. However, Section 49 of the Audit Commission Act (as amended) and section 54 of the Public Audit (Wales) Act 2004 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.

ISA (UK and Ireland) 200: Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with International Standards on Auditing (UK and Ireland)

Overall Objectives of the Auditor

In conducting an audit of financial statements, the overall objectives of the auditor are:

- (a) To obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, thereby enabling the auditor to express an opinion on whether the financial statements are prepared, in all material respects, in accordance with an applicable financial reporting framework; and
- (b) To report on the financial statements, and communicate as required by the ISAs (UK and Ireland), in accordance with the auditor's findings. (Paragraph 11)

In all cases when reasonable assurance cannot be obtained and a qualified opinion in the auditor's report is insufficient in the circumstances for purposes of reporting to the intended users of the financial statements, the ISAs (UK and Ireland) require that the auditor disclaim an opinion or withdraw (or resign) from the engagement, where withdrawal is possible under applicable law or regulation. (Paragraph 12)

The Regularity Opinion

- 39 In observing the requirements of ISA (UK and Ireland) 200, the auditor is aware that:
- for central government, specified health entities, probation boards and trusts and certain other bodies there is a requirement, laid out in statute or by convention, to obtain evidence on compliance with authorities (regularity); and
 - in recognition of the importance of regularity to the audit of these entities, the structure of the auditor's report includes an explicit opinion on the regularity of transactions.
- 40 The auditor also considers propriety. It is a related concept but propriety is not covered by the regularity opinion. Further guidance on propriety is provided in paragraphs 273 to 275 of this Practice Note.
- 41 Further guidance on regularity and the reporting of regularity in the audit opinion is included in the separate section of this Practice Note on regularity.

ISA (UK and Ireland) 210: Agreeing the Terms of Audit Engagements

Objective:

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. (Paragraph 3)

- 42 In this section of the Practice Note, the client is considered to be the audited body.

Preconditions for an Audit

In order to establish whether the preconditions for an audit are present, the auditor shall:

- (a) Determine whether the financial reporting framework to be applied in the preparation of the financial statements is acceptable; and
- (b) Obtain the agreement of management that it acknowledges and understands its responsibility:
 - (i) For the preparation of the financial statements in accordance with the applicable financial reporting framework, including where relevant their fair presentation;
 - (ii) For such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error; and
 - (iii) To provide the auditor with:
 - a. Access to all information of which management is aware that is relevant to the preparation of the financial statements such as records, documentation and other matters;
 - b. Additional information that the auditor may request from management for the purpose of the audit; and
 - c. Unrestricted access to persons within the entity from whom the auditor determines it necessary to obtain audit evidence. (Paragraph 6)

- 43 In the public sector, the preconditions for audit may derive from a number of sources, including legislation, accounts directions and the letter of understanding or engagement.

Agreement on Audit Engagement Terms

The auditor shall agree the terms of the audit engagement with management or those charged with governance, as appropriate. (Paragraph 9)

Subject to paragraph 11 [of the standard], the agreed terms of the audit engagement shall be recorded in an audit engagement letter or other suitable form of written agreement and shall include:

- (a) The objective and scope of the audit of the financial statements;
- (b) The responsibilities of the auditor;
- (c) The responsibilities of management;
- (d) Identification of the applicable financial reporting framework for the preparation of the financial statements; and
- (e) Reference to the expected form and content of any reports to be issued by the auditor and a statement that there may be circumstances in which a report may differ from its expected form and content. (Paragraph 10)

If law or regulation prescribes in sufficient detail the terms of the audit engagement referred to in paragraph 10 [of the standard], the auditor need not record them in a written agreement, except for the fact that such law or regulation applies and that management acknowledges and understands its responsibilities as set out in paragraph 6(b) [of the standard]. (Paragraph 11)

- 44 Statutory engagements in the public sector normally differ substantially from those addressed in the private sector. In the public sector there are often at least three parties with an interest in the terms of an engagement which may include; the auditor, the audited entity, the legislature (Parliament or the Assembly) and the relevant national audit agency (or Secretary of State, if responsible for the appointment of the auditor). With the exception of NHS Foundation Trusts who have the freedom to select and appoint their own auditors, in most other instances, the statutory framework allows a substantial part of the scope and objectives of the audit to be mandated by the national audit agency.
- 45 For this reason, formal engagement letters for statutory engagements may not be necessary. A letter of engagement may also be made unnecessary because the terms of the engagement have been set out comprehensively in letters of appointment and associated documents such as Codes of Audit Practice issued by the audit agency. However, 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 is appropriately understood by those charged with governance. A letter of understanding may therefore be necessary. The annex to this chapter provides examples of areas such a letter may cover.
- 46 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 three 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. However, 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. 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.

- 47 For non-statutory appointment audit engagements, an engagement letter is required, covering the matters set out in ISA (UK and Ireland) 210. The issuance of an engagement letter for a non-statutory assignment establishes a contractual relationship between the entity and the audit agency. The terms of the letter need therefore be clear as to the rights, responsibilities and duties of all parties.

Central Government

- 48 In central government, the audit of many entities is provided for in legislation or by Royal Charter. Such legislation will usually directly appoint, on behalf of the Houses of Parliament, the Comptroller and Auditor General as auditor. This creates three parties with an interest in the terms of the engagement: Parliament (or devolved assembly), the national audit agency, and the audited entity. Legislation covers the relationship between Parliament and the national audit agency, whilst a letter of understanding provides respective acknowledgement of the auditor and management responsibilities.
- 49 For UK-wide entities and those covering England, the Comptroller and Auditor General is appointed by statute to audit all government departments, agencies and all non-departmental public bodies (except those that are profit making companies).
- 50 In Wales, the Auditor General is appointed by statute or agreement to audit the accounts of the Welsh Assembly Government, its sponsored and other related public bodies and all NHS Wales entities. The Auditor General for Wales also appoints the auditors of local government bodies in Wales. In Scotland, the Auditor General appoints the auditor of the Scottish Government and most of its sponsored bodies. For Northern Ireland, the framework is similar to that applicable in England. For health entities in Northern Ireland responsibility for the audit is covered by the Audit and Accountability (Northern Ireland) Order 2003.
- 51 For financial statements produced by central government departments, including those of executive agencies, the auditor's duties are set out in legislation. As an example, the Government Resources and Accounts Act 2000 prescribes the duties of the Comptroller and Auditor General to examine, on behalf of Parliament, the accounts of government departments. In these cases the auditor normally sets out in a letter the auditor's understanding of the respective responsibilities of the auditor and of management and provides details of the scope and nature of the audit.

- 52 Legislation governing the establishment of non-departmental public bodies and the appointment of the auditor has not to date prescribed in detail the auditor's responsibilities. In such cases, a letter of understanding sets out the scope of the audit and form of the audit report, and allows for a common understanding of the responsibilities of management and the auditor.
- 53 Where the auditor has not been appointed under statute, and the financial statements are laid before Parliament, either by statute or command, 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 Chief Executive or Accounting Officer of the audited entity. The areas that may be covered in such a letter of engagement are set out in the annex to this section of the Practice Note.
- 54 The auditor also considers whether HM Treasury agreement of these terms may be required. Where the financial statements are not laid before Parliament, the auditor agrees the terms of the audit engagement with the addressee of the auditor's report.

Local Government and Health Entities

- 55 The appointment of auditors to local government and health entities (excluding NHS Foundation Trusts) is made within a statutory framework where audits are required to be executed in accordance with the applicable Code of Audit Practice. The Codes deal with many of those matters that would in the private sector context have been dealt with in a letter of engagement. The Audit Commission and Audit Scotland supply a copy of the relevant Code to all audited bodies and write to inform them of the statutory appointment, the fee arrangements and any general matters that might affect the audit.
- 56 The Audit Commission also writes a letter of appointment and provides a copy of the Statement of Responsibilities to all local government and health entities in England, to help improve understanding of the terms upon which the Commission appoints auditors, and their responsibilities and duties.
- 57 In the case of NHS Foundation Trusts, the Board of Governors is responsible, under the National Health Service Act 2006, for the appointment of auditors. Auditors must comply with the Audit Code for NHS Foundation Trusts, as published by Monitor. As part of this Audit Code, the auditor agrees an engagement letter with the NHS Foundation Trust and in doing so complies with ISA (UK and Ireland) 210. When agreeing the terms and conditions of an audit engagement, care is taken to ensure that these terms and conditions comply with the ISA (UK and Ireland) requirements and do not impose any restrictions or requirements that conflict with the auditors professional responsibilities.
- 58 In Wales, the Auditor General for Wales' Code of Audit and Inspection Practice is statutory for local government auditors and extended on a non-statutory basis to cover the whole of the Welsh public sector.
- 59 In Northern Ireland, responsibility for the audit of all health entities has been allocated, under the Audit and Accountability (Northern Ireland) Order 2003, to

the Comptroller and Auditor General for Northern Ireland. Such audits are therefore governed by the relevant statutes and by auditing standards. Local government auditors work to a statutory Code of Audit Practice and the Chief Local Government Auditor has also issued a Statement of Responsibilities.

- 60 The arrangements set out in paragraphs 55 to 59 above meet the substance and intent of ISA (UK and Ireland) 210 and therefore auditors of local government and health entities do not need to agree a separate engagement letter for the audit of the financial statements. A separate engagement letter is however required for Foundation Trusts.

Acceptance of a Change in Engagement

If, prior to completing the audit engagement, the auditor is requested to change the audit engagement to an engagement that conveys a lower level of assurance, the auditor shall determine whether there is reasonable justification for doing so.
(Paragraph 15)

- 61 Where the auditor's responsibilities are set out in statute or relevant codes of practice, the terms of the engagement cannot be changed to provide a lower level of assurance.

If the auditor is unable to agree to a change of the audit engagement and is not permitted to continue the original engagement, the auditor shall:

- (a) Withdraw from the audit engagement where possible under applicable law or regulation; and
- (b) Determine whether there is any obligation, either contractual or otherwise, to report to other parties, such as those charged with governance, owners or regulators. (Paragraph 17)

- 62 In the public sector, where the auditor is appointed under statute, the auditor cannot decline or withdraw from the engagement. However, in most cases a public sector auditor has the statutory authority to report publicly matters that may otherwise have caused withdrawal from the engagement. For example, in the central government sector such matters can be reported to Parliament.
- 63 Where the public sector auditor is not appointed by statute, the requirements of ISA 210 (UK and Ireland) will apply in full with respect to considerations for acceptance of an engagement, or changes and restrictions to the terms of an engagement.

Areas that may be Covered in a Letter of Engagement or Understanding

The auditor considers the areas that may be covered by the letter of engagement or understanding. These areas may change over time and the auditor will need to consider developments that may be relevant to the auditor's client.

In preparing the letter of engagement or understanding the auditor may consider the following:

- Individual responsibilities of the Accounting Officer or Accountable Officer, as well as the general responsibilities of those charged with governance, where relevant;
- 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, as well as reports to those charged with governance (including in respect of deficiencies in internal control covered by ISA 265 (UK and Ireland));
- Wider auditor responsibilities, such as obligations under the Freedom of Information Act or the Proceeds of Crime Act;
- Reviewing the Accounting Officer or Accountable Officer's Statement on Internal Control;
- Electronic Publication of Financial Statements;
- Value for Money Examinations;
- Other Services;
- Audit Fees.

ISA (UK and Ireland) 220: Quality Control for an Audit of Financial Statements

Objective

The objective of the auditor is to implement quality control procedures at the engagement level that provide the auditor with reasonable assurance that:

- (a) The audit complies with professional standards and applicable legal and regulatory requirements; and
- (b) The auditor's report issued is appropriate in the circumstances. (Paragraph 6)

- 64 In the context of the audit of public sector entities the following clarification of terms used in ISA (UK and Ireland) 220 is relevant:
- “firm” is taken as a general reference to the organisation, including the national audit agencies, of which the auditor is a partner or employee; and
 - “engagement partner” is taken as the nominated senior individual within the firm responsible for that engagement and its performance. Where an auditor general or equivalent is personally responsible for issuing the audit report, the engagement partner may be another individual who is responsible for delivering the engagement to the auditor general, or equivalent, in accordance with the ISAs (UK and Ireland).
- 65 Although the principles of auditing are the same in the public and private sectors, the auditor of a public service body often has wider objectives and additional statutory responsibilities, laid down in legislation, directives or codes of practice.

Acceptance and Continuance of Client Relationships and Specific Audit Engagements

The engagement partner shall be satisfied that appropriate procedures regarding the acceptance and continuance of client relationships and specific audit engagements have been followed, and shall determine that conclusions reached in this regard are appropriate. (Paragraph 12)

- 66 A public sector auditor may be specifically appointed under legislation to audit the financial statements of a public sector entity, in which case it will not be open to the auditor to decline the appointment. For example, the Comptroller and Auditor General can be named as the auditor in the legislation that creates a new public sector entity. However, auditors carry out an assessment on initial appointment and annually thereafter of the matters outlined in the ISA (UK and Ireland) and put in place sufficient safeguards to mitigate the risks identified.

- 67 In all other respects the auditor will follow the guidance set out in ISA (UK and Ireland) 220, and if necessary include in the auditor's report, for example, any constraints to undertaking sufficient work to be able to perform the audit in accordance with Auditing Standards or an imposed limitation in audit scope.

If the engagement partner obtains information that would have caused the firm to decline the audit engagement had that information been available earlier, the engagement partner shall communicate that information promptly to the firm, so that the firm and the engagement partner can take the necessary action. (Paragraph 13)

- 68 Further guidance on declining or withdrawing from engagements in the public sector is provided in paragraph 0 of this Practice Note and in paragraph A7 to ISA 220 (UK and Ireland).

Engagement Quality Control Review

For audits of financial statements of listed entities, and those other audit engagements, if any, for which the firm has determined that an engagement quality control review is required, the engagement partner shall:

- (a) Determine that an engagement quality control reviewer has been appointed;
- (b) Discuss significant matters arising during the audit engagement, including those identified during the engagement quality control review, with the engagement quality control reviewer; and
- (c) Not date the auditor's report until the completion of the engagement quality control review. (Paragraph 19)

- 69 The ISA (UK and Ireland) requires that engagement quality control review is undertaken for all audit engagements where the entity is a listed company, and that firms establish policies setting out the circumstances in which an engagement quality control review is performed for other audit engagements, whether on the grounds of the public interest or risk.

- 70 In the public sector, the auditor³ considers the circumstances in which an engagement quality control review of the audit is necessary. In doing so the auditor will need to consider the size and characteristics of the entity. Generally engagement quality control reviews are more likely to be appropriate to larger, more complex, entities than smaller ones, and to higher profile entities than lower profile entities. An engagement quality control review may be appropriate for smaller entities with a high profile, for example if there is a particularly high level of Parliamentary, public or media interest in the entity or where the entity itself is not high profile, although the activities of the entity are. It is the decision of each firm to determine what constitutes a high profile entity taking into account both the size and profile of the entity.

³ The auditor, in the public sector context, is defined in paragraph 4 of the Introduction.

ISA (UK and Ireland) 230: Audit Documentation

Objective:

The objective of the auditor is to prepare documentation that provides:

- (a) A sufficient and appropriate record of the basis for the auditor's report; and
- (b) Evidence that the audit was planned and performed in accordance with ISAs (UK and Ireland) and applicable legal and regulatory requirements. (Paragraph 5)

Assembly of the Final Audit File

- 71 Guidance on the timely preparation of the final audit file, and on the confidentiality, safe custody, integrity, accessibility and retrievability of engagement documentation is provided on the ISQC (UK and Ireland) 1 section of this Practice Note.

After the assembly of the final audit file has been completed, the auditor shall not delete or discard audit documentation of any nature before the end of its retention period. (Paragraph 15)

- 72 The auditor also considers whether there are specific statutory requirements for the retention of working papers. For instance, the Public Records Act 1958 and the Public Records (Scotland) Act 1937 could apply. Where the auditor is uncertain as to the auditor's statutory duties, the auditor considers seeking legal advice.

ISA (UK and Ireland) 240: The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements

Objectives

The objectives of the auditor are:

- (a) To identify and assess the risks of material misstatement of the financial statements due to fraud;
- (b) To obtain sufficient appropriate audit evidence regarding the assessed risks of material misstatement due to fraud, through designing and implementing appropriate responses; and
- (c) To respond appropriately to fraud or suspected fraud identified during the audit. (Paragraph 10)

- 73 An auditor conducting an audit in accordance with ISAs (UK and Ireland) is responsible for obtaining reasonable assurance that the financial statements taken as a whole are free from material misstatement, whether caused by fraud or error.
- 74 The public sector auditor's responsibilities under ISA (UK and Ireland) 240 are not any different from those of private sector auditors as regards the audit of the financial statements (although in some instances they are different with respect to the other responsibilities relating to fraud as set out in paragraphs 77 and 78).
- 75 Further details regarding the requirements of public sector auditors with regard to fraud are given in the following documents:
- central government auditors have regard to HM Treasury (or Department of Finance and Personnel in Northern Ireland) and other appropriate guidance on corporate governance;
 - the Audit Commission's Code of Audit Practice requires auditors of local government and health entities (excluding NHS Foundation Trusts) in England to review and, where appropriate, examine evidence that is relevant to the audited body's corporate performance management and financial management arrangements and report on these arrangements. This review will include consideration of the arrangements in place for ensuring that the audited body's affairs are managed in accordance with proper standards of conduct and to prevent and detect fraud and corruption. Such reviews are also carried out by auditors of health entities in Northern Ireland;
 - the Auditor General for Wales' Code requires auditors of local government entities in Wales to form a view on the adequacy of aspects of the body's stewardship and governance arrangements;

- Audit Scotland's Code of Audit Practice requires auditors of public sector entities in Scotland to consider and assess the arrangements in place for the prevention and detection of fraud and corruption; and
- Monitor's Code of Audit Practice.

76 These other responsibilities are different from and wider than those to which ISA (UK and Ireland) 240 is directly relevant. The auditor is concerned, to a greater or lesser extent, with reviewing and reporting upon the entity's arrangements for the prevention and detection of fraud. ISA (UK and Ireland) 240 is concerned with ensuring that the auditor considers the risks of material misstatement in the financial statements due to fraud and designs and performs further audit procedures whose nature, timing and extent are responsive to assessed risks.

Fraud in the Context of the Regularity Opinion

77 Fraudulent transactions cannot, by definition, be regular since they are without proper authority. Where the auditor has a duty to give a regularity opinion, fraud that is material always results in a qualification of the regularity part of the opinion, regardless of the manner or extent of disclosure in the financial statements. Guidance on fraud in the context of regularity is set out in the separate section in this Practice Note on regularity.

Unless all of those charged with governance are involved in managing the entity⁴, the auditor shall obtain an understanding of how those charged with governance exercise oversight of management's processes for identifying and responding to the risks of fraud in the entity and the internal control that management has established to mitigate these risks. (Paragraph 20)

78 The responsibilities of public sector entities in relation to the prevention and detection of fraud and error are set out in statute, standards and other guidance:

Central government entities	<p>Under "Managing Public Money" <i>the Accounting Officer</i> has a personal responsibility for the proper presentation of financial statements for which he or she is answerable and for ensuring that:</p> <ul style="list-style-type: none"> • proper financial procedures are followed; • public funds are properly and well managed and safeguarded; • assets are similarly controlled and safeguarded; and • funds are applied only to the extent and for the purposes authorised by Parliament.
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⁴ ISA (UK and Ireland) 260, "Communication with Those Charged with Governance," paragraph 13.

	<p>"Managing Public Money" also states that organisations are expected to develop and maintain effective controls to prevent fraud and to ensure that when it does occur it is detected promptly.</p> <p>In Wales, the Principal Accounting Officer of the Welsh Assembly Government follows the guidance set out in the "Accounting Officer Memorandum" issued by HM Treasury.</p> <p>In Scotland, the functions of <i>Accountable Officers</i> are set out in the Public Finance and Accountability (Scotland) Act 2000, and include:</p> <ul style="list-style-type: none"> • signing the financial statements; and • ensuring the propriety and regularity of the finances.
Local government entities	<p><i>Entities</i> have a statutory duty to make arrangements for the proper administration of their financial affairs. An <i>officer</i> is appointed to have responsibility for the administration of these arrangements. Under the Local Government Act 1972 under section 151 an officer can be appointed to have responsibility for the proper administration of financial affairs.</p> <p>In addition, in England, the Accounts and Audit Regulations 2003 require the "<i>responsible financial officer</i>" to determine accounting control systems that include measures to enable the prevention and detection of inaccuracies and fraud.</p> <p>In Wales, the Accounts and Audit (Wales) Regulations 2005 have been made by the Welsh Assembly Government under section 39 of the Public Audit (Wales) Act 2004.</p> <p>In Northern Ireland, Local Government (Accounts and Audit) Regulations (Northern Ireland) 2006 have been made under article 24 of the Local Government (Northern Ireland) Order 2005.</p>

Health entities	<p>In England, Secretary of State directions require NHS bodies to take all necessary steps to counter fraud in the NHS.</p> <p>In addition, <i>the Chief Executive and the Director of Finance</i> of health bodies (excluding NHS Foundation Trusts) in England are required by the Secretary of State to monitor and ensure compliance with the directions.</p> <p>In NHS Foundation Trusts, the Accounting Officer is required by the regulator to ensure a high standard of financial management.</p> <p>NHS Accountable Officers in Wales are appointed by the Chief Executive of NHS Wales.</p> <p>In Scotland, under the Public Finance and Accountability (Scotland) Act 2000, NHS Accountable Officers have a personal responsibility for the propriety and regularity of financial transactions and for signing the accounts of their entities.</p> <p>In Scotland, minimum financial control standards required for the Statement of Internal Financial Control also require that:</p> <ul style="list-style-type: none"> • a fraud and corruption policy and response plan are in place; and • systems are in place that produce reliable financial information and proper accounting records. <p>The position in Northern Ireland is broadly similar to England and Wales.</p>
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Risk Assessment Procedures and Related Activities

When performing risk assessment procedures and related activities to obtain an understanding of the entity and its environment, including the entity's internal control, required by ISA (UK and Ireland) 315, the auditor shall perform procedures [specified in paragraphs 17-24 of the standard] to obtain information for use in identifying the risks of material misstatement due to fraud. (Paragraph 16)

- 79 Public sector auditors consider whether internal and external fraud risk factors are present when obtaining an understanding of audited entities. The risk of external fraud may be particularly high where a body is involved in issuing

grants or benefits to the public or collecting tax revenues as there is an increased risk of fraudulent activity by individuals or groups outside of the immediate control of the audited entity, for example fraudulent benefit or prescription claims.

