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Sent by email: AAT@frc.org.uk

Dear Mr Ferris

Consultation on Revisions to Ethical and Auditing Standards 2019

EY welcomes the opportunity to respond to this consultation on revisions to the *Ethical and Auditing Standards*.

We believe that the governance, reporting and auditing ecosystem must continue to evolve to best serve business, investors and the wider public interest. Five key changes are necessary: corporate reporting needs review; the audit scope and product should be enhanced; investors and other stakeholders need to play a full role in defining their expectations; a strong regulator needs to be established; and there needs to be a rigorous framework for the new regulator to hold to account auditors, management and directors. We set out more detail on each of these, along with our suggested principles for reform, in Appendix I to this letter.

We strongly support the Government's intention to take forward a set of proposals that builds on all three of the major reviews into the capital markets ecosystem.[1] We firmly believe that to be effective for the long term, and to minimise the potential for adverse, unintended consequences to the UK capital market, the interconnected nature of the various facets of reform must be appreciated. In that context, the impact and sequencing of the revisions to the *Ethical and Auditing Standards* should be carefully considered to avoid cutting across the Government's reform process and introducing uncertainties to the market that could harm the competitiveness of the UK.

Key messages relating to the proposed revisions

General prohibition on non-audit services (NAS) – EY UK Chairman, Steve Varley, in his evidence to the BEIS Select Committee in January 2019, committed to ending non-essential non-audit services for FTSE 350 companies that EY audits. We support the introduction, through the Revised Ethical Standard, of a general prohibition on non-essential non-audit services for UK Public Interest Entities (which will include FTSE 350 companies) and we will align our commitment in accordance with the Revised Ethical Standard and proposed timetable for implementation by the FRC.

Introduction of a permitted list of services which the auditors of Public Interest Entities (PIE) can provide - EY agrees in principle with the introduction of a permitted list of NAS.

[1] Sir Donald Brydon, 'Independent Review into the Quality and Effectiveness of Audit'; Sir John Kingman, 'Independent Review of the Financial Reporting Council'; and CMA, 'Statutory Audit Services Market Study'.

However, we propose a number of changes to the permitted list within our detailed feedback contained within Appendix III.

Wider application of the Ethical Standard to audits of non-PIE entities – In its response to the Kingman Review, the Government indicated it will review the UK's PIE definition later this year. EY advises against pre-empting the outcome of that consultation by widening the scope of entities caught by the Ethical Standard via the introduction of 'Other Entities of Public Interest' (OEPIs).

Detailed responses to the consultation document questions, and comments on the proposed revisions, are provided in the attached appendices.

Once more, thank you for the opportunity to comment on the revisions to the *Ethical and Auditing Standards*. Our comments are offered in the spirit of constructive feedback and we hope that they are helpful. Should you wish to discuss any aspect of our response further, please do not hesitate to contact us.

Yours sincerely

Christabel Cowling
Partner, UK Head of Regulatory & Public Policy

Appendix I: Five key changes towards the evolution of the business eco-system

1. **Evolution of corporate reporting**

   Corporate reporting needs to evolve to meet the needs of the capital markets and wider society, particularly regarding the going concern and viability of companies and the measurement of long-term value creation for stakeholders amongst other risks. In this regard, we welcome the FRC review led by Paul Druckman into the Future of Corporate Reporting.

2. **Audit scope and product must be enhanced**

   Audit itself must be brought up to date by taking advantage of technology to enhance reliability and focusing assurance on both the financial statements and other key indicators important to societal expectations. Audit firms must also have a revitalised purpose clearly focusing on the public interest. The Brydon Review into UK Audit Standards provides the opportunity to ensure audit meets the needs of stakeholders in the 21st century.

3. **Role of investors and other stakeholders**

   Investors and other stakeholders need to play a full role in defining their expectations of corporate reporting and the scope of independent audit.

4. **Strengthened regulator**

   The UK needs an enhanced regulatory framework that ensures there is appropriate scrutiny of companies, directors and auditors. In this regard, we welcome the direction set by the proposals in the Kingman Review, including the creation of Audit, Reporting and Governance Authority ("ARGA"), and its proposed role in ensuring resilience of the audit market.

5. **Regulatory reform for auditors, management and directors**

   Management and directors (including audit committees) are primarily responsible for the accuracy of corporate information, upon which shareholders and stakeholders rely. They should be held accountable through a framework of enhanced regulatory oversight. Management accountability could be increased through reforms, adapted to the UK market, based on the Sarbanes-Oxley reforms for investor protection in the US where, among other things, management of public companies were required to certify the material accuracy of the financial statements. All audit firms need to focus on better quality audits. There should be accountability at senior levels in audit firms where audit quality systematically falls short. We believe the focus on audit quality is key and any changes to promote greater choice should not be at the expense of audit quality.

