



PRACTICE NOTE 10

Issued 1 September 2020

ICAEW welcomes the opportunity to comment on *Practice Note 10: Audit of Financial Statements and Regularity of Public Sector Bodies in the United Kingdom (revised 2020)* published by the Public Audit Forum, a copy of which is available from this [link](#).

We fully support the adoption of IFRS, as interpreted for the public sector, and the ISAs for audit. We welcome the update to Practice Note 10 but have some reservations regarding the audit requirements for going concern. We propose a relaxation of some of the going concern requirements as we do not feel that these are appropriate for all government entities.

This response of 1 September 2020 has been prepared by the ICAEW public sector team with support from ICAEW's Public Sector Advisory Group.

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KEY POINTS

Support for Practice Note 10

1. ICAEW supports the aims of Practice Note 10 (PN 10) which is to encourage consistency in the application of auditing standards while also recognising the specific legislative and regulatory frameworks that apply to the audits of public sector bodies.

Going concern

2. We are broadly supportive of the direction that PN10 has taken regarding going concern with more focus on continuation of services. However, we question whether the current audit requirements for going concern add value for all public entities.
3. The criteria to assess whether or not public sector entities are a going concern are not the same as for the private sector. Liquidity concerns or a breach of covenant are not as important compared to the extent that the continuation of services is protected. These assessments are often based on political decisions rather than cash-flow or other financial metrics-based criteria making going concern assessments, as applied to the private sector, less relevant.
4. We would welcome the position whereby the auditor is able to simply confirm that the appropriate statutory basis is in place as part of the risk assessment and that this means that the accounts are prepared on a going concern basis, and that this is sufficient. The inclusion of a rebuttable presumption that the entity is a going concern could be a way to take this forward.

ANSWERS TO SPECIFIC QUESTIONS

Question 1:

This version of Practice Note 10 includes extensive changes to the section on ISA 570 Going Concern. Do you consider the revised draft provides appropriate and useful guidance on applying the revised standard? What changes should be made, if any?

5. Going concern plays a very important role in the private sector and has rightly received a lot of attention, not just due to the strained economic environment brought about by COVID19, but also due to recent corporate failures. However, there is a view that the application of going concern is different for certain segments of the public sector.
6. We are broadly supportive of the direction that PN10 has taken regarding going concern in terms of focusing auditor's attention more on whether there will be a continuation of services and whether there are any known plans for a body to be demised through some form of government reorganisation. However, we believe that there is a disparity between the requirements of the underlying ISA and the financial reporting frameworks in place across the public sector. For example, the requirements per ISA570 require auditors to assess the going concern of an entity for twelve months from the date of approval. By contrast, many entities will not have reliable information beyond the current budgeting period, which often ends in March in line with the financial year end.
7. There is an increasing sense that the going concern audit work, in respect of some public sector bodies, does not add value. Going concern for many entities in the public sector is not about liquidity, headroom or covenants, it is about whether an entity is sufficiently supported

by the machinery of government and to what extent the continuation of its services is protected. These assessments are often based on political decisions rather than cash-flow or other financial metrics-based criteria.

8. Our point above is further corroborated by the local authority Code which states that 'an authority's financial statements shall be prepared on a going concern basis; that is, the accounts should be prepared on the assumption that the functions of the authority will continue in operational existence for the foreseeable future. Transfers of services under combinations of public sector bodies (such as local government reorganisations) do not negate the presumption of going concern.'
9. We would welcome the position whereby the auditor is able to simply confirm that the appropriate statutory basis is in place as part of the risk assessment and that this means that the accounts are prepared on a going concern basis, and that this is sufficient. For this to be effective it will be necessary to be clear, both in the Practice Note and in the relevant accounting guidance, what the specific circumstances are in which the entity and its auditor do not need to consider whether there are any material uncertainties. The inclusion of a rebuttable presumption that the entity is a going concern could be a way to take this forward.
10. Some conflate the auditor's responsibilities in respect of value for money arrangements with the requirement to assess going concern. Whilst there is often some overlap between these two elements of work, the value for money assessment is backward looking ie over the course of the accounting period, whereas going concern is forward looking. For example, the pandemic only affected the 2019-20 accounting period right at the end (second half of March 2020) and the auditor may well conclude favourably on an entity's arrangements for securing value for money in its use of resources and its operational effectiveness. But there could easily be going concern issues when taking the next twelve months from the approval date of the financial statements into account.
11. However, the new VFM guidance allows the auditor to identify weakness and report them at an early stage in the audit than was previously the case. And together with the requirement to assess the adequacy of financial planning (a forward-looking element), brings into sharp relief, the overriding objective for PN10 which is to provide auditors with a clear and consistent framework for assessing and reporting on bodies that are running into major financial challenges in the future.
12. Paragraph I-180 says 'For the bodies specified in paragraph 21-1(d) of ISA 570, the section of the auditor's report titled 'Conclusions relating to Going Concern' includes an explanation of how the auditor evaluated management's assessment of the entity's ability to continue as a going concern and, where relevant, key observations arising with respect to that evaluation. Where the auditor's conclusions are based on the considerations set out in this section of Practice Note 10, such as a necessity for the services provided by the public sector entity to continue to be delivered in some form, the auditor makes reference to these considerations in the 'Conclusions relating to Going Concern' section of the auditor's report.'