80 ISA (UK and Ireland) 240 describes 2 types of fraud that are relevant to the auditor:

- misstatements resulting from the misappropriation of assets; and
- misstatements resulting from fraudulent financial reporting.

In the public sector the auditor also considers the risk of external fraud as explained above.

81 A public sector auditor needs to consider 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 NHS Trust or where financial results affect performance ratings by an inspectorate.

Auditor Unable to Continue the Engagement

If, as a result of a misstatement resulting from fraud or suspected fraud, the auditor encounters exceptional circumstances that bring into question the auditor's ability to continue performing the audit the auditor shall:

- (a) Determine the professional and legal responsibilities applicable in the circumstances, including whether there is a requirement for the auditor to report to the person or persons who made the audit appointment or, in some cases, to regulatory authorities;
- (b) Consider whether it is appropriate to withdraw from the engagement, where withdrawal from the engagement is legally permitted and
- (c) If the auditor withdraws:
 - (i) Discuss with the appropriate level of management and those charged with governance the auditor's withdrawal from the engagement and the reasons for the withdrawal; and
 - (ii) Determine whether there is a professional or legal requirement to report to the person or persons who made the audit appointment or, in some cases, to regulatory authorities, the auditor's withdrawal from the engagement and the reasons for the withdrawal. (Paragraph 38)

82 In the public sector, where the auditor is appointed under statute the auditor cannot decline or withdraw from the engagement. Where the public sector auditor is not appointed by statute there are still a number of avenues open to the auditor other than withdrawing from the engagement. In most cases a public sector auditor has the statutory authority to report publicly matters that may otherwise have caused withdrawal from the engagement. For example, in the central government sector such matters can be reported to Parliament. In the

case of Foundation Trusts, then Monitor may be able to provide an alternative route for reporting.

Documentation

The auditor shall include in the audit documentation communications about fraud made to management, those charged with governance, regulators and others. (Paragraph 46)

83 In considering whether to report a suspected or actual instance of fraud to a proper authority, the auditor of a public sector entity has regard to paragraph 43 of ISA (UK and Ireland) 240 and 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.

84 Where, in accordance with ISA (UK and Ireland) 240, the auditor considers that there is a duty to report to a third party (because of the implication of those charged with governance in the matter or their refusal to report), the proper authorities to whom the auditor is initially expected to report instances of suspected or actual fraud may differ:

UK wide departments and central government departments covering England and Wales	HM Treasury.
Welsh Assembly Government and its sponsored public bodies	The Principal Accounting Officer of the Welsh Assembly Government.
Central government departments in Scotland	The Auditor General for Scotland.
Central government departments in Northern Ireland	The Department of Finance and Personnel.
Non-departmental public bodies and executive agencies	The sponsor department.
Local government entities	A relevant authority as set out in ISA (UK and Ireland) 240, such as the Police.
Health entities	Counter Fraud and Security Management Service In Northern Ireland, reports are made to the Department of Health, Social Services and Public Safety.

- 85 Because the public sector is covered by separate legislation on corruption⁵, the 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 and Ireland) 240.
- 86 The auditor is also aware of the responsibilities in relation to reporting money laundering offences (see guidance in paragraphs 96 to 98 of this Practice Note), including those relating to 'tipping-off'. Auditors ensure that they liaise with their firm's Money Laundering Reporting Officer (and where appropriate the audit agency's Money Laundering Reporting Officer if this is different to the firm's MLRO) in making any report.
- 87 The terms of engagement for the auditor of a non-departmental public body may require the auditor to report to the sponsor department on acts of misconduct, fraud or other irregularity irrespective of whether the entity's directors have themselves reported the matter to the sponsor department.

When identifying and assessing the risks of material misstatement due to fraud, the auditor shall, based on a presumption that there are risks of fraud in revenue recognition, evaluate which types of revenue, revenue transactions or assertions give rise to such risks. Paragraph 47 [of the standard] specifies the documentation required when the auditor concludes that the presumption is not applicable in the circumstances of the engagement and, accordingly, has not identified revenue recognition as a risk of material misstatement due to fraud. (Paragraph 26)

⁵ Specific legislation on corruption applies to United Kingdom public bodies of all descriptions and their agents, where an agent is a person serving under a public body. The generally applicable legislation comprises:

- the Public Bodies Corruption Act 1889;
- the Prevention of Corruption Act 1906; and
- the Prevention of Corruption Act 1916.

Section 117(2) of the Local Government Act 1972 is also relevant to local authorities in England and Wales: it prescribes that officers shall not accept any fee or reward under colour of their office or employment other than proper remuneration. In Northern Ireland, section 47 of the Local Government (Northern Ireland) Act 1972 applies to the same effect.

Section 2 of the Prevention of Corruption Act 1916 states that:

'any money, gift or other consideration paid to or received by a person in the employment of any... government department or public body by or from a person, or agent of a person, holding or seeking to obtain a contract from any... government department or public body shall be deemed to have been paid corruptly... unless the contrary is proved.'

The importance of this particular provision is that, where a person employed by a public body has received any money, gift or consideration from a contractor or tenderer, the burden of proof is on that person to establish that such consideration was not paid or received corruptly.

- 88 ISA (UK and Ireland) 240 states, in paragraph 26, that material misstatements due to fraudulent financial reporting often result from an overstatement of revenues (for example, through premature revenue recognition or recording fictitious revenues) or an understatement of revenues (for example, through improperly shifting revenues to a later period). Therefore, the auditor ordinarily presumes that there are risks of fraud in revenue recognition and considers which types of revenue, revenue transactions or assertions may give rise to such risks. Those assessed risks of material misstatement due to fraud related to revenue recognition are significant risks. For some public sector bodies this presumption regarding the risk of fraud relating to revenue recognition may not apply due to the immateriality of revenue streams. However, even in these cases, the public sector auditor still needs to consider whether there is a risk of material misstatement due to fraud related to revenue recognition where 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.
- 89 In the public sector, auditors also consider the risk that material misstatements due to fraudulent financial reporting may arise from the manipulation of expenditure recognition (for instance by deferring expenditure to a later period). This may arise due to the audited body manipulating expenditure to meet externally set targets. As most public bodies are net spending bodies, then the risk of material misstatement due to fraud related to expenditure recognition may in some cases be greater than the risk of material misstatements due to fraud related to revenue recognition and so the auditor has regard to this when planning and performing audit procedures.

ISA (UK and Ireland) 250: Section A - Consideration of Laws and Regulations in an Audit of Financial Statements

Objectives

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 non-compliance or suspected non-compliance with laws and regulations identified during the audit. (Paragraph 10)

Consideration of Laws and Regulations

- 90 An audit of financial statements in the public sector is similar in scope and nature to an entity in the private sector. The auditor has regard to the risk that financial statements might be materially affected by the entity's non-compliance with laws and regulation. For auditors of central government, specified health entities, probation boards and trusts and certain other bodies, there is a specific reporting requirement commonly known as regularity.
- 91 ISA (UK and Ireland) 250 is concerned with laws and regulations that, if not complied with, may materially affect the financial statements of any entity. Such laws and regulations fall into two categories:
- (a) 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 such as tax and pension laws and regulations; and
 - (b) Other laws and regulations that do not have a direct effect on the determination of the amounts and disclosures in the financial statements, but compliance with which may be fundamental to the operating aspects of the business, to an entity's ability to continue its business, or to avoid material penalties (for example, compliance with the terms of an operating license, compliance with regulatory solvency requirements, or compliance with environmental regulations); non-compliance with such laws and regulations may therefore have a material effect on the financial statements.

As part of obtaining an understanding of the entity and its environment in accordance with ISA 315⁶, the auditor shall obtain a general understanding of:

- (a) The legal and regulatory framework applicable to the entity and the industry or sector in which the entity operates; and
- (b) How the entity is complying with that framework. (Paragraph 12)

92 Where the auditor is required to examine and report on the regularity of transactions, the auditor applies the guidance on law and regulations in the context of the regularity opinion set out in the separate section in this Practice Note on regularity.

The Auditor's Consideration of Compliance with Laws and Regulations

The auditor shall 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. (Paragraph 13)

The auditor shall perform the following audit procedures to help identify instances of non-compliance with other laws and regulations that may have a material effect on the financial statements:

- (a) Inquiring of management and, where appropriate, those charged with governance, as to whether the entity is in compliance with such laws and regulations; and
- (b) Inspecting correspondence, if any, with the relevant licensing or regulatory authorities. (Paragraph 14)

93 Auditors of local government and health entities are required to have a wider regard to law and regulations than the potential impact of non-compliance on the financial statements:

- auditors of local government and health entities (excluding NHS Foundation Trusts) have separate statutory responsibilities to take specific action and/or to report in relation to matters that come to the auditor's attention that indicate that unlawful expenditure has been or will be incurred or a financial loss or deficiency has arisen or will arise;
- the Audit Commission's Code of Audit Practice requires auditors of local government and health entities (excluding NHS Foundation Trusts) in England to review and, where appropriate, examine evidence that is relevant to the audited body's corporate performance management and financial management arrangements and report on these arrangements. This review will include consideration of the arrangements in place for compliance with laws and regulations;

⁶ ISA (UK and Ireland) 315 "Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and its Environment," paragraph 11.

- In Northern Ireland, the Code of Practice for local government auditors also contains a similar requirement to that of the Audit Commission’s Code of Audit Practice;
 - In Wales, the Auditor General’s Code contains a similar requirement;
 - Audit Scotland’s Code of Audit Practice requires auditors of local government entities to consider whether there are any matters relating to failure to comply with laws and regulations to be brought to the attention of the Controller of Audit;
 - in Northern Ireland, auditors of health entities review and, where appropriate, report on the financial aspects of the audited entity’s corporate governance arrangements as they relate to the legality of transactions that might have a significant financial consequence; and
 - requirements may also be established by other regulators such as Monitor who issue the Code of Audit Practice for NHS Foundation Trusts.
- 94 Paragraph 117 of the Practice Note also provides a list of the various financial reporting requirements for each type of public body for auditors to consider compliance with.
- 95 These other responsibilities are different from those to which ISA (UK and Ireland) 250 is directly relevant 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, irrespective of the potential for a material impact on the financial statements. The auditor takes care to ensure that, where matters come to the auditor’s attention in relation to the auditor’s other responsibilities relating to legality, these findings are properly reviewed under the framework of ISA (UK and Ireland) 250 for their potential impact on the financial statements.

Reporting of Identified or Suspected Non-Compliance

If the auditor has identified or suspects non-compliance with laws and regulations, the auditor shall determine whether the auditor has a responsibility to report the identified or suspected non-compliance to parties outside the entity. (Paragraph 28)

- 96 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 APB’s Practice Note 12. This legislation includes the Money Laundering regulations 2007 and the Proceeds of Crime Act 2002.
- 97 Under regulation 49 of the Money Laundering Regulations 2007, various listed public authorities (including the Auditor General and the Auditors General for Wales, Scotland and 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 Serious Organised Crime Agency. This report will normally be made by the

firm's nominated Money Laundering Reporting Officer. Other auditors, such as those appointed by the Audit Commission or NHS foundation trusts, are not covered by regulation 49 of the Money Laundering Regulations 2007, but will be subject to the Money Laundering Regulations 2007 in accordance with regulation 3.

- 98 The auditor considers the offence of tipping off under section 333A 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 Serious Organised 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. The offence of tipping off does not apply to the Auditor General for Wales.

ISA (UK and Ireland) 260: Communication with Those Charged With Governance

Objectives

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. (Paragraph 9)

- 99 In common with other parts of the public sector, Accounting Officers in central government and NHS Foundation Trusts⁷ and Accountable Officers of specified health entities are responsible not only for maintaining adequate internal controls, but also for the regularity of the public funds for which they are accountable. Guidance on reporting to those charged with governance in the context of regularity is set out in the separate section of this Practice Note on the audit of regularity.

Those Charged with Governance

The auditor shall determine the appropriate person(s) within the entity's governance structure with whom to communicate. (Paragraph 11)

- 100 For further information on governance arrangements in the public sector, and their associated responsibilities, the auditor refers to the following Auditing Practices Board Bulletins:
- 2003/01 Corporate Governance: Requirements of Public Sector Auditors (Central Government)
 - 2003/02 Corporate Governance: Requirements of Public Sector Auditors (National Health Service)
 - 2004/02 Corporate Governance: Requirements of Public Sector Auditors (Local Government Bodies)
- 101 The auditor determines who is charged with governance at the outset of the audit. This may be the Accounting Officer or group of individuals charged with that role. It may include a Board, scrutiny committee, council, governing body or another group.

⁷ Auditors are not, however, required to report on the regularity of financial transactions of NHS Foundation Trusts.

102 The Accounting Officer has personal responsibilities for:

- 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 Government Internal Audit Standards; and
- ensuring the regularity and propriety of public finances.

Reports to Sponsoring Bodies

103 Special arrangements may have developed for reporting to those charged with governance by auditors of non-departmental public bodies (known as Assembly Government Sponsored Public Bodies in Wales) and other similar entities sponsored by government departments. In such cases the Accounting Officer of the sponsor department must obtain assurance that the financial and other management controls applied by the non-departmental public body or similar entity are adequate to ensure regularity and propriety. Reports from the auditor of the lower tier entity may assist the Accounting Officer in obtaining such assurance. Sponsor departments may require auditors of their non-departmental public 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.

104 The auditors of NHS bodies (excluding NHS Foundation Trusts) in England have a specific duty under the Audit Commission Act 1998 to refer a matter to the Secretary of State where they have reason to believe that the body or an officer of the body:

- is about to make, or has made, a decision which involves or would involve the incurring of expenditure which is unlawful; or

- is about to take, or has taken, a course of action which, if pursued to its conclusion, would be unlawful and likely to cause loss or deficiency.

105 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 Parties Interested in Reports to Those Charged With Governance

- 106 In the public sector there may be a requirement that communications between the auditor and audited body, such as an annual audit letter are made public. Even where such reports are not made public, it remains possible that a third party may seek to place reliance on a report to those charged with governance made by a public sector auditor, even though such reliance was not foreseen when the audit was undertaken. It is appropriate to ensure that third parties who see the communication understand that it was not prepared with third parties in mind.
- 107 Limitations in reports to those charged with governance on responsibilities to other parties are amplified in the Audit Commission's "Statement of Responsibilities of Auditors and Audited Bodies", provided to all audited bodies in England, the Code of Audit Practice in Scotland and the Auditor General for Wales' Code of Audit and Inspection Practice. Effective reference to these documents, as appropriate, in any report to those charged with governance achieves the purpose intended in the ISAs (UK and Ireland).

ISA (UK and Ireland) 265: Communicating Deficiencies in Internal Control to Those Charged with Governance and Management

Objective

The objective of the auditor is to communicate appropriately to those charged with governance and management deficiencies in internal control that the auditor has identified during the audit and that, in the auditor's professional judgment, are of sufficient importance to merit their respective attentions. (Paragraph 5)

The auditor shall communicate in writing significant deficiencies in internal control identified during the audit to those charged with governance on a timely basis. (Paragraph 9)

- 108 National audit entities often have a responsibility to report publicly, including in relation to deficiencies or failings in internal control, whether resulting in financial loss, irregular transactions or issues of propriety. For example, significant deficiencies may have to be communicated to the legislature (Parliament or the Assembly) or other governing body. Law, regulation or other authority may also mandate that public sector auditors report deficiencies in internal control, irrespective of the significance of the potential effects of those deficiencies, such as a breach of the statutory break even requirements for certain health bodies.
- 109 Legislation may also require public sector auditors to report on broader internal control-related matters than the deficiencies in internal control required to be communicated by this ISA (UK and Ireland), for example, controls related to compliance with legislative authorities, regulations, or provisions of contracts or grant agreements.

ISA (UK and Ireland) 300: Planning an Audit of Financial Statements

Objective

The objective of the auditor is to plan the audit so that it will be performed in an effective manner. (Paragraph 4)

- 110 Effective working by the public sector auditor requires that the evidence needed to satisfy each responsibility and meet each duty (whether laid down in statute, relevant Codes of Audit Practice, or letters of appointment) is collected and considered in a structured way that contributes with greatest effect to the objectives of the audit considered as a whole. Where the auditor has completed work in relation to other responsibilities and duties, the auditor considers whether the work meets the requirements of ISAs (UK and Ireland) before seeking to place reliance on it for the purposes of the audit of the financial statements.

Preliminary Engagement Activities

The auditor shall undertake the following activities at the beginning of the current audit engagement:

- a) Performing procedures required by ISA (UK and Ireland) 220 regarding the continuance of the client relationship and the specific audit engagement.
- b) Evaluating compliance with ethical requirements, including independence, in accordance with ISA (UK and Ireland) 220; and.
- c) Establishing an understanding of the terms of the engagement, as required by ISA (UK and Ireland) 210. (Paragraph 5)

- 111 Further guidance on declining or withdrawing from engagements in the public sector is provided in paragraph 0 of this Practice Note.
- 112 When establishing an understanding of the terms of the engagement, the auditor will need to consider the requirement to provide an opinion on the regularity of transactions. For further guidance on the audit of regularity, see the separate section of this Practice Note on regularity.

Planning Activities

The auditor shall establish an overall audit strategy that sets the scope, timing and direction of the audit, and that guides the development of the audit plan. (Paragraph 7)

- 113 Where the auditor is required to give a regularity opinion, in developing the overall audit strategy the auditor obtains a sufficient understanding of the framework of authorities governing the audited entity and its activities that is sufficient to enable the auditor to identify events, transactions and practices that may have a significant effect on the regularity of transactions in the financial

statements. Guidance on planning the audit of regularity is set out in the separate section in this Practice Note on regularity.

- 114 In the public sector, financial statements may include specific statutory notation, for instance fees and charges disclosures, which are required under the relevant applicable reporting framework. In these circumstances, in developing the audit strategy the auditor obtains an understanding of the reporting requirements and of the audited entity and its activities sufficient to design audit procedures to obtain assurance in respect of these additional requirements.

ISA (UK and Ireland) 315: Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and its Environment

Objective

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, through understanding the entity and its environment, including the entity's internal control, thereby providing a basis for designing and implementing responses to the assessed risks of material misstatement. (Paragraph 3)

The auditor shall perform risk assessment procedures to provide a basis for the identification and assessment of risks of material misstatement at the financial statement and assertion levels. Risk assessment procedures by themselves, however, do not provide sufficient appropriate audit evidence on which to base the audit opinion. (Paragraph 5)

115 This ISA (UK and Ireland) requires the auditor to make risk assessments at the financial statement and assertion levels based on an appropriate understanding of the entity and its environment. In the public sector, the auditor of specified entities has to consider the additional assertion of regularity. At the planning stage, the public sector auditor therefore needs to obtain an understanding of the framework of authorities specific to the entity. For further guidance on obtaining an understanding of the framework of authorities, the auditor may refer to the separate section of this Practice Note on regularity.

The Required Understanding of the Entity and Its Environment, Including the Entity's Internal Control

The auditor shall obtain an understanding of relevant industry, regulatory, and other external factors including the applicable financial reporting framework. (Paragraph 11(a))

116 The auditor obtains an understanding of the financial reporting framework and regulatory factors under which the financial statements are prepared and their impact on the audit. The financial reporting framework and other regulations for the public sector include those set out in:

- the specific legislation that has established the audited entity and determines its activities;
- Accounts Directions;
- the Government Financial Reporting Manual and Managing Public Money;

- standards that constitute International Financial Reporting Standards and/or UK GAAP;
- other HM Treasury guidance on the application of accounting standards, the Companies Acts and the disclosure of information;
- manuals for accounts for NHS entities and subsequent instructions issued by the Department of Health, Monitor, the Scottish Government Health Directorate, the Welsh Assembly Government and the Department of Health, Social Services and Public Safety in Northern Ireland; and
- the Code of Practice on Local Authority Accounting and the Local Authority Code of Accounting Practice (which will supersede the Local Authority Accounting SORP from 2010-11), the Charities SORP and the Pensions SORP as well as the Further Education SORP for Scotland.

117 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. The financial reporting requirements for each type of public sector entity include:

Government departments	Prescribed by HM Treasury under section 5 of the Government Resources and Accounts Act 2000 or, in Northern Ireland, by the Department of Finance and Personnel under section 9 of the Government Resources and Accounts Act (Northern Ireland) 2001.
Trading Funds	Accounts direction issued by HM Treasury to each fund in pursuance of section 4(6) of the Government Trading Funds Act 1973 or, in Northern Ireland, by the Department of Finance and Personnel under Article 8(6) of the Financial Provisions (Northern Ireland) Order 1993.
Supply financed executive agencies	Accounts direction issued by HM Treasury to each agency in pursuance of section 7 of the Government Resources and Accounts Act 2000 or, in Northern Ireland, by the Department of Finance and Personnel under section 11 of the Government Resources and Accounts Act (Northern Ireland) 2001.
Welsh Assembly Government and its executive agencies	Accounts directions issued by HM Treasury under the Government of Wales Act 2006.
Non-departmental public bodies (and Assembly Government Sponsored Public Bodies in Wales)	Provided for in specific legislation or Royal Charter, with the sponsoring body being empowered to issue directions, with HM Treasury or Northern Ireland Department of Finance and Personnel consent.