   Principles for reform of the audit market

   The objectives should be built into the ecosystem through adhering to a set of common principles. We believe the following principles should apply:

   Reforms should enhance, or at least not create risks to, audit quality.

   To be effective and sustainable, reforms need to focus on improving the audit ecosystem as a whole, including corporate reporting, corporate governance, regulation in addition to the audit product. The regulator should have the legal authority and

mandate to oversee the entire corporate reporting and governance system, taking enforcement action where necessary.

Multi-disciplinary firms with global reach are needed to allow seamless access to non-audit specialists, investment and capital for long-term resilience. Global integration is required to serve the needs of UK multinational businesses.

Audit committees need a greater choice of audit firms.

Reforms should not harm the competitiveness of the UK in a post-Brexit world.

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Appendix II: Consultation on Revisions to Ethical and Auditing Standards 2019

Responses to questions

Q1	**Do you agree with the revised definition of an 'objective, reasonable and informed third party' and with the additional guidance on the application of the test?** Yes, the additional guidance is helpful, but we suggest a few additional points to consider as follows: Involvement of INEs – a key feature of the ORTIP test is for there to be a diversity of thought on the independence matter in question, and therefore, we suggest this includes the option of seeking the views of a firm's INEs who will be familiar with the firm and bring an additional perspective to the issue. Consider developing a formal mechanism where audit committees and firms can consult with the FRC on the application of the ORITP test and other aspects of the Ethical Standard. Guidance provided through this arrangement could subsequently form the basis of an Ethical Standard FAQ/alert to help audit committees and audit firms evolve their understanding of the ORITP test.
Q2	**Do you agree with our proposed measures to enhance the authority of Ethics Partners, and do you believe this will lead to more ethical outcomes in the public interest?** Yes. Although at EY we cannot envisage a situation where the advice of the Ethics Partner is not followed by the firm, we agree that the proposed measures will give the Ethics Partner greater authority. The extent to which this new measure will lead to more ethical outcomes is debatable as we believe most firms have a well established process for consulting the Ethics Partner on a regular basis.
Q3	**Will the restructured and simplified Ethical Standard help practitioners understand requirement better and deliver a higher standard of compliance? If not, what further changes are required?** We welcome the simplification and formatting enhancements to the Ethical Standard which will help practitioners better navigate the standards. In particular, the separation of the guidance relating to Investment Circular Reporting Engagements and a reduced emphasis on the EU legislation is very helpful. However, there continues to be several areas where further changes are merited if we want to take this opportunity to achieve a better understanding of the requirements and in turn a higher standard of compliance. For example: Provide illustrative examples of the principle threats that can arise to integrity, objectivity and independence. Guidance on how to address the threat to independence in commercial conflicts when a company audited by a firm is a counterparty in connection to a service provided (by the same firm) to a company they do not audit.

	Simplification of elongated paragraphs such as ES 1.27 which includes a sentence that consists of over ninety words. Use of sub-headings in the financial relationships and removal of excessive cross-referencing. Similarly, the fees section is over six pages and would read easier with sub-headings. We would encourage the FRC to consider some of the best practices adopted by IESBA during the restructure and reformatting of the Code of Ethics in 2018, as well as the established approach taken by the PRA and FCA in their Rulebook/Handbook. We address further detailed points in Appendix IV.
Q4	**Do you agree with the introduction of a permitted list of services which the auditors of PIE audits can provide?** Yes, we agree with the introduction of a permitted list of services. As we have stated before, although we do not believe the current NAS restrictions affect audit quality we accept there are perception issues and concerns in relation to potential conflicts of interest with a firm's audit role and the provision of NAS. As a result, we (like some other firms) have taken the decision to voluntarily phase our non-essential NAS for the FTSE 350 companies EY audits. We plan to deliver on this commitment in line with the FRC's proposed timetable for implementation of the Revised Ethical Standard. Nevertheless, we encourage the FRC to provide more clarity for audit committees and audit firms to better understand the scope and limitations of what types of services that continue to be permitted. Key points in particular are: - There appears to be limited recognition on how permitted services should apply in non-UK jurisdictions; the importance of which will now be even more relevant as the Ethical Standard will apply to network firms worldwide. - Service Organisation reports (e.g. ISAE 3402 or SOC 1) play a crucial role in the market and are almost always undertaken by the auditor because of the need to comply with certain independence requirements and avoid duplication. Clarity should be provided on the permissibility of these services. - The application of the general NAS prohibition in a syndicate situation, where a member includes a PIE entity audit by a firm, is needed. Please refer to Appendix III for further comments and suggested amendments to the permitted list of services that would provide additional clarity and avoid unintended consequences. We note the FRC is proposing to adopt a permitted list of services to all UK PIEs as well as Other Entity of Public Interest (OEPIs) entities. We generally support the approach to applying this to all UK PIEs but have significant concerns on extending this to OEPI entities – see Q5 below.

