

Response to post implementation review of 2016 auditing standards

Introduction

Audit Scotland has noted with interest your proposed revisions to the 2016 auditing standards.

Audit Scotland is responsible for over 200 audits in the Scottish public sector with total audit fees of over £20 million. Audits include Scottish central government bodies, councils, health boards, and colleges, as well as more diverse entities such as charities, companies limited by guarantee, and two public interest entities which collectively spend over £40 billion of public money each year. Many of these include group accounting and increasingly, those bodies are finding new ways to collaborate and work with each other in partnership to deliver public services.

Some of the larger more significant audits include the Scottish Government (£34 billion net expenditure), NHS Greater Glasgow & Clyde (£4.6 billion gross expenditure), Glasgow City Council (£2.7 billion gross expenditure), and Scottish Water (£1.4 billion revenue).

Most of the audits are carried out by our inhouse audit practice, but six accounting firms (three of the big four and three other mid-tier firms) are appointed to carry out around 30% of the audits.

Our comments in this response are focussed on the proposed changes to ISAs (UK) 700 and 720. We hope you find them helpful. If you would like further information, please contact Paul O'Brien, Senior Manager (Professional Support)

Extending existing requirement in respect of irregularities paragraph

We are interested in the proposal to extend the existing ISA (UK) 700 requirement for auditors of public interest entities to report on the extent to which their audits are considered capable of detecting irregularities, including fraud, to all audits. Audit Scotland took the decision to extend this requirement to the audit of all public bodies within our remit from 2018/19 audits. We therefore agree with your proposal. However, we offer the following observations:

- We note the wording of paragraph A39-2 proposed to be added to ISA (UK) 700. It states that the explanation provided should not be generic expressed in standardised or boilerplate language. We took a different approach by specifying (after due consultation) the wording to be used for all public bodies. We are of the view that where bodies are subject to the same financial reporting, auditing and legislative frameworks, the use of standard wording is appropriate. While we recognise that paragraph A39-2 is part of application guidance rather than a standard, we suggest that the wording be revised to reflect that standardised wording may be appropriate where a group of bodies have similar characteristics.
- We specified fairly brief wording to be used in the explanation as follows: "The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, intentional omissions, misrepresentations, or the override of internal control. The capability of the audit to detect fraud and other irregularities depends on factors such as the skilfulness of the perpetrator, the frequency and extent of manipulation, the degree of collusion involved, the relative size of individual amounts manipulated, and the seniority of those individuals involved. I therefore design and perform audit procedures which respond to the assessed risks of material misstatement due to fraud." We believe that this conveys the appropriate message in a concise and understandable manner. If all the matters

listed at the proposed paragraphs A39-3 and A39- 4 were included, the explanation could become overly long and the main points obscured by detail.

- We also applied the other requirements of paragraph 45R-1 in respect of public interest entities to all public bodies in 2018/19. We suggest you consider also extending their application in the standard.

Proposed changes to ISA (UK) 720

We require auditors to express opinions on statutory other information that are equivalent to the requirements in the Companies Act. We have reason to believe that the findings in the FRC's recent thematic review on other information also apply in the public sector. In our view, the issues can be at least partially explained by a lack of clarity in ISA (UK) 720. We therefore welcome its revision, and offer the following observations on the proposals:

- Proposed paragraph 22-1(b) refers to auditors giving a 'conclusion' on the statutory other information. The existing paragraphs, such as 11(c)-1, refer to an 'opinion'. We suggest that 'conclusion' be replaced with 'opinion' in the proposed paragraph.
- We note the proposed paragraphs A7-1 to A7-3 in respect of materiality. The consideration of whether a misstatement is material is prone to inconsistent judgements and therefore we welcome this guidance. We interpret it as saying that the key performance indicators or principal risks that should be reported are those which are material to a user's understanding. Their omission would be therefore by definition a material misstatement. We suggest that the proposed wording could usefully be clarified to more explicitly state that view.
- Paragraph A10-2 refers to other entities for which auditors are required to report on statutory other information. Could public bodies be added to the examples given?

Further changes to ISA (UK) 720

While the proposed revisions are welcome, we believe that further changes can be made to improve clarity. In our view, the fundamental issue is that the UK requirements for statutory other information are superimposed on the international standard's requirements in respect of other information. The result can be quite difficult to follow. We therefore offer the following suggestions for further revisions (paragraph references are to the existing ISA(UK) 720):

- Paragraph 2 states that ' The auditor's opinion on the financial statements does not cover the other information, nor does this ISA (UK) require the auditor to obtain audit evidence beyond that required to form an opinion on the financial statements.' A reference could be added that opinions are required on statutory other information and additional procedures may be required.
- Paragraph 8 is quite clumsily worded as a double negative with the UK addition at the end effectively contradicting the first part of the sentence. We suggest clarity would be improved by reversing the order and starting with a positive statement that assurances on statutory other information do require to be obtained.
- Paragraph 12 - given its importance, we recommend that 'material misstatement' in the context of statutory other information be included in the definitions of key terms.
- Paragraph 14 to 14-2 - these paragraphs are critical in setting out the actions that auditors are required to carry out. However, the approach of adding paragraphs 14-1 and 14-2 as UK additions after the pre-existing paragraph 14 make it very difficult to follow. We recommend that the paragraphs be restructured in a more user-friendly way. For example
 - with some amendments paragraph 14-2 could be the introduction
 - 14(a) and 14-2 (a) could be combined
 - 14(b) and 14-2(b) could be combined

- Paragraph 14-1 - the phrase 'based on the work undertaken in the course of the audit' could be interpreted as restricting this to work that is carried out for the audit of the financial statements. It would be helpful to replace that phrase with 'based on the necessary procedures performed'.

Paragraph 22 (c) - similar to paragraph 8, this sentence is clumsily worded. As this is included in the Independent Auditors Report it can cause confusion in the minds of readers regarding the assurance that is being given. Where all the 'other information' is actually 'statutory other information' (which is often the case in public bodies), this requires auditors to report a contradiction, i.e. the report is basically saying auditors are not expressing an opinion on the information except when they are expressing an opinion on the information.

Appendix 2 - the example reports have not been tailored for the UK which can cause confusion. We suggest that either the examples are tailored or they are removed and replaced with a hyperlink to the FRC bulletin on illustrative reports.