<p>Central government entities in Scotland including Executive Agencies, NDPBs and Trading Funds</p>	<p>Prescribed by directions issued by Scottish Ministers.</p>
<p>Local government entities</p>	<p>In England, the Local Government Act 1972, Local Government Finance Act 1982, Local Government Finance Act 1988, Local Government and Housing Act 1989, School Standards and Framework Act 1998, Building Control Act 1984, Building (Local Authority Charges) Regulations 1998, Accounts and Audit Regulations 2003 (as amended in 2004 and 2006), Local Government Act 2003, Local Authorities (Capital Finance) (Amendment) Regulations 2003, Local Government (Contracts) Act 1997, Superannuation Act 1972, and the Code of Practice on Local Authority Accounting.</p> <p>In Wales, the Accounts and Audit (Wales) Regulations 2005 issued under the Public Audit (Wales) Act 2004, the Local Authority (Capital Finance and Accounting) (Wales) Regulations 2003 and the Code of Practice on Local Authority Accounting.</p> <p>In Scotland, the Local Authority Accounts (Scotland) Regulations 1985, the Code of Practice on Local Authority Accounting, and statements issued by the Local Authorities (Scotland) Accounts Advisory Committee.</p> <p>In Northern Ireland, the Local Government Act (Northern Ireland) 1972, Local Government (Accounts and Audit) Regulations (Northern Ireland) 2006, Accounts Direction issued by the Department of Environment and the Code of Practice on Local Authority Accounting.</p>

Health entities	<p>In England, for health entities (excluding NHS Foundation Trusts) Accounts directions issued by the Secretary of State under the National Health Service Act 2006, with the approval of HM Treasury, supplemented by the relevant Manual for Accounts.</p> <p>For NHS Foundation Trusts, accounts directions issued by Monitor, with the approval of HM Treasury, supplemented by the relevant manual for accounts.</p> <p>In Wales, the National Health Service Act 1977 and directions issued by the Welsh Assembly Government, with the approval of HM Treasury, supplemented by the relevant Manual for Accounts.</p> <p>In Scotland, accounts directions issued by Scottish Ministers, supplemented by the relevant Manual for Accounts.</p> <p>In Northern Ireland, accounts directions issued by the Department of Health, Social Services and Public Safety with the approval of the Department of Finance and Personnel, supplemented by the relevant Manual for Accounts.</p>
Probation Boards and Trusts in England and Wales	Criminal Justice and Court Services Act 2000 and directions issued by the Secretary of State.
Further education colleges in Scotland	Directions issued under the Further and Higher Education (Scotland) Act 1992.
The water authority in Scotland	Directions issued under the Water Industry (Scotland) Act 2002.

- 118 Each of these items is potentially subject to change between financial years and securing an understanding of the applicable financial reporting requirements is an important element in planning an audit in the public sector.
- 119 Where a report is given on statements made by those charged with governance relating to corporate governance, this is outside the scope of the audit of the financial statements, even though it may be based on work carried out for that audit. In preparing a report on the statement reference is made to APB guidance on disclosures relating to corporate governance rather than to ISA (UK and Ireland) 315, as well as to relevant guidance issued by the national audit agencies.

Nature of the Entity

The auditor shall obtain an understanding of the following: ...

The nature of the entity, including:

- (i) its operations;
- (ii) its ownership and governance structures;
- (iii) the types of investments that the entity is making and plans to make; and
- (iv) the way that the entity is structured and how it is being financed

to enable the auditor to understand the classes of transactions, account balances, and disclosures to be expected in the financial statements. (Paragraph 11(b))

120 In the public sector this will include obtaining an understanding of the legislative background of the body and the way in which it is funded.

Objectives and Strategies and Related Business Risks

The auditor shall obtain an understanding of ...

the entity's objectives and strategies, and related business risks that may result in risks of material misstatement. (Paragraph 11 (d))

121 There are a number of additional factors that may be considered by the auditor when assessing business risks for public sector entities. These arise from the particular coincidence in the public sector of a closely regulated regime, a large volume of transactions processed and a public reporting process. These additional factors may arise where:

- major new legislation or expenditure programmes have been introduced;
- there is the possibility of manipulation by management to achieve performance or other targets;
- 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
- the final form of account does not reflect the underlying management and accounting processes.

122 Where entities are required to work to annual limits on resources, the risk of transactions being recorded in the wrong accounting period is increased, since there is a temptation for an entity in surplus to bring forward payments and for an entity in deficit to delay them.

Assessing the Risks of Material Misstatement

The auditor shall identify and assess the risks of material misstatement at:

- (a) The financial statement level, and

(b) The assertion level for classes of transactions, account balances, and disclosures. (Paragraph 25)

123 Guidance on the assessment of regularity risks within the financial statements audit is set out in the separate section of this Practice Note on regularity.

As part of the risk assessment as described in paragraph 25 [of the standard], the auditor shall determine whether any of the risks identified are, in the auditor's judgment, a significant risk. In exercising this judgment, the auditor shall exclude the effects of identified controls related to the risk. (Paragraph 27)

124 Possible significant risks in the public sector include the risks that:

- organisations issuing grants may have been subject to fraudulent grant claims;
- financial reporting and disclosure requirements arising through the issuing of financial and/or statutory guarantees may not be met;
- the financial statements may have been manipulated to meet externally set targets;
- relate to guarantees or other contingent liabilities which are subject to significant change in value; and
- financial transactions entered into by the entity in the period do not conform to the authorities that govern them (known as "regularity").

If the auditor has determined that a significant risk exists, the auditor shall obtain an understanding of the entity's controls, including control activities, relevant to that risk. (Paragraph 29)

125 For further guidance on possible control procedures relating to the identified risks to regularity, the auditor may refer to appendix 3.

ISA (UK and Ireland) 320: Materiality in Planning and Performing an Audit

Objective

The objective of the auditor is to apply the concept of materiality appropriately in planning and performing the audit. (Paragraph 8)

- 126 The concept of materiality is applied by the auditor both in planning and performing the audit, and in evaluating the effect of identified misstatements on the audit and uncorrected misstatements, if any, on the financial statements and in forming the opinion in the auditor's report.
- 127 The auditor makes an assessment of materiality with reference to the auditor's understanding of the expectations of the users of the financial statements. However, in the consideration of materiality, the assessment remains the auditor's own and is not dictated directly by any explicit or implicit interest expressed by any individual (such as a Select Committee of the House of Commons) with an interest in the financial statements.
- 128 A public sector auditor may have other specific responsibilities and duties under statute or be required under the terms of engagement to make reports on matters that do not affect the opinion on the financial statements. Where this is the case, the auditor may adopt a level of significance appropriate to these other responsibilities and duties which differs from the materiality level applied to the audit of the financial statements. There is no necessary connection between the materiality of an item to the financial statements and its significance to one of the auditor's other responsibilities or duties.
- 129 For example, in the course of carrying out work relating to other responsibilities and duties, the auditor may detect errors, omissions or weaknesses in accounting arrangements. In these instances the auditor considers the materiality of the findings for the audit of the financial statements and reviews the risk assessments on which the audit was based to ensure that they remain valid.

When establishing the overall audit strategy, the auditor shall determine materiality for the financial statements as a whole. If, in the specific circumstances of the entity, there is one or more 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 economic decisions of users taken on the basis of the financial statements, the auditor shall also determine the materiality level or levels to be applied to those particular classes of transactions, account balances or disclosures. (Paragraph 10)

- 130 Where the auditor has a duty to give a regularity opinion, the qualitative considerations applying to the assessment of materiality may reflect the interests expressed by principal users in the regularity of transactions. The determination of materiality in the public sector is therefore 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 if there are particular disclosure requirements for senior staff or board members' remuneration;
- Public expectations and public interest which might deem separate disclosure of special payments, write offs and losses necessary; and
- The context in which a matter appears, for example if the matter is also subject to compliance with authorities, legislation or regulations. For example situations where a loss is turned into a deficit or in central government where expenditure limits are exceeded (Excess Vote).

131 Further guidance on the interaction between the regularity aspects and the audit of the financial statements is given in the separate section of this Practice Note on regularity.

ISA (UK and Ireland) 330: The Auditor's Responses to Assessed Risks

Objective

The objective of the auditor is to obtain sufficient appropriate audit evidence regarding the assessed risks of material misstatement, through designing and implementing appropriate responses to those risks. (Paragraph 3)

Audit Procedures to Address Risks of Material Misstatement at the Assertion Level

If the auditor has determined that an assessed risk of material misstatement at the assertion level is a significant risk, the auditor shall perform substantive procedures that are specifically responsive to that risk. When the approach to a significant risk consists only of substantive procedures, those procedures shall include tests of details. (Paragraph 21)

- 132 Paragraph 124 in this Practice Note outlines the issues the public sector auditor considers when assessing significant risks. The section of this Practice Note on regularity provides further guidance on planning the audit of regularity and responding to assessed risks. Where the auditor has identified a risk that results may have been manipulated to meet externally set targets, the auditor performs audit procedures to address this risk such as analytical procedures to identify anomalies in results, reviewing unusual transactions and reviewing significant judgements made by those charged with governance when preparing the financial statements.

ISA (UK and Ireland) 402: Audit Considerations Relating to an Entity Using a Service Organisation

Objective

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. (Paragraph 7)

133 Public sector entities may use shared service providers, often in a pooled arrangement, across a sector or departmental group. 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.

Obtaining an understanding of the Services Provided by a Service Organisation, Including Internal Control

When obtaining an understanding of the user entity in accordance with ISA (UK and Ireland) 315, the user auditor shall obtain an understanding of how a user entity uses the services of a service organisation in the user entity's operations. (Paragraph 9)

134 The responsibilities of an auditor in the public sector go beyond those in the private sector by virtue of statutory or other prescribed duties and obligations. This includes the need for an auditor of central government, specified health bodies and probation boards and trusts to give an opinion on the regularity of expenditure. This may require the public sector auditor to inspect records maintained by service organisations in relation to activities undertaken on behalf of public sector entities. Guidance on the audit of regularity is set out in the separate section in this Practice Note on regularity.

When obtaining an understanding of internal control relevant to the audit in accordance with ISA (UK and Ireland) 315, the user auditor shall evaluate the design and implementation of relevant controls at the user entity that relate to the services provided by the service organisation, including those that are applied to the transactions provided by the service organisation. (Paragraph 10)

135 Consideration is given in particular to how the user organisations oversee the performance by the provider, and consider whether this, itself raises the risk of misstatement. Also, 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.

- 136 ISA (UK and Ireland) 402 in itself is not sufficient to secure access rights for the public sector auditor, and it is important that such access rights and the purpose of such rights are recognised and provided for in the contract between the service organisation and the public sector entity.
- 137 In respect of central government entities in England, section 8 of the Government Resources and Accounts Act 2000 gives the Comptroller and Auditor General statutory access to any documents relating to a department's accounts which are managed by service organisations compiling or handling the financial records of any entity that he audits. In Wales, access rights are provided in paragraph 17 of Schedule 8 to the Government of Wales Act 2006. In Scotland, access rights are prescribed in section 24 of the Public Finance and Accountability (Scotland) Act 2000. In Northern Ireland, article 3 of the Audit and Accountability (Northern Ireland) Order 2003 provides the Comptroller and Auditor General for Northern Ireland with similar statutory access.
- 138 HM Treasury guidance on *Standardisation of PFI Contracts version 3 (April 2004)*, requires an access clause to be included in all Private Finance Initiative (PFI) contracts.
- 139 In addition, there are other sources of guidance such as the Office of Government Commerce's *Successful Delivery Toolkit* which provides guidance on model conditions of contract.
- 140 In the local government and health sectors, section 6 of the Audit Commission Act 1998 provides the appointed auditor in England with a right of access at all reasonable times to every document relating to an entity subject to audit which appears to the auditor necessary for the purposes of the auditor's functions under the Act. The auditor may also require a person holding or accountable for any such document to give the auditor such information and explanation as the auditor thinks necessary for the purposes of the auditor's functions under the Act. Similar rights are available to the auditor in Wales under section 18 of the Public Audit (Wales) Act 2004 and section 95 of the Government of Wales Act 1998, in Scotland under section 100 of the Local Government (Scotland) Act 1973 and section 24 of the Public Finance and Accountability (Scotland) Act 2000, in Northern Ireland under article 3 of the Audit and Accountability (Northern Ireland) Order 2003 and also under Schedule 10 of the National Health Service Act 2006 (for Foundation Trusts).

ISA (UK and Ireland) 500: Audit Evidence

Objective

The objective of the auditor is to design and perform audit procedures in such a way as to enable the auditor to obtain sufficient appropriate audit evidence to be able to draw reasonable conclusions on which to base the auditor's opinion. (Paragraph 4)

- 141 In the public sector, the auditor obtains sufficient audit evidence to support the regularity assertion. Entities will usually have established internal controls designed to secure the regularity of transactions. However, where the audited entity is responsible for giving grants or other financial assistance to other parties, it is often the case that the regularity of the transaction will depend on the other parties satisfying the criteria and meeting the terms for receiving assistance. Evidence might then be required on the entity's exercise of its responsibilities to satisfy itself about the transactions of these other parties. Guidance on audit evidence for regularity work is set out in the separate section in this Practice Note on regularity.
- 142 In the public sector financial statements may also include specific statutory notation, for instance fees and charges type disclosures which are required under the relevant applicable reporting framework. Where the entity makes non-GAAP disclosures in accordance with the applicable framework then this is subject to audit testing.

ISA (UK and Ireland) 505: External Confirmations

Objective

The objective of the auditor, when using external confirmation procedures, is to design and perform such procedures to obtain relevant and reliable audit evidence. (Paragraph 5)

- 143 In the public sector, certain external confirmation procedures may be carried out centrally by the audit agency. For instance, the Audit Commission carry about procedures centrally to confirm the accuracy of debtor and creditor balances held between NHS Trusts. Under these circumstances, the individual auditor documents the reasons within their audit file for relying on an external confirmation obtained in this way. Although an external confirmation has been obtained via a central procedure, this does not prevent the auditor from making further enquiries of the external body if considered necessary to obtain sufficient and appropriate audit evidence.

ISA (UK and Ireland) 510: Initial Audit Engagements – Opening Balances

Objective

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. (Paragraph 3)

144 All of the requirements of ISA (UK and Ireland) 510 are relevant to the public sector auditor. However, the variety of circumstances in which ISA (UK and Ireland) 510 will apply will be different from that in the private sector. New legislation and changes in Government policies mean that new audit appointments will arise from the imposed breaking-up or bringing-together of existing public sector entities or changes in public sector audit arrangements.

145 ISA (UK and Ireland) 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.

146 For machinery of government changes, the following additional considerations may be relevant:

Nature of Opening Balances	Additional Guidance
Opening balance amounts 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 and Ireland) 510.
Opening balance amounts are not identifiable from the preceding period's audited financial statements for another entity, but have been derived from balances contained in those statements.	<p>If relevant, the auditor discusses with the auditor of the predecessor organisation whether information is available that would provide substantive evidence for the opening balances.</p> <p>In the absence of such evidence, the auditor carries out substantive testing of opening balances to confirm they have been brought-forward appropriately in</p>

	accordance with the terms of the transfer, at an appropriate valuation in line with the accounting policies of the receiving body.
Opening balances have been calculated as part of a separate disaggregation/merger exercise, subject to a separate specific review and report by an auditor	<p>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 and Ireland) 500.</p> <p>Where the work from the separate specific review cannot be used, the auditor considers carrying out substantive testing of opening balances, in line with the box above.</p>
Opening balances have been calculated as part of a separate disaggregation/merger exercise, but not subject to separate specific review and report	<p>The auditor considers carrying out substantive testing of opening balances.</p> <p>Completeness of assets and liabilities, together with appropriate valuation can be risks in a disaggregation exercise, and engagement with the audited body is made at an early stage.</p>

- 147 Where, after performing the procedures described in paragraph 6 of ISA (UK and Ireland) 510 and the table 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

- 148 In the audit of public sector entities, the incoming auditor to a new audit assignment is normally able to obtain audit evidence about the opening balances from the procedures outlined in the guidance supporting ISA (UK and Ireland) 510.
- 149 Paragraph 6 of ISA (UK and Ireland) 510 indicates that when the prior period's financial statements were audited by another auditor, the current auditor may be able to obtain sufficient audit evidence regarding opening balances by inter alia, reviewing the predecessor auditor's working papers. In the public sector, in the interests of efficiency and reducing the audit burden, the predecessor auditor is expected by the national audit agencies to adopt a co-operative approach in dealing with enquiries and requests for information from the incoming auditor. In Scotland, Wales, Local Government and Health this expectation is normally formalised in a letter of appointment or associated document.
- 150 The auditor of a local government or health entity is required as a result of the acceptance of an appointment to make available copies of certain specified documentation to the incoming auditor on request when the appointment comes to an end. Arrangements will include an agreement on access to particular

reports or papers that may be required by the incoming auditor rather than the transfer of all the relevant papers or data. For audits under the Audit Commission's Codes of Audit Practice these requirements are set out in Standing Guidance. However, the audit of NHS Foundation Trusts sits outside of this framework. There is a general need to co-operate where there is a change in auditor and each audit agency may set out more specific requirements under their own frameworks and codes. This requirement for co-operation does not diminish the incoming auditor's responsibilities for meeting the requirements of ISA (UK and Ireland) 510, but may provide additional supporting documentation that will facilitate the meeting of these responsibilities.

ISA (UK and Ireland) 520: Analytical Procedures

Objectives

The objectives of the auditor are:

- (a) To obtain relevant and reliable audit evidence when using substantive analytical procedures; and
- (b) To design and perform analytical procedures near the end of the audit that assist the auditor when forming an overall conclusion as to whether the financial statements are consistent with the auditor's understanding of the entity. (Paragraph 3)

151 All public sector entities produce a comprehensive range of information and data. Much of the information is consolidated and published by Government entities and other bodies, particularly performance indicators. The auditor can use this information both in performing analytical procedures that compare the activities of a single entity from one year to another and in making comparisons between similar entities. Auditors, however, validate the reliability and independence of data to form expectations in analytical procedures as outlined in ISA (UK and Ireland) 520 paragraphs 5a and A12. Data validation procedures could potentially be linked to data quality work carried out by auditors at specified entities.

Data Relationships

- 152 Relationships between individual financial statement items traditionally considered in the audit of business entities may not always be relevant in the audit of government or other non-business public sector entities. The public sector auditor however, also considers relationships:
- between elements of financial information that would be expected to conform to a predictable pattern based on the entity's experience, such as staff costs; and
 - where expenditure and income are expected to conform to a demand pattern that can be deduced from other related data, such as the number of people within a certain age range.
- 153 The public sector auditor may also divide the financial information the auditor considers into two classes:
- programme expenditure and income; and
 - administrative expenditure and income.
- 154 Each has a number of essential features that influence the nature of the analytical procedures that may be undertaken.

- 155 Programme expenditure and income relate to the actual function of the audited entity, and are disclosed in the financial statements as, for example, appropriations in aid, grant payments and healthcare treatments. Features of such transactions are that:
- they may be closely related to non-financial information such as the number of bodies in receipt of grant or persons receiving hospital treatment;
 - they may not always be directly comparable to prior periods because of changes in eligibility rules and Government policy; and
 - they are comparable to published departmental/entity strategy and expenditure plans.
- 156 Administrative costs relate to the running of the audited entity and can be distinguished from programme expenditure because they are:
- usually closely related to comparable information for prior periods and are less likely to experience significant fluctuation owing to changes in Government policy and the entity's strategy;
 - closely related to information such as number of locations, number of employees and size of buildings; and
 - usually directly comparable to other entities with similar establishment sizes.
- 157 Analytical procedures are unlikely, on their own, to provide the auditor with sufficient appropriate evidence in support of a regularity opinion. Guidance on analytical procedures and regularity is set out in the separate section in this Practice Note on regularity.

ISA (UK and Ireland) 540: Auditing Accounting Estimates, Including Fair Value Accounting Estimates, and Related Disclosures

Objective

The objective of the auditor is to obtain sufficient appropriate audit evidence about whether:

- (a) accounting estimates, including fair value accounting estimates, in the financial statements, whether recognized or disclosed, are reasonable; and
- (b) related disclosures in the financial statements are adequate, in the context of the applicable financial reporting framework. (Paragraph 6)

Management bias

The auditor shall review the judgements and decisions made by management in the making of accounting estimates to identify whether there are any indicators of possible management bias. Indicators of possible management bias do not themselves constitute misstatements for the purposes of drawing conclusions on the reasonableness of individual accounting estimates. (Paragraph 21)

- 158 In the public sector, management decisions on accounting estimates can be influenced by financial factors that fall outside the scope of the financial reporting framework. For example, central government departments must adhere to HM Treasury budgetary controls, and so valuation of estimates within 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 influence management decisions.
- 159 Auditors therefore need to understand 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.

Third party estimates

- 160 Some public sector entities are reliant on accounting estimates provided by other entities within the public sector, such as prescription pricing or dental cost estimates. The auditor understands how these estimates have been derived, and may need to communicate with the auditors of the entities compiling the accounting estimates relied on.

ISA (UK and Ireland) 550: Related Party Disclosures

Objectives

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:
 - a. Achieve fair presentation (for fair presentation frameworks); or
 - b. 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. (Paragraph 9)

161 Because related parties are not independent of each other, many 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. Where the applicable financial reporting framework establishes such requirements⁸, 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 framework.

162 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. The restrictions proscribe practices that might be permissible in relationships outside the public sector.

163 Each part of the public sector has developed guidance on the restrictions on relationships between entities and related parties. Accounting guidance on the identification of related parties, disclosure requirements and related party transactions with regard to IAS 24 has also been developed:

⁸ In the UK and Ireland, specific accounting and disclosure requirements for related party relationships, transactions and balances are established in accounting standards and in law and regulations.

Central government entities and the Welsh Assembly Government	The Government Financial Reporting Manual or other applicable advice from HM Treasury, the Scottish Government or the Northern Ireland Department of Finance and Personnel.
Local government entities	Code of Practice on Local Authority Accounting.
Health entities	The relevant manual for accounts and the NHS Finance Manual. Monitor's Financial Reporting Manual.