Q5	**Do you agree with the additional prohibitions we are proposing to introduce – in learning from the experience of enforcement cases like BHS, if the more stringent PIE provisions are to have a wider application to non-PIE entities, which entities should be subject to those requirements?** No. Whilst we support the need to apply more rigorous independence standards to large private companies where there are significant stakeholders, we believe it is premature for the FRC to do so at this point through the introduction of "Other Entity of Public Interest" (OEPI) entities. As you will be aware, the Government has stated[2] it supports Recommendation 18 (by the Kingman Review) that the UK's definition of PIE should be reviewed and has stated that it will be consulting on this in the Autumn. It seems somewhat hasty and presumptuous for the FRC to introduce a new OEPI category through the Ethical Standard prior to the conclusion of the Government's consultation and without any due process to consult on the proposed definition. In addition, it will create significant confusion and disruption for companies as the FRC's definition of an OEPI would need to be replaced within a short period. We encourage the FRC to pause until the outcome of the Government's consultation has been concluded.
Q6	**Do you agree with the removal of the reliefs for SMEs in Section 5 of the Standard, and the retention of reliefs for 'small' entities (in Section 6 of the Standard)?** Yes. EY agrees with the removal of the reliefs because they are not consistent with the IESBA standards on independence.
Q7	**Do you agree with the proposed removal of the derogation in the 2016 Ethical standard which allowed for the provision of certain non-audit services where these have no direct or inconsequential effect on the financial statements?** Yes. EY agrees with the removal of the derogation because it causes confusion for auditors and audit committees.
Q9	**Do you agree with the inclusion of FRC staff guidance within the application material of the auditing standards, and has this improved clarity of the requirements?** EY supports the inclusion of the FRC staff guidance within the application material. However, not all guidance has been incorporated, for example, the SGN on Group audits. We would encourage the FRC to ensure all their guidance on applying standards is contained within the ISAs.
Q10	**Do you agree with the changes we have made to ISAs (UK) 700, 250 A and 250 B, including the extension of the requirement for auditors to report on the extent to which their audits are capable of detecting irregularities, including fraud.** ISA (UK) 700 As we set out in our response to the consultation on ISA(UK) 570 and the similar proposed change to require narrative by auditors' on-going concern for all companies, we are

[2] Chapter 2, Independent Review of the Financial Reporting Council - Initial consultation on the recommendations, Dept for BEIS (March 2019)

	concerned that overtime the inclusion of these new disclosures on irregularities will lead to the development of boilerplate reporting, detracting from the intended value of including this additional information in the audit report. Accordingly, we believe the FRC should consider what further guidance it can issue to ensure the continued effectiveness of this requirement. We also believe that in relation to this point, consideration should be given to whether the requirements should be 'scaled' rather than applying to all companies. Whilst this is currently only a requirement for Public Internet Entities, it could easily be extended to all entities where ISA701 applies and potentially 'Other Public Interest Entities' when that is determined. At the other end of the spectrum we suspect that the requirements of this paragraph will be disproportionate for many small and or semi dormant entities. ISA(UK) 250 B EY welcomes the addition of further guidance in respect of reporting to regulators, however we would encourage the FRC to provide additional guidance on when auditors should report such matters. For example, an entity may delay finalising its financial statements until it has resolved a going concern matter (where possible) and hence a delay in our conclusion of what opinion we will issue and a delay in our reporting. Clear guidance on when auditors are expected to report such matters would assist auditors in fulfilling their obligations in this area. Para A35f. It is not clear what the relevance of this new application guidance is to auditors' duty to report. If it is just to highlight that following a report there may be a need to qualify the audit report, we would suggest this is made clearer. We have nothing to note on the changes to ISA 250A and 250B.
Q11	**Do you agree with the proposed additional auditor reporting requirements, including the description of significant judgements in respect of Key Audit Matters and increased disclosure around materiality?** We would request the FRC clarify what is intend for auditors to include as 'significant judgments'. At a simple level this could be, for example, stating that we apply judgement in whether a discount rate is appropriate. Alternatively, it could mean explaining where the discount rate sat within the range of appropriate outcomes, how the range was determined and whether that was consistent with prior years and other positions taken by management in preparing the financial statements. Given the inclusion of 'significant judgements' could be interpreted in a range of ways, the FRC should clarify its expectations of auditors and consider what additional guidance can be issued to help auditors meet this requirement. We already provide additional disclosure around performance materiality in our audit reports so agree with the proposed change on this.
Q12	**Do you agree with the revisions we have made to ISA (UK) 720, including the enhanced material setting out expectations of the auditor's work effort in respect of other information?**