We are not sure whether the last sentence is needed or why the auditor needs to include additional information, rather than being part of the entity's disclosures. If we are moving to a position that going concern is not an issue for the reasons set out in PN10, then it's not clear why the audit report would need to say more than it would for other entities?

13. Paragraph 1-182 says 'In preparing the auditor's report, the auditor ensures that the explanation of conclusions relating to going concern clearly articulates the meaning of the concept of going concern as covered by the auditor's work. This section of the auditor's report should explain that the conclusions given do not amount to assurance regarding the entity's current or future financial sustainability.'

We are not sure what the intentions are of the last sentence in paragraph I-182. We note that this is not required for the standard report and question why the public sector should be any different. It seems odd to require more than for companies generally.

14. We fully support the adoption of IFRS, as interpreted for the public sector, and the ISAs for audit. There will be some entities for which the above proposed relaxation of the going concern requirements will not be appropriate and some cases will be more nuanced. The rebuttable presumption of going concern status with no uncertainties would allow the auditor discretion to extend their work in this area if deemed appropriate.

Question 2:

Guidance is included for the case where the reporting framework requires the other information to be “fair, balanced and understandable” (ISA 720). Does this paragraph set out an appropriate audit response for this circumstance?

15. There is some variation in language used relating to “fair, balanced and understandable” across the various public sector reporting frameworks and it would be helpful for these frameworks to make it clear whether they include this requirement. Currently there are inconsistencies.

Question 3:

The guidance in the section on ISA 560 Subsequent Events has been re-ordered and clarified. Do you consider the revised draft provides appropriate and useful guidance on applying the revised standard? What changes should be made, if any?

16. We consider the revised draft provides appropriate and useful guidance on applying the revised standard.

Question 4:

The section on the audit of regularity reflects existing practice in the public sector. Do you consider that the guidance in Part 2: The audit of regularity is appropriate, sufficient and applicable to all parts of the public sector? If not, what changes would you like to see made and why?

17. We believe Part 2 of PN 10 is appropriate, sufficient and applicable to all parts of the public sector and have no further comments to add.

Question 5:

This version of Practice Note 10 has been drafted with the intention that further iterations be issued over the coming years to take account of further standards and guidance that will be released, as well as the result of wider developments in the auditing profession. Do you consider that this approach is appropriate? What aspects, if any, of current developments not yet included should be incorporated into this version of the Practice Note?

18. It is inevitable that PN 10 will need to be updated over the coming years in response to new auditing standards and guidance as well as wider developments in the auditing profession – for example the Redmond review recommendations are due to be published on 8 September and may lead to changes being required.

Question 6:

Are there any other changes you believe would be appropriate? If so, what changes would you like to see made and why?

19. No comment.

Question 7:

The Auditor General for Wales and the Wales Audit Office are required to comply with Welsh Language Standards that provide for the Welsh language not to be treated less favourably to the English language in Wales and for individuals to be able to access public services in Wales though the Welsh or English languages. Do you consider there to be anything in this consultation draft that undermines these requirements? Do you consider there is any revision that could be made to support the use of the Welsh language?

20. No comment.

Further comments:

21. Paragraph I-116 suggests that “liabilities relating to defined benefit pension schemes” may be subject to “a very high degree of estimation uncertainty caused by the need to project forecasts far into the future”. This is not different to any entity with defined benefit pension schemes and would seem to be significantly less challenging to audit (not least due to the existence of accepted methodologies) than the other example of “provisions related to the disposal of nuclear waste”. This would appear to suggest that bodies with defined benefit pensions schemes should identify the liability as a significant risk in most, if not all circumstances – is this the intention?
22. Paragraph I-116 also suggests as an inherent risk factor “general political uncertainty and the possibility of future changes in public policy having an impact on the assumptions used to prepare accounting estimates”. It may be helpful to clarify this statement, and the extent to which possible future changes of policy should be treated as solely a subsequent event, rather than recognised in year-end accounting estimates.
23. And finally we have two small drafting comments – the last two lines of page 12 were unclear and the last sentence in paragraph I-5 on page 12 is not needed in our view.