ISA (UK and Ireland) 560: Subsequent Events

Objectives

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. (Paragraph 4)

Events Occurring Between the Date of the Financial Statements and the Date of the Auditor's Report

The auditor shall perform audit procedures designed to obtain sufficient appropriate audit evidence that all 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 have been identified. The auditor is not, however, expected to perform additional audit procedures on matters to which previously applied audit procedures have provided satisfactory conclusions. (Paragraph 6)

- 164 In addition to the procedures described in paragraph 7 of ISA (UK and Ireland) 560, the auditor considers matters arising from relevant proceedings of Parliament and other related entities which the auditor may have become aware of during the course of the audit as being scheduled to take place at or after the period end, the outcome of which may have an impact on the audited entity.

Subsequent Events in the Audit of Local Government and Health Entities (Excluding Health Entities in Wales and Northern Ireland)

- 165 For the auditor of a local government or health entity, the concept of subsequent events is restricted by the status that the auditor's report is given by statute. In order to fulfil statutory requirements, the audit opinion and audit certificate have to be issued when the audit has been concluded. The issue of the audit certificate marks the closure of the audit and the end of the exercise of the auditor's powers and duties in respect of that audit.
- 166 In local government the date of closure of an audit can be delayed for a significant time after the audit of the financial statements has been completed whilst the auditor satisfies other statutory responsibilities and duties. In England and Wales, it is therefore common practice for the auditor to give an opinion in advance of closure. However, this is not the opinion that the auditor is required to enter on the relevant statement of accounts in accordance with section 9 of the Audit Commission Act 1998 (the statutory opinion).

- 167 Prior to issuing this advance opinion the auditor considers whether an adverse conclusion to outstanding questions or objections could result in a material impact on the financial statements and hence on an opinion that they present fairly the financial position of the audited entity. In such circumstances, the auditor considers whether it is appropriate to issue such an advance opinion. Where an advance opinion is given, the auditor makes it clear that it is an opinion given in advance of closure of the audit.
- 168 If an opinion is given in advance of the closure of the audit, this opinion will be revisited to establish whether it is still appropriate at the time the audit is concluded and the statutory audit opinion and certificate are issued. The auditor carries out a subsequent events review from the date of issue of the advance opinion up to the date when the audit is concluded and the statutory opinion and certificate are issued.
- 169 As the statutory opinion can only be given when the audit is concluded, it is necessary formally to issue an opinion at the same time that the completion certificate is issued. The auditor refers to the advance opinion and to any additional work the auditor has carried out since it was issued in order to reach the auditor's current view (i.e. post balance sheet event procedures). If the auditor has not issued a completion certificate on the prior year audit then a completion certificate is not issued on the current year audit until this process has been completed.

Facts which become known to the Auditor After the Date of the Auditor's Report But Before the Financial Statements are Issued

- 170 In interpreting the requirements of ISA (UK and Ireland) 560, the financial statements of central government entities are considered to be "issued" on the following dates:

Central government entities where the statutory auditor is responsible for the printing of the document containing the audited financial statements	Date of despatch by the auditor to the Clerk of the House of Commons or House of Lords for laying before Parliament. This is normally the same date as the Auditor's certificate and report.
Central government entities where the financial statements are laid before the Houses of Parliament by the Secretary of State of the sponsoring department or by HM Treasury, and where the statements are considered by an intermediate body before being laid before Parliament	Date of despatch by those charged with governance to the Secretary of State of the sponsoring department or HM Treasury, or to the Members of the intermediate body, whichever is the earlier.

Welsh Assembly Government and its sponsored and related public bodies, and NHS Wales entities	Date of despatch by the Auditor General to the Table Office of the National Assembly.
Central government entities in Scotland	Date of despatch by the Auditor to the Auditor General
Central government and health entities in Northern Ireland	Date of despatch by the department, body or person specified in the relevant legislation for laying before the Northern Ireland Assembly.

Date financial statements are laid before members or equivalent

- 171 For central government entities, the date that the financial statements are laid before members or their equivalent is taken to refer to the date that they are laid before the Parliament or the Assembly.
- 172 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 National Assembly for Wales, the Northern Ireland Assembly or the Scottish Parliament. However, for certain entities, usually non-departmental 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 Parliament.
- 173 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 and Ireland) 560 for subsequent events occurring between the dates of issue and of laying before the Parliament or the Assembly.

The auditor has no obligation to perform any audit procedures regarding the financial statements after the date of the auditor's report. However, when, 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, the auditor shall:

- (a) Discuss the matter with management and, where appropriate, those charged with governance;
- (b) Determine whether the financial statements need amendment and, if so,

(c) Inquire how management intends to address the matter in the financial statements. (Paragraph 10)

174 If the Accounting Officer or Chief Executive decides 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. For example:

- 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.

175 Where the financial statements are produced by an entity which is audited by the Comptroller and Auditor General, the auditor has the possibility, in addition to the options described in paragraph 178, 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 National Assembly for Wales and for the C&AG for Northern Ireland to the Northern Ireland Assembly. For local government or health entities the issue of the audit certificate marks the closure of the audit and the end of the exercise of the auditor's powers.

176 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 to the Auditor After the Financial Statements Have Been Issued

The auditor shall include in the new or amended auditor's report an Emphasis of Matter paragraph or Other Matter(s) paragraph referring to a note to the financial statements that more extensively discusses the reason for the amendment of the previously issued financial statements and to the earlier report provided by the auditor. (Paragraph 16)

- 177 In the public sector, the issue of the auditor's statutory audit opinion marks the end of the audit and once the financial statements have been issued they cannot be revised and the auditor's report cannot be re-issued.
- 178 If a matter that needs to be drawn to the attention of stakeholders arises once the financial statements have been issued, the auditor has other mechanisms available for making a public statement. For example, in the central government sector the Comptroller and Auditor General can report to Parliament and the auditor of a local government or a health entity can consider the issue of a public interest report.

ISA (UK and Ireland) 570: Going Concern

Objectives

The objectives of the auditor are:

- (a) To obtain sufficient appropriate audit evidence regarding the appropriateness of management's use of the going concern assumption in the preparation of the financial statements;
- (b) To conclude, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the entity's ability to continue as a going concern; and
- (c) To determine the implications for the auditor's report. (Paragraph 9)

- 179 Some financial reporting frameworks contain an explicit requirement for management to make a specific assessment of the entity's ability to continue as a going concern, and standards regarding matters to be considered and disclosures to be made in connection with going concern. For example, International Accounting Standard (IAS) 1 requires management to make an assessment of an entity's ability to continue as a going concern. The detailed requirements regarding management's responsibility to assess the entity's ability to continue as a going concern and related financial statement disclosures may also be set out in law or regulation.
- 180 Under some circumstances, the management of an audited body may not have made a formal assessment of the body's ability to continue as a going concern. Under these circumstances the auditor discusses the going concern assumption with management and documents the considerations around the going concern assumption arising from that discussion.
- 181 The public sector auditor may have other responsibilities relating to going concern different from those to which ISA (UK and Ireland) 570 is directly relevant. The public sector auditor may be required to review and report upon the entity's arrangements to maintain its general financial health.
- 182 The auditor of a local government or a health entity (excluding NHS Foundation Trusts) in England is required by the Audit Commission's Code of Audit Practice to review and, where appropriate, examine evidence that is relevant to the audited body's corporate performance management and financial management arrangements and report on these arrangements. This review will include consideration of the arrangements to safeguard the financial standing of the audited body. The auditor of a local government entity in Scotland is also expected to consider such matters. The auditor of an NHS Foundation Trust follows guidance issued by the regulator, Monitor.
- 183 The auditor of a local government or a health entity in Northern Ireland and Wales also assesses the general financial standing of the audited entity.

- 184 For entities where the form of financial statements prepared is determined by an accounts direction issued by HM Treasury (for central government departments and executive agencies) or a Secretary of State of a sponsor department (for non-departmental public bodies and NHS entities) by reference to the Government Financial Reporting Manual or equivalent guidance, the Government Financial Reporting Manual (or equivalent guidance) indicates the circumstances in which the going concern basis may or may not be adopted by the entity.
- 185 Where there is no reference in the direction to the Government Financial Reporting Manual, the direction will normally require such financial statements to be prepared on a going concern basis.
- 186 Where central government entities prepare financial statements on a cash basis, ISA (UK and Ireland) 570 does not apply to the audit as the going concern basis is not used in the preparation of the statements. However, the auditor still considers whether there are any matters affecting the audited entity's ability to continue as a going concern. Where the auditor identifies such matters, the auditor considers the need to report separately to Parliament on those matters and may include an emphasis of matter paragraph in the auditor's report. The auditor does not, however, qualify the audit opinion on the proper presentation of the financial statements.
- 187 For local government entities, there is an explicit requirement in the Code of Practice on Local Authority Accounting for the financial statements to be prepared on the going concern basis. There is a similar requirement for health entities in the NHS Manual for Accounts and for NHS Foundation Trusts in the NHS Foundation Trust FReM.

Risk Assessment Procedures and Related Activities

When performing risk assessment procedures as required by ISA (UK and Ireland) 315, the auditor shall consider whether there are events or conditions that may cast significant doubt on the entity's ability to continue as a going concern. In so doing, the auditor shall determine whether management has already performed a preliminary assessment of the entity's ability to continue as a going concern ... (Paragraph 10)

- 188 To apply ISA (UK and Ireland) 570 in the public sector, the auditor considers the circumstances in which a public sector entity may cease to continue in its operational existence.
- 189 It is not uncommon in the public sector for entities to spend more in one year than they have resources to cover or to become overstretched in their commitments, such that they might have a deficit of income over expenditure or an excess of liabilities over assets. However, it is less common that the operational existence of a public sector entity will cease or its scale of operations be subject to a forced reduction as a result of an inability to finance its operations or of net liabilities (although this is possible where a central government entity operates at arm's length from Government, particularly in a trading capacity). The reasons for this are:

- local government entities carry out functions essential to the local communities and are themselves revenue-raising bodies (without a specified limit on revenue-raising powers), and have the possibility, on application, of recovering losses over a period;
- for health entities (excluding NHS Foundation Trusts), 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; the position of Health Trusts in Northern Ireland is also covered by legislation; and
- ultimately 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 (although this may require Parliamentary authority).

190 In the public sector it is not uncommon for statutory bodies to give guarantees which, if called upon, can not be met by the resources currently available to the organisation. In such circumstances, the auditor considers if the matter needs to be referred to in an emphasis of matter paragraph within the auditors report.

191 Cessation is most likely to result from a Government policy decision. A policy decision may be taken to:

- wind up and dissolve an entity in its entirety where the Government determines that its 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.

192 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.

Consideration of the foreseeable future

193 ISA (UK and Ireland) 570 specifies that, in assessing whether the going concern assumption is appropriate, those charged with governance take into account all available information for the foreseeable future, which is at least twelve months from the balance sheet date. If the period to which those charged with

governance have paid particular attention in assessing going concern is less than one year from the date of approval of the financial statements, and those charged with governance have not disclosed the fact, the auditor complies with the requirements of paragraph 17-2 of ISA (UK and Ireland) 570.

- 194 Government policy is inherently subject to political uncertainty. Changes of Government or ministerial positions can have a significant impact on the status and functions of public sector entities. However, it is rare that the future cannot be predicted with some certainty for the period up to one year from the date of approval of the financial statements. Political decisions are often no more uncertain than those completely unforeseeable risks faced by all private sector companies, of which neither the directors nor the auditor could be aware. The provisions of paragraph 4 of ISA (UK and Ireland) 570 are therefore applied by the auditor.

Auditor's responsibilities for the consideration of the appropriateness of the going concern basis

- 195 In forming a view on the entity's ability to continue its operations, public sector auditor's consideration of going concern embraces two separate, but sometimes overlapping, factors:
- the greater risk associated with changes in policy direction (for example, where there is a change in Government); and
 - the less common operational, or business, risk (for example, where an entity has insufficient working capital to continue its operations at its existing level).
- 196 To minimise the risk of it not coming to the auditor's attention that the Government has made, or is likely to make, a decision on policy direction which could impact on the going concern assumption, the auditor ascertains whether:
- the Government has a known intention to review an area of policy affecting the audited entity, for example as a result of a manifesto commitment;
 - a review has been announced and is in progress;
 - a review has indicated that the audited entity could be rationalised or that an entity's future may be re-examined; or
 - there is a known intention to privatise the activities of the audited entity.
- 197 When the auditor becomes aware of information which indicates that the Government has made, or plans to make, a policy 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, going concern will not generally be an issue. If not, 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 for the foreseeable future.

- 198 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 instance it may be appropriate to consider the financial performance of the entity, including the effectiveness of financial recovery plans.

Additional Audit Procedures When Events or Conditions are Identified

If events or conditions have been identified that may cast significant doubt on the entity's ability to continue as a going concern, the auditor shall obtain sufficient appropriate audit evidence to determine whether or not a material uncertainty exists through performing additional audit procedures, including consideration of mitigating factors. These procedures shall include:

- (a) Where management has not yet performed an assessment of the entity's ability to continue as a going concern, requesting management to make its assessment.
- (b) Evaluating management's plans for future actions in relation to its going concern assessment, whether the outcome of these plans is likely to improve the situation and whether management's plans are feasible in the circumstances.
- (c) Where the entity has prepared a cash flow forecast, and analysis of the forecast is a significant factor in considering the future outcome of events or conditions in the evaluation of management's plans for future action:
 - (i) Evaluating the reliability of the underlying data generated to prepare the forecast; and
 - (ii) Determining whether there is adequate support for the assumptions underlying the forecast.
- (d) Considering whether any additional facts or information have become available since the date on which management made its assessment.
- (e) Requesting written representations from management or, where appropriate, those charged with governance, regarding their plans for future action and feasibility of these plans. (Paragraph 16)

- 199 Paragraph 16 of ISA (UK and Ireland) 570 requires that the auditor considers the need to obtain written confirmations of representations from those charged with governance regarding their assessment that an entity is a going concern and any relevant disclosures in the financial statements.

- 200 Given that a key consideration in the public sector is Government policy, the public sector auditor considers whether to request that the entity secures direct confirmation from the department or executive body responsible for providing financial backing to the entity. In such circumstances, a representation provided by the Accounting Officer, Accountable Officer or responsible financial officer of the entity that financial backing will continue to be received may not be sufficient as meaningful assurance on 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.

- 201 Where 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.
- 202 If no appropriate representations or confirmations can be obtained, the auditor considers whether there is a limitation on the scope of the audit work that requires a qualified opinion or a fundamental uncertainty that requires an emphasis of matter paragraph in the auditor's report.

Illustrative Examples of Audit Procedures and Auditor's Reports

Example – A supply financed executive agency where the Secretary of State of the parent department has announced a review of its operations

Situation 1

- *The auditor considers that the probability of any change in the nature of operations is remote.*
- *An unqualified auditor's report without an added emphasis of matter paragraph.*

203 When planning the audit, the auditor becomes aware of the following matters:

- the Secretary of State of the parent department has recently announced a review of the agency's operations. The review will examine the services provided by the agency and consider whether, together with the services provided by two other agencies, they could be better provided by one trading fund; and
- the Chief Executive believes that the agency's services would be more expensive to provide under the new proposed arrangements and that the review is unlikely to recommend any significant change in operations.

204 The auditor's initial assessment might be that there is some uncertainty about the ability of the agency to continue as a going concern. The auditor plans to monitor the progress of the review by liaising with the Chief Executive and reconsider the position when the auditor has completed the audit.

205 Having completed all other aspects of the audit, the auditor considers the progress of the review:

- the Chief Executive knows that the review is almost completed and the department has begun to consider its findings. The Chief Executive has been told that it is unlikely that the Secretary of State will recommend the closure of the agency;
- the auditor informs the Chief Executive that the auditor intends to contact the department to confirm this understanding;
- on behalf of the Principal Accounting Officer, the Finance Director of the parent department gives a written representation to the auditor that, while the recommendations arising from the review have not been finalised, it is now unlikely that the agency would be significantly affected by them; and
- the auditor therefore considers that the probability of the agency not being a going concern is remote.

206 The Chief Executive considers that no special disclosures are required in the financial statements. The auditor agrees and accordingly does not consider it necessary to qualify the audit opinion or to add an emphasis of matter paragraph to the auditor's report.

Situation 2

- *The auditor considers that there is significant uncertainty as to the future of the agency, but as yet the Secretary of State has made no decision on the agency's future.*
- *An unqualified auditor's report with an added emphasis of matter paragraph.*

207 The circumstances and audit work are as in Situation 1 except as follows.

208 Having completed all other aspects of the audit, the auditor considers the progress of the review:

- the Chief Executive knows that the review is almost completed and the department has begun to consider its findings. He does not know what the Secretary of State's recommendation might be on the future of the agency;
- the Chief Executive arranges a meeting between himself, the auditor and officials of the parent department to discuss the situation;
- the departmental officials indicate that preliminary studies showed a merger might result in efficiencies and that a further cost benefit study is ongoing. Its results will not be known for some months; and
- in view of this uncertainty, the parent department's Finance Director, acting for the Principal Accounting Officer, is not willing to provide any written representation about the future of the agency.

209 The auditor believes there is significant uncertainty as to the future of the agency and discusses the concerns with the Chief Executive. The Chief Executive has already decided to make appropriate disclosures in the financial statements as follows.

Extract from the notes to the financial statements

Note 1 Basis of preparing financial statements

On 1 September 20XX the Secretary of State for XXXX announced a review of the operations of the agency which would examine the different ways in which its current services can be provided in the future. The review is considering several options, including the possible merger of the agency with other entities. The Secretary of State has not yet announced the outcome of the review and therefore the Chief Executive considers that it is appropriate to prepare financial

statements on the going concern basis. The financial statements do not include any adjustments that would result from a decision to alter the operations of the agency, or to transfer its activities to another entity.

210 In these circumstances, the auditor considers an audit opinion can be formed but has a significant level of concern about the ability of the agency to continue as a going concern. Hence, while the auditor does not qualify the audit opinion, the auditor includes a suitable emphasis of matter paragraph when setting out the basis of the opinion, as set out below.

211 Paragraph 19 of ISA (UK and Ireland) 570 requires that:

“the auditor shall express an unmodified opinion and include an Emphasis of Matter paragraph in the auditor’s report to: a) highlight the existence of a material uncertainty relating to the event or condition that may cast significant doubt on the entity’s ability to continue as a going concern; and to b) draw attention to the note in the financial statements that discloses the matters set out in paragraph 18.”

In this example, the auditor does not disagree with the preparation of the financial statements on the going concern basis.

Extract from the 'Basis of opinion' section of the auditor’s report

Going concern

In forming our opinion, we have considered the adequacy of the disclosures made in Note 1 of the financial statements concerning the uncertainty as to the continuation of the agency in its present form. In view of the significance of this uncertainty to the financial statements, we consider that it should be drawn to your attention, but our opinion is not qualified in this respect.

Situation 3

- *The Secretary of State has announced that the agency will cease operations at the end of the next financial year and its activities will be transferred to a new trading fund.*
- *The auditor is satisfied that the agency has made appropriate adjustments to, and disclosures in, its financial statements.*
- *An unqualified auditor’s report without an added emphasis of matter paragraph.*

212 The circumstances and audit work are as in Situation 2 except as follows.

213 During the audit the Secretary of State announces that the review has been completed and that the agency will cease operations and be wound up at the end of the next financial year. Its activities will be transferred to a new trading fund, together with the activities of two other executive agencies.

- 214 The auditor obtains further details of the restructuring plans through the Chief Executive. The auditor ascertains that all assets and liabilities will be transferred for nil consideration to the new trading fund. The majority of staff will be transferred to the trading fund, but a number will be made redundant. The costs of redundancy will be borne by the agency in the next financial year. All operating leases will be transferred to the trading fund for nil consideration and there are no other contingent liabilities.
- 215 The Chief Executive considers that the agency cannot prepare financial statements on the going concern basis. The financial statements therefore show:
- full provision for the redundancy and early retirement costs expected to be incurred over the next year and the fact that the decision has been communicated to employees before the year-end; and
 - all fixed assets written down to the fair value at which they will be taken into the new entity's books. The Chief Executive's budget for the next financial year shows the agency will break even and so no provision for future losses need be considered.
- 216 The auditor reviews these treatments and audits the values attributed to fixed assets and the provision for redundancy costs. The auditor concludes that appropriate adjustments have been made.
- 217 The financial statements contain the following note.

Extract from the notes to the financial statements

Note 1 Basis of preparing financial statements

On 1 July 20XX the Secretary of State for XXXX announced that the agency would be wound up on 31 March 20XY and its activities transferred to a new trading fund, the JKL Centre. The operations of the agency will not transfer to the JKL Centre as a going concern and the Chief Executive considers it inappropriate for the financial statements to be prepared on a going concern basis. Appropriate adjustments have been made to the values of fixed assets to bring them into line with the bases of measurement applicable to the trading fund (see Note Z) and full provision has been made for the cost of redundancy and early retirement for staff who will not transfer to the JKL Centre.

- 218 The auditor concludes that the agency have made appropriate disclosures in the financial statements. The auditor issues an unqualified opinion in the auditor's report.

Situation 4

- *As for situation 3, except that the auditor is not satisfied as to the appropriateness of adjustments and disclosures made and considers that the financial statements are materially misstated.*

- *A qualified auditor's report - disagreement with accounting treatment.*

- 219 The circumstances and audit work are as in Situation 3 except as follows.
- 220 The Chief Executive believes it is inappropriate to adjust the values of fixed assets, as they are being transferred with all other assets and liabilities for nil consideration. The Chief Executive does not believe it appropriate to provide for redundancy costs on the grounds that the agency will receive specific additional funding in the following financial year.
- 221 The auditor disagrees, as the audit determines:
- some fixed assets will be surplus to the requirements of the trading fund and will have no value to it; and
 - the decision on making some staff redundant was taken and communicated before the year-end and therefore full provision is made.
- 222 If the auditor cannot persuade the Chief Executive to make appropriate adjustments to the financial statements, the auditor will qualify the audit opinion on the grounds of disagreement. As the opinion has been qualified, there is no need to include an emphasis of matter paragraph in the Basis of Opinion section.