	Whilst the changes to ISA (UK) 720 incorporate some of the findings from the recent AQRT thematic on other information, the application material does not incorporate all the areas of best practice we were expecting. For example, there is no application material in relation to the Directors' Remuneration Report or KPIs. It would be helpful if the FRC incorporated all the findings of the thematic reviews which auditors are expected to apply. Corporate governance statements and disclosures are now required for AIM and large private companies however there is a mismatch in the work effort needed on these entities compared with those complying with the UK Corporate Governance Code. Whilst for AIM and large private companies we acknowledge there are no additional reporting requirements, unlike Code entities, it would be helpful for the FRC to recognise that these corporate governance and disclosure requirements exist and to confirm that auditors only need to comply with the general principles of reading for consistency/misstatement. In addition, the ISA may need to be revised when the Listing Rules are updated to determine auditors' responsibilities in respect of the Code. To clarify the revisions proposed by ISA (UK)720 to our audit reports, we would welcome the FRC updating its bulletin on audit reports or providing an example from which we can make the necessary amendments. Paragraph A36-5 is unclear and could be read as requiring auditors to be designing and performing procedures to identify material errors or inconsistencies in other information as opposed to in the context of our audit of the financial statements. We request the FRC amend the wording in this paragraph to clarify the requirements.
Q13	**We are proposing changes to the standards to be effective for the audit of periods commencing on or after 15 December 2019. Do you agree this is appropriate, or would you propose another effective date, and if so, why?** EY believes the effective date of 15 December 2019 is too short a period for firms and companies to implement the revised Ethical Standard particularly for companies with a 31 December year end. We encourage the FRC to allow more time for implementation and consider the following: Defer the effective date to early 2020; Allow "in-flight" NAS (that would be prohibited under the Revised ES) to be completed/transitioned subject to a maximum 12-month period from the effective date; and Currently active contingent fee arrangements may continue until the event/decision crystallising the contingent fee has arisen and the fee has been collected. This is similar to the grandfathering arrangements the FRC allowed under the 2016 revision.

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Other matters relating to the Ethical Standard

In addition to specific questions raised in this consultation we would like to highlight the following key matters in respect of the Exposure Draft:

Extraterritoriality

As currently drafted the Exposure Draft introduces a NAS prohibition (under ES 5.40) that would apply to any worldwide parent of a UK PIE. This does not follow the stated objective detailed in the FRC's Feedback Statement and Impact Assessment of ensuring greater consistency with changes to the UK legislation in respect of the withdrawal of the UK from the European Union.

The application to a parent should, in our view, be limited to a parent "incorporated or formed in any part of the United Kingdom" as drafted in Section 80 of The Statutory Auditors and Third Country Auditors (Amendment) (EU Exit) Regulations 2019 (SI 2019/177).

We encourage the FRC to address this over-reach of the jurisdictional application of the ES and limit the restrictions to a UK parent in accordance with the EU withdrawal legislation proposed in the UK.

Syndicates

There is limited guidance on the application of the proposed NAS prohibition where a member of a syndicate includes a UK PIE audited by a firm who is also performing a NAS engagement for the syndicate. We note footnote 50 of the Exposure Draft refers to SGN 01/2018[3] and would encourage the FRC to expand further on how this guidance should be interpreted by firms and audit committees when applying the Ethical Standard in a syndicate situation.

Cooling-in restrictions for internal audit services

It would be important for both companies and audit firms, in relation to 2020 audit tenders, to get clarity that the cooling-in restriction for internal audit services does not apply retrospectively i.e. it applies to cooling-in periods commencing on/after the effective date of the Revised Ethical Standard.

Investment Circular Reporting Engagements (ICRE)

We are supportive of the decision to separate out the provisions specific to ICRE from the detail of the Ethical Standard. However, in a number of respects the drafting of section I8 in the Exposure Draft could be improved to make it clearer. Our understanding is that the intention is that the Ethical Standard should only be applied to ICRE where specific provisions can be seen to be directly relevant to the particular engagement and our comments in Appendix V reflect this.

Audit fees

The Exposure Draft is proposing to introduce a new requirement relating to audit fees and how these compare to the full cost of an audit (ES 4.2). Where audit fees do not routinely cover the full cost of an audit the matter needs to be disclosed to the audit committee. It is stated that the purpose of this requirement is to ensure the delivery of a fully compliant audit.

[3] The Auditor's Provision of Restructuring Services to Public interest Entity Participants in Bank Lending or Bond Funded Syndicates

EY considers the introduction of this requirement unnecessary for the following reasons:

- There is an existing requirement in the extant Ethical Standard that addresses the need to ensure audit firms allocate sufficient resources to an audit irrespective of the audit fee – see ES 4.1.

- Some firms may not have accounting systems that could determine the "full cost" of an audit and therefore unable to make the necessary changes needed within the limited period the FRC intending to introduce the revised ES.

- Further consideration should be given as to the approach the FRC is taking in calculating the "full cost" of an audit by excluding partnership profit - it seems arbitrary to not include the risks borne by audit partners into this. In addition, no consideration is given to how a firm's overhead costs should be factored in.