ISA (UK and Ireland) 580: Written Representations

Objectives

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 Ireland); 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. (Paragraph 6)

Written Representations about Management's Responsibilities

The auditor shall request management to provide a written representation that it has fulfilled its responsibility for the preparation of the financial statements in accordance with the applicable financial reporting framework, including where relevant their fair presentation, as set out in the terms of the audit engagement. (Paragraph 10)

223 In addition to the representations made relating to the financial statements in accordance with ISA (UK and Ireland) 580 the auditor of a public sector entity may be required to meet other responsibilities additional to giving a true and fair opinion on the financial statements. For example, the auditor may be required to report on the regularity of transactions entered into by the entity. The auditor may wish to obtain representations relevant to these additional responsibilities in the same letter or statement from the entity.

The auditor shall request written representations from management with appropriate responsibilities for the financial statements and knowledge of the matters concerned. (Paragraph 9)

- 224 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 (for instance, a legal officer may be best placed to make representations about contingent liabilities) –

this may be particularly relevant where the financial statements comprise a consolidation of information from lower tier accounts.

- 225 In central government and health entities, representations will usually be obtained from the Accounting Officer or the Accountable Officer. In Local Government, 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.
- 226 Where the auditor has a responsibility to give a regularity opinion, it may be necessary to obtain representations about knowledge and opinions relevant to the duty, such as the application of any grants or other financial assistance given by the audited entity to other parties. Guidance on the role of representations in the audit of regularity is set out in the separate section in this Practice Note on regularity.

ISA (UK and Ireland) 600: Special Considerations – Audits of Group Financial Statements (Including the work of Component Auditors)

Objectives

The objectives of the auditor are:

- (a) To determine whether to act as the auditor of the group financial statements; and
- (b) If acting as the auditor of the group financial statements:
 - (i) To communicate clearly with component auditors about the scope and timing of their work on financial information related to components and their findings; and
 - (ii) To obtain sufficient appropriate audit evidence regarding the financial information of the components and the consolidation process to express an opinion on whether the group financial statements are prepared, in all material respects, in accordance with the applicable financial reporting framework. (Paragraph 8)

227 All national audit agencies have agreed to work within the principles set out in the Public Audit Forum document *What Public Sector Bodies can Expect from their Auditors* published in March 2000.

228 There are four generally applicable situations in which the public sector auditor may encounter another auditor and become group auditor, as described below, such that the requirements of ISA (UK and Ireland) 600 need to be considered:

- The audit of Whole of Government Accounts by the Comptroller and Auditor General. This situation is analogous to the audit of a group of companies. The National Audit Office considers the work of the national audit agencies, of auditors of local authorities and health entities appointed by the other national audit agencies, and private sector auditors of public corporations, non-departmental public bodies that are companies and NHS Foundation Trusts.
- Where the auditor audits an entity that consolidates or summarises the financial statements of lower tier bodies. Two examples are: the audit of a local authority that has interests in companies that require disclosures in the financial statements where the auditor of the authority considers the work of the auditor to the company; and the audit of the National Health Service summarised accounts prepared by the Department of Health, where the National Audit Office consider the work of the auditor appointed to audit the individual authorities, boards and trusts that make up the summarised accounts.
- Where the auditor audits an entity that has contracted out services to another party outside of the group. In this situation, whether the auditor needs access to the contractor and/or to the contractor's auditor depends on the

particular nature of the service provided, the information available at the principal entity and the terms of engagement of the other auditor. The guidance on ISA (UK and Ireland) 402 discusses the requirements of an auditor in this position.

- Where the auditor has a duty to give a regularity opinion, it will be necessary to obtain assurance about the application of any material grants or other financial assistance given by the audited entity to other parties. Guidance on using the work of another auditor for this purpose is set out in the separate section in this Practice Note on regularity. In the audit of regularity, the auditor may seek to use the work of the auditor of the grant recipient and reduce the extent of the auditor's own audit procedures. In some cases the auditor does not have a right of access to the lower tier entity and may have no alternative source of audit evidence outside the work of the other auditor – an auditor in such a situation considers carefully whether there is a limitation of scope that impacts on the auditor's acceptance of an appointment, the auditor's procedures or the auditor's report in accordance with this ISA (UK and Ireland).

229 In the situations described above, the other auditor whose work the group auditor may seek to use might also be a public sector auditor. In this case, the requirements of ISA (UK and Ireland) 600 are equally applicable to the work of this other auditor.

Understanding the Component Auditor

If the group engagement team plans to request a component auditor perform work on the financial information of a component, the group engagement team shall obtain an understanding of the following:

- (a) Whether the component auditor understands and will comply with the ethical requirements that are relevant to the group audit and, in particular, is independent.
- (b) The component auditor's professional competence.
- (c) Whether the group engagement team will be able to be involved in the work of the component auditor to the extent necessary to obtain sufficient appropriate audit evidence.
- (d) Whether the component auditor operates in a regulatory environment that actively oversees auditors. (Paragraph 19)

230 Where the auditor is appointed by a national audit agency, the appointed auditor will have had to demonstrate professional qualifications, experience and resources to the national audit agency. Whilst this does not mean that the principal auditor can then assume the competence of this auditor, it provides a clear framework within which the assessment required by paragraph 19 can be made.

231 A32 of ISA (UK and Ireland) 600 sets out examples of the nature, timing and extent of the group engagement's team's procedures to obtain an understanding of the component auditor are affected by factors such as previous experience

with or knowledge of the component auditor, and the degree to which the group engagement team and the component auditor are subject to common policies and procedures. In the UK public sector the national audit agencies share common audit methodologies. Quality control policies are also shared, for instance the sharing of “cold” reviewers. These factors may therefore influence the assessment required by paragraph 19 (of the standard) where the component and Group auditor are from different audit agencies.

ISA (UK and Ireland) 610: Using the Work of Internal Auditors

Objectives

The objectives of the external auditor, where the entity has an internal audit function that the external auditor has determined is likely to be relevant to the audit, are:

- (a) To determine whether, and to what extent, to use specific work of the internal auditors; and
- (b) If using the specific work of the internal auditors, to determine whether that work is adequate for the purposes of the audit. (Paragraph 6)

232 A distinctive feature of internal audit in the public sector is that it is normally a mandatory element of any entity's framework of internal control. Details of the role and responsibilities of internal audit, and applicable internal auditing standards and practices are set out in paragraph 235.

Determining Whether and to What Extent to Use the Work of the Internal Auditors

The external auditor shall determine:

- (a) Whether the work of the internal auditors is likely to be adequate for purposes of the audit; and
- (b) If so, the planned effect of the work of the internal auditors on the nature, timing or extent of the external auditor's procedures. (Paragraph 8)

233 Where the auditor has other responsibilities in relation to systems of internal control, the work of internal audit may be considered as a part of that framework. An assessment of the internal audit function may be carried out for such purposes, even if the auditor considers that it may not be possible or desirable to rely on its work in specific areas for the purpose of the external audit of the financial statements. For example, where the auditor has a responsibility to provide a negative assurance on the Statement on Internal Control or the Annual Governance Statement and has assessed internal audit's work in this area, the auditor will often rely on the Head of Internal Audit's annual assurance report.

234 The work of internal audit may also be considered in relation to the auditor's other responsibilities. The auditor takes care to ensure that, where matters come to the auditor's attention relating to the work of internal audit in relation to the auditor's other responsibilities, these findings are properly reviewed in accordance with ISA (UK and Ireland) 610 for their potential impact on the audit of the financial statements.

In order for the external auditor to use specific work of the internal auditors, the external auditor shall evaluate and perform audit procedures on that work to determine its adequacy for the external auditor's purposes. (Paragraph 11)

235 Roles and responsibilities of internal audit, and applicable internal auditing standards and practices:

	Roles and responsibilities of internal audit	Internal auditing standards and practices
Central government entities	<p>The precise responsibilities of an internal audit unit are determined by the permanent head of a department as Accounting Officer (Accountable Officer in Scotland), or by the Chief Executive of an executive agency or non-departmental public body. These include, the provision of assurance on risk management, internal control and governance established by management to:</p> <ul style="list-style-type: none"> • achieve the entity's objectives; • ensure the economical, effective and efficient use of resources; • ensure compliance with established policies, procedures, laws and regulations; • safeguard the entity's assets and interests from losses of all kinds, including those arising from fraud, irregularity or corruption; and • ensure the integrity and reliability of information and data. 	<p>An Accounting Officer (Accountable Officer in Scotland) is charged with making arrangements for internal audit to accord with the objectives, standards and practices set out in the Government Internal Audit Standards.</p> <p>Under the framework document for NDPBs, the internal audit arrangements for non-departmental public bodies may be required to be approved by the sponsor departments.</p>

	Roles and responsibilities of internal audit	Internal auditing standards and practices
Local government entities	<p>There is a statutory responsibility for authorities in England, Wales and Northern Ireland to maintain an adequate and effective system of internal audit.</p> <p>There is no direct statutory requirement for authorities in Scotland, but internal audit is an implicit element of the administrative arrangements to be made by the responsible financial officer under section 95 of the Local Government (Scotland) Act 1973.</p> <p>No detailed specification for internal audit is imposed on local government entities.</p>	<p>Local government entities in England are required to maintain an adequate and effective system of internal audit in accordance with ‘proper internal audit practices’ which are contained in the CIPFA Code of Practice for Internal Auditors in Local Government in the UK.</p> <p>This Code of Practice is also followed by local government entities in Wales, Scotland and Northern Ireland.</p>
Health entities (excluding NHS Foundation Trusts)	<p>The Accountable Officer has responsibility for ensuring that the arrangements for internal audit comply with those described in the NHS Internal Audit Standards. The Head of Internal Audit is accountable to the Accountable Officer although this accountability may be discharged via a designated Director, e.g. the Director of Finance.</p>	<p>The NHS Internal Audit Standards set out mandatory standards and guidelines for the internal audit function.</p> <p>The Audit Committee has a responsibility to agree plans, monitor performance and evaluate the extent to which the internal audit function complies with the mandatory standards and guidelines.</p>

ISA (UK and Ireland) 700: The Auditor's Report on Financial Statements

Objectives

The objectives of the auditor are to:

- (a) Form an opinion on the financial statements based on an evaluation of the conclusions drawn from the audit evidence obtained; and
- (b) Express clearly that opinion through a written report that also describes the basis for the opinion. (Paragraph 7)

236 Illustrative auditor's reports for public sector entities are provided in the most recent APB Bulletin on public sector audit reports.

Basic Elements of the Auditor's Report

The auditor's report shall be appropriately addressed as required by the circumstances of the engagement. (Paragraph 13)

237 ISA (UK and Ireland) 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.

238 For central government entities, audits are normally undertaken on behalf of a Parliament or an Assembly. The principle that the auditor is working on behalf of Parliament means that in most instances the auditor's report is addressed to the Parliament. The only exceptions to this are:

- where legislation requires the appointment of the auditor and specifies the person or persons to whom the auditor reports. For example, for some non-departmental public bodies the governing legislation requires the auditor to report to the relevant Secretary of State; and
- where the audited financial statements are not required to be laid before Parliament. In such cases the auditor considers on whose behalf the audit is undertaken. Although this is normally the person or persons making the appointment, the auditor may need to look behind this. For example, HM Treasury may appoint the auditor on behalf of a Secretary of State.

239 For local government entities, the relevant legislation does not specify the person to whom the auditor reports. The auditor takes into account the advice of the Audit Commission, the Auditor General for Wales and the Accounts Commission in addressing the auditor's report. It is normally expected that the auditor's report is addressed to the members of the local authority. The Accounts Commission's Code of Audit Practice also expects that the report will be addressed to the members of the Accounts Commission. In Northern Ireland, the report is addressed to the authority as a corporate identity.

- 240 In England, the auditor’s report on health entities is addressed to directors of the board. In Scotland the auditor’s report on health entities is addressed to the members of the entity, the Auditor General for Scotland and the Scottish Parliament. In Northern Ireland, the report is addressed to the Northern Ireland Assembly. In Wales, the Auditor General for Wales addresses the report to the National Assembly for Wales.
- 241 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 audit report to the audit agency. Under these circumstances this is outside of the scope of ISA (UK and Ireland) 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 auditor’s report shall identify the financial statements of the entity that have been audited, including the date of, and period covered by, the financial statements.
(Paragraph 14)

- 242 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 non-departmental public bodies and is incorporated into the wording of the introductory paragraph. 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 refer to paragraphs 165 to 169 of this Practice Note and to the separate guidance on this issue that is published from time to time by the Audit Commission and the Auditor General for Wales.

The auditor’s report shall include a statement that those charged with governance are responsible for the preparation of the financial statements and a statement that the responsibility of the auditor is to audit and express an opinion on the financial statements in accordance with applicable legal requirements and International Standards on Auditing (UK and Ireland). The report shall also state that those standards require the auditor to comply with the APB’s Ethical Standards for Auditors. (Paragraph 15)

- 243 For public sector entities, the responsibilities equivalent to those of directors may lie with different individuals or groups.
- 244 In all entities required to have their accounts laid before a Parliament (or an Assembly), responsibility for the financial statements rests with either an Accounting Officer or in some cases a Principal Accounting Officer and one or more Additional Accounting Officers. The financial statements are required to include a statement of those responsibilities. In all such entities the statement of responsibilities draws attention to the responsibilities of the Accounting Officer separately from those of any board members. Where appropriate, it also refers

to any joint responsibilities of the Accounting Officer, board members and their equivalents.

245 Local government entities are required by the Code of Practice on Local Authority Accounting to include in their statement of accounts a statement of responsibilities which sets out the respective responsibilities of the authority and the chief financial officer for the accounts. The mandatory minimum information requirement for the statement is a disclosure of:

- the authority's responsibilities for the accounts under local government legislation and other requirements; and
- the Chief Financial Officer's legal and professional responsibility for the accounts.

246 For health entities, the statements of responsibilities are required to set out separately the responsibilities of the Chief Executive as Accountable Officer for the entity and the responsibilities of the directors / Board members in respect of the accounts. A pro forma for the statement is published each year in the relevant Manual for Accounts.

The opinion paragraph of the auditor's report shall clearly state the auditor's opinion as required by the relevant financial reporting framework used to prepare the financial statements, including applicable law. (Paragraph 17)

When expressing an unqualified opinion on financial statements prepared in accordance with a true and fair framework the opinion paragraph shall clearly state that the financial statements give a true and fair view. It is not sufficient for the auditor to conclude that the financial statements give a true and fair view solely on the basis that the financial statements were prepared in accordance with accounting standards and any other applicable legal requirements. (Paragraph 18)

247 The applicable financial reporting frameworks are set out in paragraph 117 of this Practice Note.

248 Where the requirement to audit an entity's financial statements is provided for under statute, the auditor may refer to the relevant Act of Parliament when identifying the financial statements have been audited:

Government departments and supply financed executive agencies	The Government Resources and Accounts Act 2000; in Wales, the Government of Wales Act 1998; in Scotland, the Public Finance and Accountability (Scotland) Act 2000; and, in Northern Ireland, the Government Resources and Accounts Act (Northern Ireland) 2001.
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Trading Funds	Government Trading Funds Act 1973; in Scotland, the Public Finance and Accountability (Scotland) Act 2000; and, in Northern Ireland, the Government Resources and Accounts Act (Northern Ireland) 2001.
Non-departmental public bodies and public bodies sponsored by the Welsh Assembly Government	Legislation establishing the audit requirement for the particular entity (and orders made under devolved powers of the National Assembly).
Local government	<p>In England, the Audit Commission Act 1998 and the Code of Audit Practice issued by the Audit Commission.</p> <p>In Wales, the Public Audit (Wales) Act 2004 and the Auditor General’s Code of Audit and Inspection Practice.</p> <p>In Scotland, Part VII of the Local Government (Scotland) Act 1973 and the Code of Audit Practice approved by the Accounts Commission.</p> <p>In Northern Ireland, the Local Government (Northern Ireland) Order 2005 and the Code of Audit Practice issued by the Chief Local Government Auditor.</p>
Health entities (and social services entities in Northern Ireland)	<p>In England for health entities excluding NHS Foundation Trusts, the Audit Commission Act 1998 and the Code of Audit Practice issued by the Audit Commission. For NHS Foundation Trusts, the Health and Social Care (Community Health and Standards) Act 2003 and the Audit Code issued by Monitor.</p> <p>In Wales, the Public Audit (Wales) Act 2004.</p> <p>In Scotland, the National Health Service (Scotland) Act 1978.</p> <p>In Northern Ireland, the Health and Personal Social Services (Northern Ireland) Order 1972 as amended (for trusts and some agencies) or the Health and Social Care Reform Act 2009 (for the Health and Social Care Board and some</p>

	agencies) and directions issued by the Department of Health, Social Services and Public Safety.
Probation Boards and Trusts	In England, the Audit Commission Act 1998 In Wales, the Public Audit (Wales) Act 2004.
Further education colleges in Scotland	The Further and Higher Education (Scotland) Act 1992.
The water authority in Scotland	The Water Industry (Scotland) Act 2002.

- 249 In central government, these requirements are usually set out in an accounts direction issued by HM Treasury, the Northern Ireland Department of Finance and Personnel, Scottish Ministers or a Secretary of State, the Welsh Ministers, or in guidance provided by the Government Financial Reporting Manual. Where such an accounts direction refers to primary statements required by the Companies Acts (or in Northern Ireland, the Companies (Northern Ireland) Orders) and the further primary statements required by accounting standards, the auditor refers to all such statements when expressing the audit opinion.
- 250 Health entities are also required to prepare their financial statements in accordance with an accounts direction issued by the Secretary of State, Monitor, the Welsh Ministers, Scottish Ministers or the relevant department.
- 251 For local government entities, the financial statements are to be prepared in accordance with the Code of Practice on Local Authority Accounting. The statutory framework for this is established for England by the Audit Commission Act 1998 and the Accounts and Audit Regulations 2003 and for Scotland by the Local Government (Scotland) Act 1973 and the Local Authority Accounts (Scotland) Regulations 1985 and for Wales by the Public Audit (Wales) Act 2004 and the Accounts and Audit (Wales) Regulations 2005 issued under section 39 of that Act. However, the standard audit opinions recommended by the Auditor General for Wales expects the auditor to refer only to the accounts having been prepared "in accordance with the accounting policies relevant to local authorities" as set out in the statement of accounting policies. In Northern Ireland, the Local Government (Northern Ireland) Order 2005 and the Local Government (Accounts and Audit) Regulations (Northern Ireland) 2006 provides for the Department of Environment to give a direction on the form of the accounts to be prepared by district councils.
- 252 Across the public sector, most financial statements include an opinion as to whether the financial statements give a true and fair view. However, there are instances where the auditing framework requires an opinion as to whether the financial statements present fairly or properly present the entity's transactions or balances. Whichever wording is used for the opinion on the financial statements, this will not have an impact on the extent to which the auditor observes the requirements of Auditing Standards.

The regularity part of the auditor's opinion

253 Further guidance on the reporting of regularity in the audit opinion is included in the separate section of this Practice Note on regularity.

ISA (UK and Ireland) 720: Section A - The Auditor's Responsibilities Relating to Other Information in Documents Containing Audited Financial Statements

Objective

The objective of the auditor is to respond appropriately when documents containing audited financial statements and the auditor's report thereon include other information that could undermine the credibility of those financial statements and the auditor's report. (Paragraph 4)

The auditor shall read the other information to identify material inconsistencies, if any, with the audited financial statements. (Paragraph 6)

The Annual Report

254 Most public sector entities are required to include an annual report in the same documents as the financial statements:

<i>Entity</i>	<i>Requirements</i>
Central government departments and supply financed executive agencies	Accounts direction issued under the Government Resources and Accounts Act 2000, the Public Finance and Accountability (Scotland) Act 2000 or the Government Resources and Accounts Act (Northern Ireland) 2001 and relevant guidance (notably the Government Financial Reporting Manual).
Supply financed executive agencies	Accounts direction issued under the Government Trading Funds Act 1973, the Public Finance and Accountability (Scotland) Act 2000 or the Government Resources and Accounts Act (Northern Ireland) 2001 and relevant guidance.
The Welsh Assembly Government and its executive agencies	Accounts directions issued under the Government of Wales Acts 1998 and 2006 and relevant guidance.
Non-departmental public bodies and Assembly Government sponsored public bodies	Accounts direction issued under the specific legislation setting up the entities concerned and relevant guidance such as the Government Financial Reporting Manual.
Local government bodies	The Accounts and Audit Regulations 2003 (England only), the 2005 regulations issued by the Welsh Assembly Government and/or the Code of Practice on Local Authority Accounting.
Health bodies	Accounts direction issued under the relevant legislation and the relevant Manual for Accounts.

- 255 For the most part, entities are required to incorporate the elements of the Companies Act 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 "surround information" published with the accounts, it is important for the audit report to identify what is covered by the consistency statement.
- 256 In addition to this consistency statement, ISA 720 (UK and Ireland) requires the auditor to read all information published with the financial statements, which includes all material covered by the consistency statement. Again, the audit report clarifies what material has been read.

Other information

- 257 The requirements for publishing other information outside the annual report but in documents containing financial statements will vary, depending on the nature of the entity's operations, and the reporting requirements imposed by the accounts direction or Code of Practice on Local Authority Accounting. Typically, they may include a statement setting out the responsibilities of the Accounting Officer or equivalent and a corporate governance statement.
- 258 The auditor's responsibility on the Statement on Internal Control or Annual Governance Statement is to 'review' the statement. This review is not to provide assurance on the statement, but to:
- consider the completeness of the disclosures in meeting the requirements of proper practices as specified by Codes of Accounting Practice, or other regulators such as Monitor;
 - 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.
- 259 Further guidance on the auditor's responsibilities in relation to the Statement on Internal Control can be found in the following APB Bulletins:
- 2003/02 Corporate Governance: Requirements of Public Sector Auditors (National Health Service Bodies)
- 2003/01 Corporate Governance: Requirements of Public Sector Auditors (Central Government)
- 2004/02 Corporate Governance: Requirements of Public Sector Auditors (Local Government Bodies).
- 260 Increasingly, entities are required, usually under a provision of the accounts direction, to provide information on performance. This may cover, for example, performance against financial, quality of service, volume of work and efficiency targets. Such performance information may be taken directly from the audited

financial statements, or derived in part through calculation using data taken from the accounting or other records.

- 261 Health entities are exceptional in the amount of additional information that is required to be associated with the financial statements. There is a separate requirement for health entities to produce an annual report, usually accompanied by summary financial statements (subject to a separate report, based on the work carried out for the audit of the financial statements). There is a requirement for the annual report to include the information required by the Companies Acts to be disclosed in the Directors' Report. However, if entities do not take the option of publishing summary financial statements with the annual report, then the full accounts must be published with it, bringing the annual report within the scope of ISA (UK and Ireland) 720 for the audit of the financial statements.
- 262 Health entities are required to submit a number of other statements as part of the annual reporting cycle, including summarisation schedules for consolidation of the NHS accounts, and a corporate governance statement. In Northern Ireland, health entities are also required to include other financial statements including those for endowments and other property held in trust and accounts for monies held on behalf of patients or residents.
- 263 Each of these statements is subject to separate requirements for reporting outside the scope of the audit of the main financial statements.

If, on reading the other information for the purpose of identifying material inconsistencies, the auditor becomes aware of an apparent material misstatement of fact, the auditor shall discuss the matter with management. (Paragraph 14)

If, following such discussions, the auditor still considers that there is an apparent material misstatement of fact, the auditor shall request management to consult with a qualified third party, such as the entity's legal counsel, and the auditor shall consider the advice received. (Paragraph 15)

If the auditor concludes that there is a material misstatement of fact in the other information which management refuses to correct, the auditor shall notify those charged with governance, unless all of those charged with governance are involved in managing the entity, of the auditor's concern regarding the other information and take any further appropriate action. (Paragraph 16)

264 Where the auditor:

- identifies an inconsistency between the other information and corresponding or related amounts or disclosures in the audited financial statements; and
- concludes that, under the circumstances, the other information needs to be amended,

the auditor considers whether to take action as recommended by ISA (UK and Ireland) 720.

- 265 In taking action, the auditor's concern is to ensure that the credibility of the financial statements and the related auditor's report is not undermined. Possible steps that might be taken to protect the auditor's report include:
- no further action - subject to management agreeing to amend the other information, either after communicating concerns to the responsible officer or, where appropriate, to the sponsoring government department or other entity to which the entity might be accountable - requests might also be made that the responsible officer consults an appropriate third party if disagreement persists;
 - consider the implications for the auditor's report - the impact on the opinion itself will only be considered where doubt remains that an amendment might be required to the financial statements themselves; or
 - resigning from the appointment.
- 266 Where audits are conducted under statute by the Comptroller and Auditor General, (including NHS bodies in Wales audited by the Auditor General for Wales and health entities in Northern Ireland which are audited by the Comptroller and Auditor General of Northern Ireland) the resignation option is not available and the auditor's reports attract specific legal privileges. In these cases, if the information is not corrected, the auditor's report includes an explanatory paragraph.
- 267 For local government and health entities, the options for action additionally include reporting in the annual audit letter or its equivalent or, if the matter is significant, making a report in the public interest (England and Wales or referring the matter to the Controller of Audit (Scotland)). In Northern Ireland, the Comptroller and Auditor General is able to report on any issue relating to central government or health matters to the Northern Ireland Assembly. For local government auditors in Northern Ireland options for action include reporting in the annual audit letter or if the matter is significant making a report in the public interest.

The Audit of Regularity

- 268 The concept of regularity reflects Parliament's concern that public money raised through taxation on the public is used only for those purposes approved by Parliament. The preparation of financial statements by public bodies is an important means by which they are accountable for the use of public funds made available to them by Parliament. This leads to the financial statements for bodies directly accountable to Parliament including an implied assertion regarding the regularity of financial transactions, in addition to the financial statement assertions identified in ISA (UK and Ireland) 500.
- 269 Regularity can be defined as the requirement that a financial transaction is in accordance with:
- authorising legislation;
 - regulations issued under governing legislation;
 - Parliamentary authorities; and (where relevant)
 - HM Treasury authorities.
- 270 As noted in the Introduction, in central government and for specified health entities (including special health authorities, strategic health authorities and primary care trusts) and probation boards and trusts there is an explicit statutory requirement on the auditor to provide an additional statement on the regularity of the transactions underlying the entity's financial statements. This is discharged through the audit of the financial statements and is reported in a separate part of the audit opinion on the financial statements. Regularity adds an additional dimension to the audit of financial statements in the public sector. Nevertheless the auditor, as far as possible, adopts an integrated audit approach covering the audit of the financial statements and of regularity.
- 271 The auditor is expected to comply with the Auditing Practices Board's engagement standards and quality control standards on all audits of public sector financial statements. These standards apply equally to the auditor's work in relation to the regularity assertion. The objective of this section is to provide an auditor who has a duty to provide an additional statement on regularity of transactions underlying the entities' financial statements with practical guidance on the audit of regularity and to expand on:
- obtaining an understanding of the framework of authorities;
 - gathering evidence on compliance with authorities; and
 - giving an explicit opinion on the regularity of transactions (where this is required).

- 272 In considering the framework of laws and regulations auditors of central government, specified health entities and probation boards and trusts distinguish 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. Laws and regulations that fall within the general framework include 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 it may nevertheless have financial consequences for the entity.

The guidance is supplementary to, and intended to be read in conjunction with, the relevant engagement standards and quality control standards and the guidance set out elsewhere in this Practice Note.

Propriety – a Related Concept

- 273 Whereas regularity is concerned with compliance with appropriate 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. In central government, propriety is defined in Managing Public Money.
- 274 Propriety is not readily susceptible to objective verification and 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. Where propriety is part of the wider statutory role, as it is for the Comptroller and Auditor General, the auditor considers whether a matter is of such significance that it needs to be reported to Parliament. In other cases, where propriety falls within the terms of the auditor's engagement, reporting may be to management. 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.
- 275 The concept of propriety is discussed further in the Public Audit Forum's document Propriety and Audit in the Public Sector.

The Audit of Regularity - an Overview

- 276 As ISA (UK and Ireland) 250 states, where statutory requirements exist which requires the auditor to report, as part of the audit of the financial statements, whether the entity complies with certain provisions of laws or regulations, the auditor needs:

- to obtain a general understanding of the legal and regulatory framework applicable to the entity and the industry or sector in which the entity operates and how the entity is complying with that framework; and
- 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.

277 This provides the basis for the auditor's approach to the audit of the regularity assertion on the financial statements of public sector entities, which can be summarised as:

- ***obtaining a sufficient understanding of the framework of authorities.*** The auditor identifies laws and regulations 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 authorities. The auditor obtains an understanding of the internal control environment to enable a preliminary assessment of control risk in relation to, where appropriate, the regularity assertion;
- ***testing for regularity.*** To obtain sufficient appropriate evidence to substantiate assertions about regularity, the auditor will usually have to perform substantive procedures on transactions. The extent of these procedures will depend on the auditor's assessment of the effectiveness of the design of systems in translating authorities into controls and the extent to which tests of those controls support an assessment of moderate or low control risk. Tests are usually integrated with those relating to the audit of the financial statements. In complex regulatory environments this may involve an examination of the translation of authorities into relevant rules and procedures; and
- ***reporting on regularity.*** Auditors in the central government and health sectors and auditors of probation boards and trusts give a separate and explicit opinion on regularity. Auditors may also provide separate reports to Parliament, Assemblies or the Secretary of State on regularity issues.

These steps in the audit of regularity are considered in more detail in the rest of this section.

Obtaining a Sufficient Understanding of the Framework of Authorities

278 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. 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 will consider the translation of authorities into relevant rules and procedures. In obtaining a sufficient understanding of the framework of authorities, the auditor may seek representations from the entity about the authorities that govern its operations, but any representations received are reviewed critically in accordance with ISA (UK and Ireland) 580.

- 279 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. Where the environment is complex, this will include a responsibility for translating authorities into local procedures and to monitor adherence to those procedures. However, the auditor has a responsibility for understanding the framework of authorities and cannot rely wholly on management representations about the framework, as the auditor's opinion on regularity must be based on evidence of compliance with authorities, rather than on evidence of compliance with the entity's understanding of the framework.

Identifying laws and regulations which form the framework of authorities

- 280 The governing authorities which the auditor considers when obtaining a knowledge of the entity's activities and identifying the framework of authorities will include: -

- authorising legislation;
- regulations issued under governing legislation;
- Parliamentary authorities; and (where relevant)
- HM Treasury authorities.

- 281 The auditor can identify the framework of authorities governing public sector entities from a number of sources, for example:

- previous experience with the entity or similar entities;
- discussions with the staff employed by the entity (finance officers, internal audit, policy and legal branches); and
- documents produced by the entity (for example minutes of board and other principal committee meetings, correspondence and minutes of meetings with HM Treasury and sponsor departments (for central government bodies), prior years' financial and annual reports, budgets, internal management reports, management policy manuals, manuals of accounting and internal control, scheme control plans).

Obtaining an understanding of the framework of authorities

- 282 Understanding the framework of authorities and using this information appropriately will assist the auditor in developing the audit plan and in identifying potential material irregularity 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. For central government entities this may be obtained from discussions with the department and, where appropriate, by reference to the relevant departmental papers and notes on clauses within an Act or Statutory Instrument. Where the auditor is uncertain whether legislation has been properly interpreted and the effect could be material, it may be necessary to seek a legal opinion (see paragraphs 345 to 349 below). In the case of executive agencies and non-departmental public bodies this may involve consultation with the sponsor department.

- 283 For some public sector entities the authorities governing their nature and activities may not change from year to year. In these circumstances, the auditor may already have sufficient knowledge of those authorities from previous audits. Where the authorities change, the auditor obtains sufficient knowledge of any new or amended authorities which are likely to be material to the financial statements and the regularity opinion.

Extent of auditor's work on the framework of authorities

- 284 The nature and complexity of the relevant legislation and other authorities can vary significantly between different entities (see paragraphs 285 to 287 below). These authorities will in turn determine the extent of the auditor's work on regularity. In the case of specified health entities the same legislative and regulatory framework may be applicable to a number of entities, for example all strategic health authorities operate within a common legislative framework.
- 285 In some entities, such as the Ministry of Defence and the Foreign and Commonwealth Office, many activities are conducted under the common law powers of the Crown and subject only to the limitations of the Supply grant and the ambit in the Appropriation Act, which may be set out in general and wide-ranging terms. In these entities the auditor's primary concern will be that the activities financed by supply fall within the provisions of the Estimate.
- 286 In other central government entities, such as the Department for Work and Pensions the regulatory framework is complex with a wide range of statutory authorities governing the administration of individual schemes and hence the individual transaction. For example, eligibility for specific Social Security benefits will vary from benefit to benefit and are often set out in supplementary regulations issued by the Secretary of State. It remains the audited body's responsibility to ensure that legislation and regulations are appropriately reflected at all stages through to operational guidance. In these entities the auditor's work on regularity will involve obtaining sufficient appropriate evidence regarding whether transactions are in accordance with authorities governing individual schemes. This evidence can be obtained through tests of controls and from substantive procedures. Where the regulations are complex this work will usually involve reviewing the process for translation of authorities into the entity's detailed operating instructions and procedures relating to

financial transactions. The extent of the auditor's work will have regard to judgements on materiality (see paragraphs 299 to 302 below).

- 287 For specified health entities, there are a number of direct statutory authorities that enable Primary Care Trusts to perform functions such as commissioning healthcare from providers and making payments to general practitioners. However, many of the constraints over the regularity of transactions will derive from the Secretary of State's discretions written into the relevant legislation. For instance, the terms of payments to general practitioners in England are set out in the relevant contract, consolidating directions issued by the Secretary of State. In these circumstances, the auditor's work on regularity is restricted to those governing authorities that directly affect the audited entity's powers and duties, and excludes the Parliamentary or HM Treasury authorities that might overlie the direct authorities. Thus, the auditor has an interest in a Primary Care Trust's arrangements for ensuring that payments meet the terms of the relevant contract and in whether the contract complies with the Secretary of State's directions, but not in whether the directions themselves have the proper authorities.

Consideration of systems and procedures designed to ensure compliance

- 288 Public sector entities will usually have installed internal controls to ensure regularity. In obtaining a general understanding of the framework of authorities and risks to regularity, the auditor considers how the entity's management complies with the framework and seeks to mitigate the risk of material irregularity through controls. The auditor's consideration of the controls over regularity will involve an assessment of the general control environment at the entity level and control procedures relating to individual transaction streams.

- 289 As part of the auditor's review of the control environment in public sector entities the auditor also 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 devolved from, for example in central government, the Accounting Officer (Accountable Officer in Scotland and in specified health entities) or Chief Executive to, for example, the Principal Finance Officer or Finance Director;
- the Accounting Officer's or Chief Executive's methods of controlling those officers, departments or agents responsible for ensuring regularity;
- the results of that part of internal audit's work programme which covers controls over compliance with laws and regulations; and
- the entity's corporate governance arrangements, in so far as the arrangements address compliance with regulations.

In considering the general control framework the auditor may also take account of the work carried out by the entity to support the corporate governance statements, and the auditor's own work in reviewing the statement.

290 Controls and procedures which the audited body operates to ensure regularity of individual transaction streams may include:

- application of desk instructions for staff which translate statutory requirements into a set of operating procedures;
- appointment of an officer responsible for ensuring that desk instructions are kept up-to-date and reflect any legislative changes;
- guidance set out in financial memoranda between the sponsor department and the entity in receipt of grants;
- monitoring of compliance with financial memoranda; and
- receipt of reports on compliance from auditors of other entities.

Translation of authorities into relevant rules and procedures

291 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.

292 The auditor's consideration of the translation 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 authorities which govern, for example:

- the powers of Ministers and their departments and HM Treasury to determine the rules and procedures under delegated authority;
- 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 grant or any other payments; and
- the setting of fees and charges and other revenues.

- 293 In considering relevant rules and procedures relating to schemes, the auditor also identifies those controls that are designed to prevent and detect material irregularities.
- 294 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. Internal audit units may also have their own programme of work for reviewing controls to ensure compliance with regulations and authorities. The auditor may seek to place reliance on the entity's systems governing the translation of authorities and the design of rules and procedures by testing the controls over this process. The testing of controls may involve a review of the work of those charged with governance or internal audit on compliance with rules and procedures.
- 295 Where only minor changes in legislation occur it may not be necessary to carry out a re-assessment of regulations. The auditor nevertheless remains alert for significant problems encountered by the audited body relating to the interpretation of new and existing legislation or the application of regulations. The auditor considers such problems and records, as necessary, any impact on the audit.
- 296 In the case of lower tier entities, such as strategic health authorities, the auditor is entitled to rely on the regulations that the entities receive from higher tier bodies and are concerned only with the arrangements put in place by the entity to implement them. The auditor does not consider whether those regulations are, themselves, a proper reflection of a higher regulation or statute.

Testing for Regularity

- 297 Where specific authorities govern transactions of the entity, the auditor plans and performs procedures to determine whether in all material respects the entity's expenditure and income (payments and receipts) comply with those authorities. The principles and procedures applied to obtain sufficient appropriate evidence to support an opinion on the regularity of transactions in the financial statements of an entity in central government, specified health entities and probation boards and trusts are the same as those applied to the audit of any other financial statement assertion. Thus, in forming an opinion on regularity, the auditor seeks to provide reasonable assurance that the financial statements are free from material irregularity.
- 298 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 the regularity assertion (as set out below). In addition to these considerations the auditor may have particular regard to the regularity of receipts, the disclosure of transactions in accordance with appropriate authorities, and securing management representations. This section also considers using the work of others in the audit of regularity.

Materiality

- 299 The concept of materiality applies to the audit of regularity as to the other assertions in relation to the financial statements. The auditor is therefore only required to obtain sufficient appropriate evidence to give an opinion, in central government and for specified health entities and probation boards and trusts, on whether expenditure and income (payments and receipts) have been applied for the purposes intended by Parliament and conform with the authorities which govern them "in all material respects". This explicitly recognises the fact that the auditor cannot detect all occurrences of irregularity through the audit work. In determining whether individually material items require detailed testing, the auditor will have regard to the auditor's assessment of inherent and control risk. In some circumstances the auditor's assessment of risk may necessitate that all individually material transactions are tested in detail.
- 300 The auditor's assessment of what is material is a matter of judgement and includes both quantitative (value) and qualitative (nature) considerations. Materiality affects both the way in which the auditor plans and designs the audit work on regularity and how the auditor evaluates and reports the results of that work. The assessment of materiality at the planning stage is likely to be at the same value for regularity as for other aspects of the audit of the financial statements.
- 301 Auditors of central government, of specified health entities and of probation boards and trusts may also have to consider whether and how auditors may report irregularities that have been identified and which may not be quantitatively material. This is because Parliament has 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. For example, in the context of regularity, the auditor applies separate qualitative assessments in relation to breaches of Parliamentary authority where:
- expenditure incurred is in excess of the amounts authorised by Parliament. An Excess Vote will automatically result in qualification irrespective of the amount involved; and
 - expenditure incurred is outside the ambit of the Vote or without HM Treasury authority. An ex-gratia payment made by central government body to a staff member leaving the organisation, without prior HM Treasury approval, is an example of this type of irregular expenditure.
- 302 The auditor remains alert to the nature of irregularities and considers their significance having regard to Parliament's interest in the matter. The auditor may adopt specific procedures where the auditor considers there is a risk of an Excess Vote or to identify activities or transactions that may not be in accordance with Parliament's intentions as set out in the framework of authorities.

Assessing the risk of material misstatement

303 In central government, for specified health entities and for probation boards and trusts the auditor considers the risk of material misstatement at the financial statement level and the assertion level for classes of transactions, account balances, and disclosures. In respect of regularity, the auditor considers the risk that an inappropriate audit opinion will be given on:

- whether the expenditure and income (or payments and receipts) have been applied for the purposes intended by Parliament and conform to the authorities which govern them; and
- whether there is proper disclosure in the financial statements of any transactions which are not in compliance with the appropriate authorities.

In this context, the auditor considers;

- a) the risks identified through the process of obtaining an understanding of the entity and its environment (the inherent risk);
- b) the identified risks in relation to what can go wrong at the assertion level, taking account of the relevant controls that the auditor intends to test (the control risk).

304 To assess the inherent risk of a material misstatement occurring, the auditor uses judgement to evaluate a range of factors. In the context of the regularity opinion specific factors include:

- the complexity of the regulations;
- the introduction of major new legislation or changes in existing regulations;
- services and programmes administered under European Union authorities, where the framework of authorities can be complex;
- services and programmes delivered through third parties; and
- payments and receipts made on the basis of claims or declarations.

305 Control risk in the context of regularity is the risk that an irregularity that could occur in an account balance or class of transactions and that could be material 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 auditor's assessment of control risk to reduce the extent of substantive procedures relating to regularity, the auditor makes a preliminary assessment of control risk and plans and performs tests of controls to support that assessment.

306 Some of the risk factors and the possible mitigating controls the auditor may consider in relation to regularity are summarised in Appendix 3.

307 The auditor considers the significance of inherent and control risk of material irregularity 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.

- 308 The auditor remains aware that risks may be specific to one financial statement assertion. A high inherent risk to regularity would not necessarily mean that high inherent risk applies to all other aspects of the audit of the financial statements.

Audit procedures

- 309 Audit procedures designed to test regularity will usually be based on a mix of tests of controls and substantive audit procedures.

Tests of controls

- 310 The auditor may identify specific risks to regularity that leads to an assessment that the inherent risk of material breach is high. In these circumstances it is likely that the same risks will have been recognised by management and controls put in place to mitigate the risk. The table at Appendix 3 sets out some of the control procedures that might be used in relation to the main inherent risks.
- 311 The auditor may seek to reduce the extent of substantive procedures for the regularity assertion where the auditor obtains satisfactory evidence as to the effectiveness of the entity's accounting and internal control systems. In doing so the auditor may also have regard to work carried out on the auditor's review of the statement on internal control. However, when the auditor concludes that the controls to ensure regularity are not effective, the auditor will not rely on them.
- 312 The auditor plans and performs the audit of the internal controls designed to ensure regularity as the auditor would for the audit of any other aspect of the audit financial statements.

Substantive audit procedures

- 313 The auditor will usually have to perform some substantive procedures to confirm that expenditure incurred conforms to governing authorities, the range and scope being dependent on the extent to which evidence from tests of control support a moderate to low assessment of control risk. The extent of substantive procedures will also be determined with regard to any evidence relating directly to regularity or irregularity provided by tests of controls. Evidence in support of the regularity assertion will often go some way towards satisfying other financial statement assertions, and will usually be gathered as part of an integrated approach to the audit of an account balance.
- 314 The auditor may encounter difficulties obtaining audit evidence regarding certain aspects of regularity, for instance eligibility for grants. In such cases, the auditor considers the reliability of the audit evidence available. 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.