- It is difficult to understand what an audit committee is expected to do if they receive such a disclosure from the audit firm.

We encourage the FRC to delay the introduction of this requirement until there has been further discussion and consultation with audit committees and firms.

Contingent fees

The definition of contingent fees in paragraph 4.6 is different to that included in the glossary, which is unhelpful.

Paragraph 4.7 says that "differential hourly fee rates" do not constitute contingent fees but it is not clear what "differential" is referring to. Clarification would be helpful.

Differential fees for due diligence work

Paragraph 4.18 of the extant Ethical Standards says:

"Paragraph 4.14 is not intended to prohibit a firm from charging a lower fee where the service relates to a transaction or engagement that was either aborted or prematurely terminated for whatever reason and where the rationale for the lower fee is to take account of either the reduced risk and responsibility involved or the fact that less work was undertaken than had been anticipated."

This clarification does not appear in the Exposure Draft. Whilst some of the structures in this paragraph could be described as contingent fees, some clearly are not. The intent behind this deletion is therefore not clear. For the due diligence services market to operate effectively it is important that there is clarity regarding what fee structures are permitted. It should be made clear if the intention is that a lower fee cannot be charged to reflect reduced risk. Paragraph 4.7 of the Exposure Draft permits fees to be negotiated after the completion of an engagement which suggests that it would be possible to agree a reduced fee to reflect reduced risk.

Guidance

Following the Revised Ethical Standard 2016, the FRC's Technical Advisory Group developed a catalogue of comprehensive material that has proved invaluable to firms and audit

committees when interpreting the standards. Although some of this material has been incorporated into the Exposure Draft or become redundant, there are a number that have not, for example:

- Playing any part in management or decision making (SGN 02/2016)
- Period of engagement (SGN 03/2016)
- Power of attorney (SGN 04/2016)
- How to deal with breaches for audit reporting purposes (Rolling Record of Action Arising)
- Tax advocacy services (Rolling Record of Action Arising)
- Audit Committee reporting on the audit tender process (Rolling Record of Action Arising)
- Impact of gaps in service on auditor rotation (Rolling Record of Action Arising)
- Application of KAP requirements to non-EU partners (Rolling Record of Action Arising)
- Investment Circular Work (Rolling Record of Action Arising)

We would encourage the FRC not to abandon this guidance and instead update and have it available for practitioners. Further we believe there is considerable merit in keeping the FRC's Technical Advisory Group operational and for it to provide further assistance on the interpretation of the Revised Ethical Standard in the coming years.

In addition, we would welcome the FRC developing regular (perhaps annually) independence guidance/FAQs based on thematic issues arising from the type of enquiries they have received from firms/audit committees and from the audit firm inspections programme.

Appendix III: Permitted Non-audit/Additional Services for PIEs

Permitted NAS (ES 5.40)	Comments
	A general comment that it would be helpful for practitioners and audit committees if each of these permitted services are numbered/referenced. ES 5.40 is limited to firms carrying out audits of PIEs and does not extend to other public interest assurance engagements. Therefore, we believe the term "Additional Services" should be removed as this term only applies to public interest assurance engagements "other than an audit…". The Ethical Standard uses the term "non-audit services" for audit engagements (see Glossary.
Services required by UK law or regulation and exempt from the non-audit services cap	We note from past guidance issued by the FRC that the exemption from the fee cap is not limited to services required by UK law/regulation and instead applies to any "national" law/regulation (refer to Application of the non-audit services fee cap to regulatory reporting work, 10 July 2017 Meeting – Ethical Matters, FRC Technical Advisory Group – Rolling Record of Actions Arising). We would encourage the FRC to make the following amendment: *"Services required by ~~UK~~ law or regulation and exempt from the non-audit services fee cap"* This would also address a number of anomalies and unintended consequences concerning non-UK jurisdictions (see below).
Reporting required by a competent authority or regulator under UK law or regulation for example;	There are situations where reporting is required by a competent authority/regulator in non-UK jurisdictions e.g. US GAO, Japan FSO. Taking into consideration the proposed extraterritorial application of the Revised Ethical Standard, we believe it is important for the FRC to consider non-UK jurisdictions where a UK PIE entity may have subsidiaries. The removal of the term "UK" from this section would enable this.
In the case of a parent undertaking or controlled undertaking incorporated and based in a third country, reporting required by law or regulation in that jurisdiction where the auditor is required to undertake that engagement (such services can only be provided by network	The term "engagement" is defined by ES as an audit engagement or other public interest assurance engagement. Therefore, it would appear this permitted service is referring to local statutory audits (or other public interest assurance engagements) but not professional services in third country jurisdictions. We do not believe a permitted NAS list should include these types of engagements as they would not be considered a non-audit service under the Ethical Standard.