- 315 Rather than pay grants directly to the recipients intended by Parliament, public sector bodies may fund other bodies that are responsible for the administration of a scheme. Where this is the case, and insofar as it is consistent with the objective of giving an opinion on the financial statements based on independent audit evidence, the auditor of the body may seek to make use of the financial reporting 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.
- 316 The auditor may adopt more extensive procedures where there is a potential Excess Vote. An Excess Vote can arise when a department exceeds the cash, resource or administration budget set down in their Estimates. Such procedures might involve detailed tests to confirm:
- that income and expenditure has been recorded in the correct period and is valid;
 - that income has been correctly categorised as Appropriations in Aid or Consolidated Fund Extra Receipts (CFER); and
 - the accuracy and completeness of administrative costs recorded in the accounts.
- 317 The auditor may also carry out specific tests to identify activities and transactions that may not be in accordance with Parliament's intention. These tests might involve:
- the review of Accounts against the Estimates and the Appropriation Act and any specific legislation to identify transactions which may be outside Parliament's intention;
 - 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.

Analytical procedures

- 318 Analytical procedures on their own are unlikely to provide the auditor with sufficient appropriate evidence in support of regularity. They may nevertheless, in certain circumstances, 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.

Auditing compliance with European Union authorities

- 319 An auditor engaged in the examination of expenditure on schemes funded by the European Union considers the compliance of transactions with the governing European legislation. In particular, the auditor obtains satisfaction that any regulations established in delegated legislation are consistent with the provisions in the governing European Council or Commission Regulation and that these provisions are properly translated into departmental instructions and procedures. Any expenditure outside the provisions in the governing Regulation is irregular.
- 320 European Directives allow the national authorities discretion in the choice of form and methods of implementation. However, delays or inconsistencies in the implementation of Directives may leave the national enacting legislation and any related expenditure open to legal challenge in the European Court of Justice. The auditor obtains satisfaction that those central government departments responsible for enacting laws relative to Directives have taken appropriate action to ensure that the national law is enacted and that the legislation is consistent with the Directives concerned. This may form part of the auditor's review of the overall control environment to ensure compliance with legislation.
- 321 The auditor also remains alert to any legal actions that challenge the provisions of Acts or delegated legislation implementing European legislation by making enquiries of the entity and obtaining representations. The auditor enquires of the management of public sector bodies whether the Commission has, for any reason, instituted legal action or infringement proceedings against the United Kingdom on the implementation of European legislation.

Regularity of receipts

- 322 The auditor approaches the audit of regularity of receipts, including revenues from taxation, in the same way the auditor would approach the audit of the regularity of expenditure. There may, nevertheless, be particular considerations when auditing the regularity of fees and charges levied by public sector entities. These involve:
- reviewing the relevant primary legislation to confirm that it provides appropriate authority for Ministers, departments or other public sector bodies 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;
 - for supply funded activities, confirming that the Appropriation Act provides the appropriate Parliamentary authority for the receipts to be applied in aid of expenditure; and
 - for specified National Health Service entities, that income generation activities fall within the scope of the NHS and Community Care Act 1990.
- 323 In addition to these considerations, an auditor in central government will also obtain satisfaction that fees and charges levied for services reflect the

appropriate costs for those services. In particular, the auditor obtains satisfaction that Ministers or their departments are not abusing their powers to deliberately set fees and charges at levels that would generate a surplus, unless exceptionally an order under Section 102 of the Finance (No 2) Act 1987 is in force allowing fees to be set at a level to recover past deficits. Equally, where fees are waived or deliberately set at a level to incur a deficit the auditor confirms that the entity has the authority to waive fees or not recover all appropriate costs.

- 324 The treatment of surplus receipts and deficits by a Trading Fund must be considered in the light of the Fund's financial objectives. The fact that a body is a Trading Fund does not relieve it of the need to obtain a Section 102 order to recover a deficit for statutory services.
- 325 As well as determining the authorities for levying fees and charges, the auditor also confirms that receipts are properly utilised and disclosed in financial statements as authorised by Parliament in the appropriate legislation.

Disclosure and regularity

- 326 In addition to the risk of giving an inappropriate opinion on the regularity assertion, auditors in central government, of specified health entities and of probation boards and trusts also consider the risk that irregularities may not be properly disclosed in financial statements. This component of audit risk can be defined as "the risk that the auditor will give an inappropriate opinion on whether there is proper disclosure in the financial statements of any (financial) transactions which are not in compliance with the appropriate authorities". Even where a breach of regularity is disclosed, auditors in central government still consider the implications for the audit opinion on regularity and the need to present a separate report on the matter to Parliament. In doing so the auditor will need to consider the materiality of the matter at issue.
- 327 Specific disclosure risks faced by auditors in central government include:

- inappropriate treatment of expenditure and receipts in relation to an Excess Vote;
- the failure to obtain HM Treasury or other appropriate authority for virement (i.e. transfer of expenditure) between Estimate lines or;
- the failure to note special payments, write-offs or any other losses in the financial statements.

The auditor may adopt particular procedures to address these risks, as part of the auditor's overall review of the financial statements. In determining the appropriate treatment of receipts the auditor will consider, for example:

- amounts appropriated in aid do not exceed the gross provisions on the Request for Resources;
- that any excess receipts are surrendered to the Consolidated Fund; and

- that receipts are not netted-off against expenditure, except in the limited circumstances prescribed in the Government Financial Reporting Manual. The auditor may also perform detailed substantive procedures in relation to losses incurred and special payments made by the entity.

Representations on regularity

- 328 Audit evidence on regularity will be gathered from the auditor's substantive procedures and tests of control. However, because of the importance of regularity in central government, to specified health entities and to probation boards and trusts, the auditor will also seek representations from Accounting Officers (for central government sector entities and probation boards and trusts) or Accountable Officers (in Scotland and for specified health entities) on the discharge of their responsibility for the regularity of transactions. This is particularly important in areas, such as certain benefit and grant schemes, where direct evidence is not available to the auditor.
- 329 Accounting or Accountable Officers are 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 it in the responsibilities section of the auditor's report; where the statement is not included or is not comprehensive in setting out responsibilities, the auditor makes the disclosures in the responsibilities section of the auditor's report. 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 assertion.

Regularity and using the work of others

- 330 The auditor of a public sector entity may use the work of auditors in other entities when examining the application of grants. The auditor may also consult, in central government, with HM Treasury or the sponsor department on issues of regularity and seek independent legal advice.

Using the work of internal audit

- 331 The auditor of a public sector entity may wish to make use of the work of the internal auditor to obtain sufficient appropriate evidence in support of the regularity assertion. Where the auditor considers internal audit work the auditor applies ISA (UK and Ireland) 610.

Using the work of another auditor

- 332 There are three main situations where the auditor of a central government entity or specified health entity may encounter the work of another auditor, 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.
- 333 Whenever possible, and in so far as it is consistent with the objective of giving an opinion on the financial statements based on independent audit evidence, the auditor of a central government entity, a specified health entity or a probation board or trust in the interests of efficiency and to reduce the overall burden of audit, seeks to use the work of the auditor of the other entity.

Where the entity consolidates or summarises the financial statements of other bodies

- 334 The auditor may be responsible for reporting on the financial statements of a public sector entity where those financial statements include financial information from one or more components (or other entities). An example of this is the Resource Account prepared by the Department of Health that consolidates the results of individual health bodies.
- 335 Where the financial statements of public sector entities consolidate or summarise the financial information of other entities, the auditor of the higher entity determines how the work of the other auditor will affect the audit of regularity. Where the auditor of a public sector entity wishes to use the work of another group auditor in testing the regularity assertion, the auditor follows the standards and guidance in ISA (UK and Ireland) 600.
- 336 The group auditor obtains representations from another auditor as to that auditor's independence from the entity and their compliance with the relevant auditing and reporting requirements. This also applies if the group auditor uses audited financial statements, signed by the other auditor, which contain a specific opinion on regularity.

Where the public sector entity has paid a grant-in-aid or other grant to another entity.

- 337 Examples of this situation include grants-in-aid paid by central government departments to fund most non-departmental public bodies and the grants paid by other government departments to local authorities.
- 338 The central government department or principal entity will usually establish controls designed to ensure that the recipient or other entity complies with the grant conditions. It is common practice for financial memoranda and grant conditions to require a report or certificate on regularity to be sent by the other entity's auditor to the principal entity's management or for the entity to prepare financial statements including grant transactions and submit these to the principal entity together with the auditor's report on the statements. For example, the Department of Communities and Local Government requires local authorities to secure auditor's certification of expenditure against grants made to local authorities.
- 339 The auditor of a public sector entity is usually able to audit most assertions by reference to the entity alone, but the auditor may need to examine the application of grants paid to other entities. The auditor can do this through:

- 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.

In some cases the auditor of a public sector entity does not have a right of access to the other entity and will have no alternative but to use the work of the other auditor.

340 Where the auditor seeks to use the evidence available to the principal entity, where this includes the work of another auditor, the auditor exercises professional judgement as to whether sufficient appropriate evidence to support the regularity assertion has been obtained.

341 Where the auditor seeks to use the work of the internal auditor to obtain sufficient appropriate evidence in relation to grants paid to other entities, the auditor may do this through:

- examining the scope, nature and extent of evidence available from the internal auditor of the principal entity, from the audit of grant payments to the other entity;
- examining, from the information available in the principal entity, the scope, nature and extent of the evidence available from the internal auditor of the other entity. In examining this work, the public sector external auditor has regard to:
 - the results of any effectiveness monitoring performed by the principal entity on the internal audit function of the other entity; and
 - any assessment of the internal audit function of the other entity as may have been performed by the external auditor of the entity and as may have been reported to the principal entity.

342 Both the Audit Commission and the Wales Audit Office issues detailed instructions to the auditor concerning the certification of grants to local authorities, NHS bodies and probation boards and trusts including detailed checklists covering the statutory requirements. The central government auditor may use the certificate and reports issued by the auditor of other entities on grants and subsidies by:

- confirming that the instructions issued to the auditor of the other entity address the regularity considerations satisfactorily; and

- agreeing the scope and reviewing the results of the quality control review programmes by the Audit Commission, Wales Audit Office and Audit Scotland.

343 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. Reports or certificates are sometimes provided as late as one year after the period end. However, central government sector and specified health entity auditors ensure that only the evidence available to the principal entity relating to the period for which the principal auditor is reporting an opinion on regularity 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.

Where the public sector entity has contracted out services to a service organisation.

344 In this situation, whether the public sector auditor needs access to the service organisation and/or the contractor's auditor to audit the regularity assertion depends on the nature of the services provided, the information available at the principal entity, and the terms of engagement of the other auditor.

Obtaining legal advice

345 It is reasonable for the auditor to rely on legal opinions obtained by the entity concerning the regularity of schemes or transactions where such opinions are provided by an appropriate independent expert and where there are no factors, other than those on which legal opinions have been obtained, which may lead the auditor to question the regularity of expenditure. In such circumstances, the auditor applies the principles of ISA (UK and Ireland) 620.

346 Where the auditor is uncertain about the regularity of schemes or individual transactions the auditor may seek legal advice. 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 and Ireland) 620.

347 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 irregularity based on the nature and complexity of the governing authorities; and
- the availability of other relevant audit evidence. In particular, the auditor determines whether the entity has sought its own legal advice at the time the scheme was designed or, where the uncertainty relates to a particular group of transactions, at the time the transactions occurred.

- 348 Where the auditor determines that it is appropriate to seek a legal opinion, and the entity has not taken legal advice on the matter, the approach is discussed and the point on which the opinion is required agreed with the entity. Usually where the entity accepts there is doubt about the regularity of transactions it will be willing to seek clarification of 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.
- 349 When planning to seek a legal opinion, the auditor assesses the objectivity, professional qualifications, experience and resources of the expert. When planning to rely on the opinion of the entity's own legal advisers, the auditor pays particular attention to the objectivity of advice given.

Consulting HM Treasury and sponsors

- 350 Where the auditor is uncertain about the regularity of expenditure in relation to conditions of grant or HM Treasury authority the auditor may seek advice from the sponsoring department or from HM Treasury. In these circumstances the auditor follows similar steps to those the auditor would take when seeking legal advice.
- 351 The auditor first determines whether the entity sought clarification or, where necessary, obtained the appropriate authorities from the sponsoring department or HM Treasury at the time the expenditure was incurred. If the entity has not sought appropriate advice or authorisation the auditor asks it to do so.

Regularity and Reporting

- 352 Auditors in central government and of specified health entities and probation boards and trusts are required to give a separate and explicit opinion on the regularity of transactions in the entity's financial statements. In addition, the auditor may provide separate reports, other than through audit opinions, on issues of regularity. In certain circumstances the auditor may be required to report matters relating to regularity to third parties. For example, the auditor of other entities may be required to report to sponsor departments on the regularity of the activities and the transactions of those entities.

Response to breaches of regularity

- 353 Where non-compliance with regulations is suspected or discovered, the auditor considers the wider implications for the financial statements as a whole. This will also include consideration of the implications for the auditor's assessment of risks and controls in relation to material irregularities and the reliance the auditor can place on the overall control environment and representations from management.
- 354 The auditor will consider the nature and extent of any non-compliance and, in particular, whether it arises from a fundamental misinterpretation of legislation or a misapplication of departmental rules. The most likely course is that the auditor will obtain further evidence, for example, by carrying out additional testing of a particular category of transactions.

- 355 Cases of non-compliance with regulations will usually be reported to the 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 auditor may encourage it to disclose the non-compliance in its 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, auditors in central government still consider the implications for the audit opinion on regularity and the need to present a separate report on the matter to Parliament. In doing so the auditor will need to consider the materiality of the matter at issue.
- 356 In most cases of suspected irregularity which are material, the auditor is able to reach agreement with management on whether the relevant transactions were in compliance with the authorities which govern them. However, 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:
- communicates in a report to the appropriate level of management, the board of directors or the audit committee the findings from the auditor's investigations into the circumstances surrounding the suspected irregularity and the conclusions drawn therefrom;
 - for central government bodies, considers whether, under the terms of Managing Public Money or, for a non-departmental public body, the financial memorandum, the matter is one which management is required to report to the sponsor department or HM Treasury and if so, request in writing that management notify the appropriate proper authority;
 - reports direct to the sponsor department or to HM Treasury (as appropriate) the circumstances of the non-compliance with authority if management are required to do so and the auditor is unable to establish whether management have complied with the requirement; and
 - for a non-departmental public body, considers whether, under the terms of the auditor's engagement the matter is one which the auditor is required to report to the sponsor department and if so, report the matter to the department.
- 357 If, after taking these steps, management continue to take the view that the relevant transactions are in accordance with the appropriate authorities, and decline to apply the accounting treatment and to make the disclosures in the financial statements which the auditor considers necessary in the circumstances, then the auditor evaluates the implications for the audit opinion, in accordance with the guidance described in paragraph 37 of ISA (UK and Ireland) 240. Further guidance on fraud and regularity is provided in paragraphs 359 to 364 below.
- 358 Auditors of specified health bodies in England also have a responsibility under section 19 of the Audit Commission Act to refer forthwith to the Secretary of State any matter where it is believed that a decision by the body or an officer has

incurred or would involve unlawful expenditure or that some action by the body or an officer has been or would be unlawful and likely to cause loss or deficiency. Qualification of the regularity opinion will normally trigger a section 19 report, but not vice versa if the matter is not judged material.

Fraud and irregularity

- 359 Only a court of law can determine whether a particular transaction is fraudulent. 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 does have a responsibility to determine whether, in the auditor's opinion, the transactions concerned are in compliance with the authorities that govern them.
- 360 Fraudulent transactions cannot, by definition, be regular since they are without proper authority. Since central government, specified health entity auditors and auditors of probation boards and trusts are required to express an opinion on regularity, fraud which is material always results in qualification of the regularity part of the opinion, regardless of the manner or extent of disclosure in the financial statements. Fraud in the context of the auditor's opinion on the regularity of transactions may embrace suspected as well as proven fraud.
- 361 The definition of fraud in ISA (UK and Ireland) 240 includes acts committed by individuals both inside and outside the audited entity. Guidance in the ISA (UK and Ireland) is, however, primarily concerned with internal fraud as it is this type of fraud which is considered most likely to lead to material misstatements in the financial statements. The responsibility that the public sector auditor has to reach an opinion on regularity means that the auditor is also concerned with the extent of fraud perpetrated from outside the entity.
- 362 The guidance in appendix 1 of ISA (UK and Ireland) 240 provides examples of fraud risk factors. These are all relevant to central government and specified health entities and probation boards and trusts, but in addition, the auditor considers those conditions and events which increase the risk of external fraud.
- 363 Paragraph 28 of ISA (UK and Ireland) 240 requires the auditor to determine overall responses to address the assessed risks of material misstatement due to fraud at the financial statement level and design and perform further audit procedures whose nature, timing and extent are responsive to the assessed risks at the assertion level. However, as explained in paragraph 6 of ISA (UK and Ireland) 240, owing to the inherent limitations of an audit, there is an unavoidable risk that some material misstatements of the financial statements will not be detected, even though the audit is properly planned and performed in accordance with ISAs (UK and Ireland). In addition, the likelihood of the auditor detecting material fraud, and in particular external fraud, is always lower than a reasonable expectation of detecting error, since fraud is usually accompanied by acts specifically designed to conceal its existence, or involving collusion between employees, or employees and third parties, or falsification of records. The auditor cannot be expected to identify forged documentation in support of claims for grants or other benefits, other than the most obvious

forgeries, and generally do not have investigative powers or rights of access to individuals or organisations making claims.

- 364 Both for practical reasons and in recognition of the responsibilities of those charged with governance in this area, the auditor is likely to focus on the adequacy of the entity's internal controls for preventing and detecting fraud.

Regularity opinion on financial statements

- 365 Central government, specified health entity and probation board and trust auditors provide an additional expression of opinion on the regularity of transactions. Depending on the basis on which the financial statements are prepared, the form of words used in the regularity part of the opinion should relate to the statutory requirements for the regularity opinion. The statutory requirements for the regulatory opinion can be summarised as:

Entity	Relevant legislation applicable to the regularity opinion
Central government departments in Scotland	<p>Section 22 (1) (c) of the Finance and Accountability (Scotland) Act 2000 refers to the auditor reporting:</p> <p>a) whether the expenditure and receipts shown in the account were incurred or applied in accordance with:</p> <ul style="list-style-type: none"> (i) any enactment by virtue of which the expenditure was incurred or the income received, (ii) the Budget Act or Acts for the financial year, or any part of the financial year to which the account relates, and (iii) sections 4 to 7 of this Act, <p>b) where sums have been paid out of the Scottish Consolidated Fund for the purpose of meeting such expenditure, whether the sums were applied in accordance with section 65 of the Scotland Act 1998,</p> <p>c) whether the expenditure and receipts shown in the account were incurred or applied in accordance with any applicable guidance (whether as to propriety or otherwise) issued by the Scottish Ministers,</p> <p>d) whether the account complies with any applicable direction by virtue of any enactment.</p>
Welsh Assembly Government and its sponsored public bodies	<p>Section 97 of the Government of Wales Act 1998 refers to the auditor reporting:</p> <p>a) that the expenditure to which the accounts relate has been incurred lawfully and in accordance with the authority which governs it</p> <p>b) that money received by the Assembly for a particular purpose or particular purposes has not been expended otherwise than for that purpose or those purposes.</p>

NHS bodies in England	Section 9 (1) (b) of the Audit Commission Act 1998 refers to the auditor giving an opinion on the accounts, which under the Code of Audit Practice for NHS bodies includes an opinion for specified NHS bodies on the regularity of the expenditure and income.
NHS Bodies in Wales	Section 61(3) of the Public Audit (Wales) Act 2004 refers to the auditor satisfying himself a) that the expenditure to which the accounts relate has been incurred lawfully and in accordance with the authority which governs it, and b) that the body to which the accounts relate has made proper arrangements for securing economy, efficiency and effectiveness in its use of resources.
Probation bodies in England	Section 9 (1) (b) of the Audit Commission Act 1998 refers to the auditor giving an opinion on the accounts, which under the Code of Audit Practice for local government bodies includes an opinion, for probation boards, on the regularity of their expenditure and income.
Central government bodies in England	The Exchequer and Audit Departments Act 1921 refers to the Comptroller and Auditor General having to “satisfy himself that the money expended has been applied to the purpose or purposes for which the grants made by Parliament were intended to provide and that the expenditure conforms to the authority which governs it”. More recently, the Government Resources and Accounts Act 2000 refers to the Comptroller and Auditor General satisfying himself “that resources authorised by Parliament to be used have been used for the purposes in relation to which the use was authorised; and that the department’s financial transactions are in accordance with any relevant authority.”
Central government departments in Northern Ireland	The Exchequer and Audit Act (Northern Ireland) 1921, the Northern Ireland Act 1998 and the Government Resources and Accounts Act (Northern Ireland) 2001 set out the requirements. The latter piece of legislation requires the Comptroller and Auditor General to satisfy himself that money provided by the Assembly has been expended for the purposes intended by the Assembly, that resources authorised by the Assembly to be used have been used for the purposes in relation to which the use was authorised and that the department’s financial transactions are in accordance with any relevant authority.

- 366 The wording of the audit opinion given may vary according to these statutory requirements. Examples are given in Bulletin XX/XXXX.
- 367 The wording of the regularity opinion is designed to be consistent with the statutory requirements and is not intended to extend the auditor's responsibilities beyond those set out in the statutory provisions. The wording also needs to be accompanied by:
- disclosure of the Accounting Officer/Accountable Officer'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.
- 368 Where the auditor concludes that material financial transactions are not in compliance with the appropriate authorities as set out in the table above, the auditor qualifies the regularity part of the opinion. Where the auditor is unable to obtain sufficient evidence to reach an opinion on regularity the auditor qualifies the regularity part of the opinion on the grounds of a limitation in audit scope.
- 369 A qualified opinion on regularity does not in itself lead to a qualification of the truth and fairness, fair presentation or proper presentation part of the opinion. 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. Examples of qualifications to the regularity part of the opinion are provided in the APB Bulletin on public sector audit reports.