Permitted NAS (ES 5.40)	Comments
member firms in that jurisdiction and shall not be provided by the audit firm);	Nevertheless, there are a number of non-UK jurisdictions where a local law or regulation will require that the auditor performs certain NAS for the company it audits. For example, in some jurisdictions there is a legal requirement for the auditor to "sign-off" (in their capacity as auditors) a local corporate tax return prepared by the company. Similarly, in the US the auditor is required to perform broker-dealer examination reports while in South Africa the Reserve Bank requires certain prudential reporting to be audited by the auditor. In addition, there are common situations where a company or its controlled undertaking has reporting obligations in multiple non-UK jurisdictions but may not be required to have a local statutory audit. Therefore, the audit firm (not the network) will be legally required to undertake the non-audit service. Separately, please see our comments above on extending the NAS ban to a non-UK parent. Based on the above explanation, we propose the following amendments: *"In the case of a ~~parent undertaking or~~ a PIE or its controlled undertaking incorporated and based in a third country, reporting required by law or regulation that the audit firm or network member firm is required to undertake that ~~engagement~~ non-audit service ~~(such services can only be provided by network member firms in that jurisdiction and shall not be provided by the audit firm);"~~*
Reporting on internal financial controls when required by law or regulation;	Current drafting of this section indicates that reporting on internal financial controls would only be permitted when required by "UK" law or regulation. In a number of non-UK jurisdictions (e.g. US COSO report used for Sarbanes-Oxley opinions – US SOX, and China internal control and audit – C SOX) local laws require the auditor to report in these areas. Therefore, clarity should be provided that "..required by law or regulation" extends to non-UK jurisdictions. See above, our recommendation that the term "UK" be removed from this section.
Reports, required by or supplied to competent authorities / regulators supervising the audited entity, where the authority / regulator has either specified the auditor to provide the service or identified to the entity that the auditor would be	We see close similarity of this permitted service with the above "Reporting required by a competent authority or regulator under UK law or regulation..." and would, through the deletion of the term "UK", suggest these be merged.

Permitted NAS (ES 5.40)	Comments
an appropriate choice for service provider;	
Audit and other services provided as auditor of the entity, or as reporting accountant, in relation to information of the audited entity for which it is probable that an objective, reasonable and informed third party would conclude that the understanding of the entity obtained by the auditor for the audit of the financial statements is relevant to the service, and where the nature of the service would not compromise independence	Such services are permitted where the service is required by UK law or regulation. However, there are a number of reports under a typical reporting accountant role that are not required by regulation/law e.g. comfort letters, working capital, FPP reports. There may be circumstances where it is not practicable for a firm other than the auditors to issue such reports – for example due to timing and confidentiality. A SAS 72 comfort letter effectively has to be issued by the auditor because it requires the issuer to have a basis for the letter (that can realistically only the auditor would have) and for the auditor to be independent. We would suggest allowance is given for this by either including a reference in this section e.g. "(where reporting accountant services are not required by law or regulation they would be subject to the fee cap") or adding reporting accountant as a permitted service under the section subject to the fee cap. The reference to "…would conclude that the understanding of the entity obtained by the auditor for the audit of the financial statements is relevant to the service" is likely to lead to inconsistent practice as "relevant" is a rather vague term. Given that there may be good reasons such as confidentiality and expediency for the auditor performing the service and the proviso that independence is not compromised this additional "relevancy" test is not necessary. In addition, removing the term "UK" in the main heading, reporting accountant activities can continue in non-UK jurisdictions. This would be critical for the effective functioning of non-UK capital markets where a UK company has an overseas listing.
Services which support the entity in fulfilling an obligation required by UK law or regulation, where: the provision of such services is time critical; the subject matter of the engagement is price sensitive; and an it is probably that an objective, reasonable and informed third party would conclude that the understanding of the entity obtained by the auditor for the audit of the financial statements is relevant to the service, and where the nature of the service would not compromise independence	As mentioned above we believe it is important for the FRC to consider non-UK jurisdictions where a UK PIE entity may have subsidiaries and therefore services which support an entity fulfilling obligations required by non-UK law or regulation should to be considered. The ORITP test applies to all permitted NAS – suggest it is removed or addressed in introduction to ES 5.40.