Published reports other than audit opinions

- 370 Auditors of central government entities consider the need for reporting other than through the audit opinion where the audit opinion is qualified as a consequence of a material irregularity. The purpose of a separate report is to provide Parliament with a detailed explanation beyond that given in the audit opinion and which could form the basis of a hearing by the Committee of Public Accounts (or the Public Accounts Committee of the National Assembly for Wales (previously known as its Audit Committee) or other Parliamentary Committees in Scotland or Public Accounts Committee of the Northern Ireland Assembly).
- 371 In England auditors of specified health entities may consider the issue of a public interest report on any matter which comes to the auditor's attention in the course of the audit in order that it may be considered by the entity concerned or brought to the attention of the public.
- 372 In central government a separate report will always be required where there is an Excess Vote on a Resource Account. An excess constitutes a breach of Parliamentary control and, regardless of the amounts involved, the Committee of Public Accounts has to be informed of the background and reasons. In such

circumstances Parliament must be requested to give retrospective approval to the additional expenditure.

- 373 In Wales, the Auditor General for Wales may report in the public interest on any body where he is the statutory auditor. Any such reports must be laid before the Assembly which ensures that they are published and come within the remit of the Public Accounts Committee of the National Assembly for Wales.
- 374 The auditor may in some cases identify irregularities 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 Parliament or 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 provisions of an Act.

Reporting to sponsors

- 375 As stated in paragraph 338 above, the auditors of other bodies may be required as part of the engagement to submit reports to sponsoring departments that cover compliance with authorities. The form and scope of these reports may be determined by the sponsoring department as part of a specific condition of the grant or subsidy and, in the case of payments to local authorities, 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. Again the nature and scope of such reports will be determined by the auditor's terms of engagement.

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. In Northern Ireland, the Accountable Officers' Memorandum is issued by the Department of Health, Social Services and Public Safety.

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, amongst 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. See also **Principal Accounting Officer**.

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 the National Assembly for Wales 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 and Personnel is responsible for issuing accounts for central government departments and executive agencies whilst 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 and Personnel.

Additional Accounting Officer – the senior full-time official, usually the Chief Executive, of a supply financed executive agency who is designated by the appropriate Accounting Officer of the parent department to assume personal responsibility for the management of the entity's activities.

Administration Budget – the budget set in the Estimates. An Excess Vote qualification will usually be required if a department exceeds its Administration Budget.

Ambit – the description, in Part I of a Supply Estimate, of departmental operations funded through Supply. The ambit can only be extended or otherwise modified by the presentation of a Revised or Supplementary Supply Estimate. The ambit is structured in a way that relates directly to the individual Requests for Resources contained in the Estimate.

Appropriation Act – annual acts which give legal standing to the limits set out in Supply Estimates for Resource Expenditure, Net Cash Requirement and Appropriations in Aid and the purposes to which expenditure may be applied (the ambit). The Appropriation Act also authorises issues from the Consolidated Fund and prescribes the overall sum to be appropriated to particular Estimates in order to finance specified services.

Appropriations in aid – income that, with the authority of Parliament, is used to finance some of the gross expenditure of the department. Amounts that may be appropriated in aid are voted separately in relation to income related to each Request for Resources and for a single amount for non-operating income. In Northern Ireland appropriations in aid are referred to as accruing resources.

Assembly – the National Assembly for Wales or the Northern Ireland Assembly.

Assembly Sponsored Public Bodies (ASPBs) – In Wales, non-departmental public bodies are known as assembly sponsored public bodies. The Assembly's Principal Accounting Officer appoints the Chief Executives as the ASPB's Accounting Officers and the Assembly issues the ASPB's financial memorandum.

Audit Commission – the independent body with statutory responsibilities to regulate the audit of local government and health entities (excluding NHS Foundation Trusts) in England, and to promote improvements in the economy, efficiency and effectiveness of local government and NHS services. 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.

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 (AGW) – the individual responsible for examining and certifying the accounts of the Welsh Assembly Government, its sponsored and other related public bodies and NHS Wales entities. The AGW is responsible for authorising the issue of public funds from the Welsh Consolidated Fund to the

Assembly Government and other public sector bodies. The AGW also appoints the auditors of local government bodies in Wales, undertakes performance and value for money studies and work under the Local Government Measure. The AGW and his staff form the Wales Audit Office (see below).

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**.

Audit Scotland – the body that supports the Auditor General for Scotland and the Accounts Commission (under their direction) in the exercise of their functions and, in particular, provides them, or ensures that they are provided, with the property, staff and services which they require for the exercise of those functions. Audit Scotland may make arrangements with any public body or office-holder for the provision of administrative, professional or technical services in connection with the conduct of audits.

Authorities – relevant Acts of Parliament, Statutory Instruments, directions, regulations, or other statutory guidance, and authorities issued by HM Treasury and by sponsoring departments using powers given in statute with which entities are required to comply.

Central government (sector) auditors – any external auditors or audit firm, from the public or private sectors, responsible for the external audit of an entity in central government.

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 non-departmental public bodies. For the purposes of this Practice Note, central government does not include National Health Service bodies, local authorities, public corporations or nationalised industries.

Certificate (1) – the title of an audit report containing the opinion of the Comptroller and Auditor General, the Auditor General for Wales and the Comptroller and Auditor General for Northern Ireland on financial statements audited under statute where there is a statutory requirement for his 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 audit report from any other report of the Comptroller and Auditor General, Auditor General for Wales and the Auditor General for Northern Ireland.

Certificate (2) – the declaration by auditors under the Audit Commission Act 1998 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 audit 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 an executive agency or non-departmental public body or an Assembly-sponsored public body accountable to the Secretary of State or Scottish Minister of the parent or sponsor department or National Assembly for Wales for the management and operations of that agency.

Code of Audit Practice – any document identified as such, issued by a national audit 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.

Code of Practice on Local Authority Accounting – the document specifying the principles and practices of accounting required to prepare a Statement of Accounts which ‘presents fairly’ the financial position and transactions of a local government entity in the United Kingdom. Prepared by a joint committee of the Chartered Institute of Public Finance and Accountancy and the Local Authorities (Scotland) Accounts Advisory Committee, and endorsed by the Accounting Standards Board as a Statement of Recommended Practice.

Committee of Public Accounts – the Select Committee of the House of Commons empowered to inquire into the financial administration of government departments and examine their accounts. The Committee reports on its findings to the House of Commons. Similar committees exist in the Scottish Parliament and the Wales and Northern Ireland Assemblies.

Comptroller and Auditor General (the C&AG) – the head of the National Audit Office, appointed by the Crown and an Officer of the House of Commons. 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 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 himself 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.

Consolidated Fund – the central fund into which receipts from taxation and certain miscellaneous revenue are paid and from which comes money voted by Parliament by annual Supply procedures.

Consolidated Fund (Appropriation) Act – the Act that authorises issues from the Consolidated Fund and prescribes the overall sum to be appropriated to particular Estimates in order to finance specified services.

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.

Department of Finance and Personnel – the government department responsible for carrying out the HM Treasury role in Northern Ireland. Managing Public Money Northern Ireland, issued by the Department of Finance and Personnel, sets out the overall principles for accountability and accounting in central government in Northern Ireland.

Entity – the generic term used in the Practice Note for any government department, executive agency, trading fund, non-departmental public body, company or other body or organisation which produces audited financial statements.

Excess vote (1) – audit qualifications where a department’s expenditure has exceeded the resources or cash voted; or exceeded the Administration Budget set in the Estimate.

Excess vote (2) – the voting by Parliament to retrospectively approve additional resources or cash where the expenditure on a Resource Account exceeded the funds previously approved by Parliament or to amend the Ambit previously voted by Parliament.

Executive agency – an entity established to carry out the executive functions of government as distinct from providing policy advice. The term executive agency is a generic one that encompasses both bodies financed by departmental Supply Estimates and trading funds. See also **supply financed executive agency** and **Trading Fund**.

Financial memorandum – the document issued by the Secretary of State of a parent or sponsor department of an executive agency or a non-departmental public body which sets out the accounting and other rules governing the use of funds provided by Parliament for the entity's activities.

Government Departments – these represent the top tier of central government. Parliament provides money annually to each department to spend for purposes that are specified in Supply Estimates. 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.

Government Financial Reporting Manual – the manual which sets out the principles applicable to the accounting and disclosure requirements for the preparation and presentation of accounts by central government entities.

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

Grant-in-Aid – regular payments made by departments to outside bodies (usually non-departmental public bodies) to finance expenditure on agreed items or functions.

Health entities – individual corporate entities that are part of the National Health Service but that do not form part of a department or are constituted as executive agencies, non-departmental public bodies or public corporations. Includes strategic health authorities, NHS trusts and primary care trusts. 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, 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 Government Auditors – local government auditors in Northern Ireland are designated to audits by the Department of the Environment under the Local Government (Northern Ireland) Order 2005. The Order provides for the Department of the Environment to designate persons who are members of staff of the Northern Ireland Audit Office as local government auditors with the consent of the Comptroller and Auditor General for Northern Ireland.

Local government entities – entities whose auditors are subject to appointment by the Audit Commission (other than health entities), the Auditor General for Wales, the Accounts Commission or the Northern Ireland Department of the Environment. Includes local authorities, police authorities, fire authorities, National Park authorities, joint committees and joint boards.

Managing Public Money – the manual published by HM Treasury through The Stationery Office, which sets out the main principles for dealing with resources used by public sector organisations in the UK. References to Managing Public Money include versions of the Manual used in Wales and Northern Ireland.

Manual for Accounts – the documents produced by the Department of Health and Monitor for health entities each financial year giving more detailed instructions as to the meeting of the obligations set out in the relevant accounts direction. In Northern Ireland the Department of Health, Social Services and Public Safety produces manuals of accounts which are updated annually with Statement of Accounts guidance.

Members – the individuals of a local government or health entity, who have either been elected, nominated or appointed to non-executive positions or who are officers who have been appointed as board directors (health entities only).

Monitor - a non-departmental public body established under the Health and Social Care (Community Health and Standards) Act 2003 (now consolidated into the National Health Service Act 2006). Monitor is the independent regulator of NHS Foundation Trusts and is responsible for authorising, monitoring and regulating NHS Foundation Trusts.

National audit agency – one of the United Kingdom agencies responsible for carrying out the audit of the financial statements of public sector bodies for a public

sector auditor (the National Audit Office for the Comptroller and Auditor General, the Wales Audit Office for the Auditor General for Wales, Audit Scotland for the Auditor General for Scotland, the Accounts Commission, and the Northern Ireland Audit Office for the Comptroller and Auditor General for Northern Ireland) or for the appointment and regulation of auditors of public sector bodies (the Accounts Commission and the Auditor General for Scotland, the Audit Commission and the Auditor General for Wales). National audit agencies may also have responsibilities under statute or agreement for carrying out other assignments in their own right, such as examinations of economy, efficiency and effectiveness.

National Audit Office – the office that carries out the audit of the accounts of government departments and a wide range of public bodies on behalf of the Comptroller and Auditor General.

Non-departmental public body – an entity that has a role in the process of government but is neither a government department nor forms part of a department. It is established at arm's length from departments and may carry out executive, regulatory, administrative or commercial functions. (For Wales, see Assembly sponsored public bodies.)

Northern Ireland Audit Office – the office that carries out the audit of the accounts of central government departments, health entities and other public bodies on behalf of the Comptroller and Auditor General for Northern Ireland. Certain Northern Ireland Audit Office staff are designated as local government auditors.

Officers – individuals employed by an entity to be responsible for the administration and operations of the entity.

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.

Parent department – used in the context of executive agencies, in contrast with the term "sponsor department" as used for non-departmental public bodies, to refer to the government department which any individual executive agency remains a part of, both in terms of Parliamentary funding and accountability.

Parliament – the United Kingdom Parliament and the Scottish Parliament, but not the National Assembly for Wales or the Northern Ireland Assembly.

Principal Accountable Officer – the most senior member of the staff of the Scottish Administration, responsible for signing the accounts of the expenditure and receipts of the Scottish Administration or any part of it (so far as it is not a function of any Accountable Officer) and for ensuring the propriety and regularity of the finances of the Scottish Administration.

Principal Accounting Officer – the permanent head of a government department appointed by HM Treasury in compliance with section 5 of the Government Resources and Accounts Act 2000, as the Accounting Officer for the resource accounts of that department. In Wales, the Principal Accounting Officers for both the

National Assembly for Wales and the Welsh Assembly Government are appointed by HM Treasury under section 98 of the Government of Wales Act 1998. In Northern Ireland, the appointment is made by the Department of Finance and Personnel in compliance with section 9 of the Government Resources and Accounts Act (Northern Ireland) 2001.

Propriety – concerned with Parliament's intentions as to the way in which public business should be conducted, including the conventions agreed with Parliament and in particular, the Committee of Public Accounts.

Public Authorities – the Freedom of Information Act 2000 applies to approximately 100,000 public authorities. These public authorities are either listed as such in schedule 1 of the Act or have subsequently been designated as public authorities under Schedule 5 of the Act.

Regularity – the requirement that financial transactions are in accordance with the legislation authorising them, regulations issued by a body with the power to do so under governing legislation, Parliamentary authority and HM Treasury authority.

Request for Resources (RfR) – the functional level into which departmental Estimates may be split. RfRs contain a number of functions being carried out by the department in pursuit of one or more of that department's objectives.

Responsible financial officer – the officer appointed by a local government entity under section 151 of the Local Government Act 1972 to be responsible for the proper administration of its financial affairs.

Sponsor department – normally the department through which Parliamentary funding and accountability is made for non-departmental public bodies.

Subhead – individual elements of departmental expenditure identifiable in Estimates as single cells, for example A1 being administration costs within a particular line of departmental spending.

Supply - the money voted by Parliament to meet the services shown in Supply Estimates.

Supply Estimates – the detailed expenditure plans produced annually by and for government departments which are laid before Parliament and voted upon by the House of Commons.

Supply Financed Executive Agency – an executive agency which is either a department in its own right, or forms part of a government ('parent') department and is financed as a Supply service through an Estimate.

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

Trading Fund – a department, and/or an executive agency established under the Government Trading Funds Act 1973 as amended by the Government Trading Act 1990. It is financed outside the Supply system and operates within a financing framework covering its operating costs and receipts, capital expenditure, borrowings and cash flows.

Virement – the transfer of savings on one subhead to meet excess expenditure on another subhead within the same Request for Resources, subject to HM Treasury approval.

Vote – this term refers to the process by which Parliament approves funds in response to Supply Estimates.

Wales Audit Office – The body established following the passing of the Public Audit (Wales) Act 2004 consisting of the Auditor General for Wales and his staff.

The legislative framework governing the audit of public sector bodies in the UK

1. The Comptroller and Auditor General and the National Audit Office

The requirement for the Comptroller and Auditor General to carry out **financial statement audit** is set out in the Government Resources and Accounts Act 2000 (for central government) and also the Trading Funds Act 1973. The requirements for central government bodies other than departments and trading funds to prepare financial statements and the associated audit arrangements are covered in the legislation establishing the bodies.

For central government, the Government Resources and Accounts Act 2000 requires the Comptroller and Auditor General to satisfy himself that money provided by Parliament has been expended for the purposes intended by Parliament, that resources authorised by Parliament to be used have been used for the purposes in relation to which the use was authorised and that the department's financial transactions are in accordance with any relevant authority. This is known as **compliance with legislative authorities (regularity)**.

The National Audit Act 1983 empowers the Comptroller and Auditor General to carry out examinations into the **economy, efficiency and effectiveness** with which departments have used their resources in discharging their functions.

2. The Audit Commission

Under the Audit Commission Act 1998 the **audit of financial statements** in local government and NHS entities in England (excluding NHS Foundation Trusts) is the responsibility of the Audit Commission and its appointed auditors.

Auditors appointed under the Audit Commission Act 1998 are required to obtain satisfaction that the accounts have been prepared in accordance with relevant directions and regulations and comply with all other applicable statutory requirements.

Auditors of local government bodies are also specifically required to:

- consider applying to the Courts for a declaration that an item of account is unlawful; and
- consider whether to issue and, if appropriate, to issue an advisory notice or an application for judicial review.

Auditors of NHS bodies appointed under the Audit Commission Act 1998 are required to refer a matter to the Secretary of State if there is reason to believe that NHS bodies have made or are about to make decisions involving potentially

unlawful expenditure or have taken or are about to take potentially unlawful action likely to cause a loss or deficiency.

The Audit Commission Act 1998 requires that the Commission's appointed auditors obtain satisfaction that the audited body has made proper arrangements for securing **economy, efficiency and effectiveness** in its use of resources.

3. Monitor

Monitor was established under the Health and Social Care (Community Health and Standards) Act 2003. Monitor is the independent regulator of NHS Foundation Trust and is responsible for authorising, monitoring and regulating NHS Foundation Trusts.

4. The Auditor General for Wales and the Wales Audit Office

The office of Auditor General for Wales was established under the terms of the Government of Wales Act 1998. Under that Act, arrangements were made for the Auditor General to **examine and certify the accounts** of the National Assembly for Wales (now the Welsh Assembly Government), and its sponsored and other related public bodies and to undertake economy, efficiency and effectiveness examinations, the results of which are reported to the Public Accounts Committee of the National Assembly for Wales. In examining accounts, the AGW is required to satisfy himself that the expenditure has been incurred lawfully and in accordance with the authority which governs it.

The Public Audit (Wales) Act 2004 extended the Auditor General's functions by:

- appointing him as the external auditor of the accounts of all NHS Wales entities;
- giving him the responsibility for appointing the auditors of and undertaking value for money/performance studies on local government bodies in Wales; and
- giving him responsibility for undertaking best value inspections under the Local Government Act 1999 (known as the Local Government Measure).

The Auditor General and his staff form the Wales Audit Office.

The responsibilities of local government auditors in Wales are similar to those appointed by the Audit Commission in England (see above).

5. The Accounts Commission, the Auditor General for Scotland and Audit Scotland

The Accounts Commission for Scotland has a statutory duty under the Local Government (Scotland) Act 1973 to secure the audit of the accounts of local authorities in Scotland. The Act requires that the appointed auditor:

- satisfies himself that the financial statements of the body have been prepared in accordance with all statutory requirements applicable to the accounts;
- considers certain matters relating to legality, loss and deficiency;
- satisfies himself that the body has made proper arrangements for securing **best value and is complying with its duties for community planning**; and
- satisfies himself that a local authority has made adequate arrangements for collecting, recording and publishing prescribed performance standards.

Devolution in Scotland has had a major impact on this framework of responsibility, with the establishment of the Scottish Parliament, an Auditor General for Scotland and the formation of a public audit agency, Audit Scotland. Beyond the establishment of the office of the Auditor General for Scotland (contained in the Scotland Act 1998) detailed legislative provisions regarding the responsibilities of the Auditor General and accounting and audit arrangements are contained in the Public Finance and Accountability (Scotland) Act 2000. The Auditor General's responsibilities cover devolved central government bodies, health bodies, further education institutions and the water authority.

The Act provides for the establishment of Audit Scotland to support the Auditor General and the Accounts Commission in exercise of their respective functions. The Act also provides for the audit of accounts by the Auditor General. Under the Act, the auditor's report on such accounts must set out the auditor's findings on a number of matters. These include whether the expenditure and receipts shown in the account were incurred or applied in accordance with the appropriate authority or in accordance with applicable guidance issued by Scottish Ministers (whether as to propriety or otherwise).

The Act also provides for the Auditor General to initiate examinations into the economy, efficiency and effectiveness with which bodies and office holders referred to in the Act have used their resources in discharging their functions.

6. Northern Ireland

The Comptroller and Auditor General and the Northern Ireland Audit Office

The principal legislative authorities for the responsibility of the Comptroller and Auditor General in Northern Ireland, including the requirement to carry out the audit of the financial statements of Northern Ireland departments, executive agencies and health entities, are the Northern Ireland Act 1998, the Government Resources and Accounts Act (Northern Ireland) 2001 and the Audit and Accountability (Northern Ireland) Order 2003. The requirement for other Northern Ireland central government bodies to prepare financial statements and the associated audit arrangements are covered in the legislation establishing the bodies.

For central government departments the Northern Ireland Act 1998, the Government Resources and Accounts Act (Northern Ireland) 2001 and the Audit and Accountability (Northern Ireland) Order 2003 require the Comptroller and Auditor General for Northern Ireland to satisfy himself that expenditure and income have been applied in accordance with the Assembly's intentions and conform to governing authorities (regularity).

The Audit (Northern Ireland) Order 1987 established the Northern Ireland Audit Office as an organisation independent of government. The Order also provided for the Comptroller and Auditor General for Northern Ireland to carry out **examinations into the economy, efficiency and effectiveness** with which any department, authority or other body to which the Order applies has used its resources in discharging its functions. This was extended by Section 60(2) of the Northern Ireland Act 1998, section 23 of the Government Resources and Accounts Act (Northern Ireland) 2001 and article 3 of the Audit and Accountability (Northern Ireland) Order 2003.

Local Government

The principal legislative authority for the responsibilities of local government auditors is contained in the Local Government (Northern Ireland) Order 2005 and includes the audit of every district, borough and city council in Northern Ireland. Auditors of these local government audits are also specifically required to:

- consider applying to the court for a declaration that an item of account is unlawful;
- certify a sum due arising from any failure to account and certify losses caused by wilful misconduct; and
- consider and, if appropriate, make an application for judicial review.

A local government auditor, if required by the Department of the Environment or the chief local government auditor, can carry out comparative and other studies aimed at making recommendations for improving economy, efficiency and effectiveness in the provision of services by councils.

Appendix 3

Risks to regularity and possible control procedures

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.	<ul style="list-style-type: none"> • 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.
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.
European Union Schemes	Where legislation is developed by the European Commission there is a risk that regulations and guidance may be misinterpreted or omitted from internal instructions.	The mitigating controls identified in connection with the complexity of regulations apply equally to EU funded schemes.

Risk	Description	Mitigating Controls
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.	<ul style="list-style-type: none"> • 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 certification of payments and receipts by the third parties' auditor.
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.	<ul style="list-style-type: none"> • Established criteria for making claims, clearly set out in departmental instructions and guidance to claimants. • 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 certification of the application of grant by external auditor.