Permitted NAS (ES 5.40)	Comments
Services subject to the non-audit services cap	To be consistent with the section above we suggest amending the sub-heading as follows: "Services not required by law or regulation and subject to the non-audit services fee cap".
Extended audit or assurance work that is authorised by those charged with governance performed on financial or performance information and/or financial controls where this work is integrated with the audit work and is performed on the same principal terms and conditions	A well-established market practice for companies, that act as third-party Service Organisations on financial reporting and other information systems, is for the auditor (of the Service Organisation) to issue assurance reports for the Service Organisation (e.g. ISAE 3402/SOC 1). These reports are relied on by "user entities" and their auditors. Service Organisation reports address many areas covered by the audit and are performed under similar standards to that of the audit. However, Service Organisation reports are not normally integrated with the audit work. In addition, these reports relate to the operational controls of the Service Organisation in relation to the financial controls of a "user entity". For a company to commission a separate firm to undertake these activities it would create significant duplication and costs. There would also be the potential danger of there being limited choice for the Service Organisation as potential firms may not be independent under the relevant standards to undertake the engagement. To avoid significant disruption to this market we encourage the FRC to amend this permitted service, to allow Service Organisation reports and suggest the following amendment: *Extended audit or assurance work that is authorised by those charged with governance performed on financial or performance information and/or ~~financial~~ controls ~~where this work is integrated with the audit work and is performed on the same principal terms and conditions~~*
Reporting on covenant or loan agreements, which require independent verification, including to third parties with whom the entity relevant to an engagement has a business relationship[50]	We would encourage the FRC to expand further how this permitted service would apply to general creditor advisory services such as Independent Business Reviews (IBRs) and in particular where there is a banking syndicate which includes a PIE audited by a firm advising a syndicate. See above comments on syndicates.
	Other matters We note there does not appear to be any allowance for firms to undertake general assurance engagements performed in accordance with the International Standards on Assurance Engagements (ISAEs) or equivalent local assurance standards

Permitted NAS (ES 5.40)	Comments
	These types of engagements require the firm to comply with relevant local or international auditing or assurance standards (e.g. Section 900 - International Code of Professional Ethics, IESBA). In many cases the auditor is best place to meet these independence requirements. We would encourage the FRC to includes these types of engagements as the threats to auditor independence are clearly insignificant. Otherwise companies may have limited choice if the auditor is excluded and other firms are not able to comply with the applicable independence standards.

Appendix IV: General comments on the Exposure Draft

Section/paragraph	Comments
1.47-1.48	Amend sub-heading as follows: **Other Firms Involved** in the **Engagement** ES 1.47 needs to be reconciled with SEP 2.4 with regard to network firms. The later states that a network firm needs to comply with the ES regardless of whether or not its work is used in the conduct of an engagement. However, in the introduction to ES 1.47 there is a reference to using "the work of another firm (including network firms)...".
2.3 - 2.15	Consider introducing sub-headings to allow practitioners to better navigate the financial relationships section. Introduction to paragraph 2.3 cross refers to five paragraphs which creates unnecessary complexity. The wording and terminology used in paragraph 2.4 is based on EU legislation and it would be helpful if there was some simplification of this paragraph.
2.16	The Exposure Draft states a trustee interest held through a 'living will' or power of attorney (PoA), will be prohibited if the person (being a Key Audit Partner or directly involved covered person) holding that interest is or may be a potential beneficiary. However, SGN 04/2016 (Ethical Implications of a Power of Attorney) provides for some dispensation where the matter is disclosed and the PoA has not yet come into force. Consider reconciling the difference between the two by continuing the use of SGN 04/2016.
2.50	Reference to 2.41 should be 2.40
2.50-2.51	Formatting error between paragraphs
2.60	Formatting error on paragraph
3.9	There remains very limited guidance on audit firm rotation, we encourage the FRC to work with BEIS and consider developing additional material in this important area.
4.2	See above comments on audit fees
4.6/4.7	See above comments on contingent/differential fees
4.46	We note the proposed expansion of the litigation related requirements to situations when a firm is acting on behalf of another party (e.g. as administrators) and as part of this role

Section/paragraph	Comments
	legal action is taken against a company that is audited by the same firm. We would encourage the FRC to provide additional guidance in this area as there could be unintended consequences in the marketplace of this new requirement. In particular: - there are often situations where routine legal action is taken against numerous third parties e.g. debt collection from customers, where the matter is often immaterial to all parties; this should continue to be permitted as the threat to independence is clearly insignificant; - where a company audited by the firm is only identified after the arrangement has commenced, the firm should be allowed to implement safeguards that avoid the need to resign as auditors even where the matter is material. These may include appointing an independent third party to pursue the legal action. - whether it is probable that an ORITP would conclude that an adversarial position has not arisen and therefore the management's willingness to make complete disclosures of relevant information to the audit firm has not been affected.
5.35	Reference to 4.15R/4.16R should be 4.15/4.16 as "R" refers to the EU Audit Regulation where the emphasis on this legislation has been reduced.
5.40 An audit firm carrying out statutory audits of public interest entities and, where the audit firm belongs to a network, any member of such network, shall not provide to the audited entity, to its **parent undertaking** or to its controlled undertakings, services other than those set out in the rest of this paragraph, subject to the approval of the audit committee after it has properly assessed threats to independence and the safeguards applied in accordance with this Ethical Standard[49]	Application to parent undertaking should be limited to a parent "incorporated or formed in any part of the United Kingdom" to ensure consistency with Section 80 of The Statutory Auditors and Third Country Auditors (Amendment) (EU Exit) Regulations 2019 (SI 2019/177).
([49] In accordance with this Ethical Standard and Schedule 1 to the Statutory Auditors and Third Country Auditors Regulations 2016.)	We believe footnote 49 should be referring to Section 74 of The Statutory Auditors and Third Country Auditors (Amendment) (EU Exit) Regulations 2019 (SI 2019/177)

Section/paragraph	Comments
5.41	Reference to paragraph 45R-1(b) of ISA(UK) 700 should be paragraph 45R-1(e).
5.42	Reference to paragraphs 5.40-5.42 should be 5.40-5.41
5.44-5.46	Guidance should be provided on whether an assessment of a company's internal audit function (outside the audit) would be permitted. For example, an independent quality assurance review of an internal audit function under standards issued by Institute of Internal Auditors (IIA).
Appendix B An audit firm carrying out the statutory audit of a public interest entity, or any member of the network to which the audit firm belongs, shall not directly or indirectly provide to the audited entity, to its **parent undertaking** or to its controlled undertakings any prohibited non-audit services in:	Application to parent undertaking should be limited to a parent "incorporated or formed in any part of the United Kingdom" to ensure consistency with Section 80 of The Statutory Auditors and Third Country Auditors (Amendment) (EU Exit) Regulations 2019 (SI 2019/177)
Glossary: Direct effect (on the financial statements)	We believe this definitional term applies to the derogation currently available under ES 5.168R which will be removed under the proposed revisions. To ensure consistency we suggest the term is excluded from the Glossary.
SME list entity	SME definition should be removed if the exemption has been withdrawn.
Various	Although the FRC's Feedback Statement and Impact Assessment indicates the Exposure Draft has been revised to reflect UK legislation that has been passed in support of the EU Exit, the Glossary continues to reference the EU legislation in a number of areas.

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Appendix V: Investment Circular Reporting Engagements (ICRE)

Section/ Paragraph	Comments
I8	This says that "This Ethical Standard applies to public interest assurance engagements involving investment circulars intended to be issued in connection with a securities transaction governed wholly or in part by the laws and regulations of the United Kingdom". This has been taken from the SIRs and in our comments on the proposed revisions to the SIRs earlier this year we said we did not believe that this was correct (please refer to our submission). Additionally, we note that it is inconsistent with footnote 1 to paragraph I1 as the latter would also include engagements where there was no requirement to apply the SIRs but they were none the less being followed. I8(b) is too widely drawn – our comments on paragraphs 2.36 and 4.10 below provide examples of the consequence of this which could result in services being prohibited where there is no independence threat, and which could significantly inconvenience a company undertaking a transaction.
I8-1	Given the requirement of I8(c) and paragraph 5.17 it is not clear what purpose I8-1 serves. Furthermore, I8-1 introduces a concept of the "objective of the service" which is not present in paragraph 5.17. This appears to have a narrower application than paragraph 5.17, so it is not clear what provision actually applies to ICRE.
I8-3	This rationale for this provision is understandable where the subject matter of the ICRE relates to historical financial information but where no historical financial information is involved, for example a report on working capital projections or financial reporting procedures, there is no reason to reference the period for consideration to the last audited balance sheet. We would suggest amending this as follows: *"The relevant period for consideration covers the period during which the engagement is undertaken and, where the most recent audited financial statements of an entity relevant to the engagement are relevant to the subject matter of the engagement, any additional period before that but subsequent to the balance sheet date of those ~~most recent audited financial statements of the entity relevant to the engagement~~. A firm's procedures shall include reference to records of past and current services / engagements whenever a new investment circular reporting engagement is proposed."*
I8-4	This provision refers to "other parties who are connected with the investment circular" which includes "other entities directly involved in the transaction". This could be read to include a wide range of entities who are not relevant to the independence assessment - for example the client's lawyers. It would be helpful to clarify if this is in fact the intention.
I8-5	This can be problematical in practice because of the lack of materiality thresholds for direct financial interests. On occasions situations have arisen where a partner holds a completely immaterial financial interest in an entity that is relevant to a transaction and is unable to sell the holding due to insider dealing regulations. As a consequence, they would be ruled out of working on the ICRE. We would suggest permitting such direct financial interests provided that they are clearly immaterial and disclosed in the communication to the audit committee of the company issuing the investment circular. The reference to paragraph 2.10 should presumably be to 2.9.

Section/ Paragraph	Comments
1.47	This paragraph refers to "the use of work of another firm". It is presumed that this point is referring to where another firm is involved in the ICRE and is not intended to apply where the reporting accountant is preparing an accountant's report pursuant to SIR2000 and is accessing the auditor's working papers. This point is addressed in SIR 2000.
1.54	This requires communication in respect of an ICRE to "each entity relevant to an engagement". There is no reason why the communication should be, in the case of class 1 acquisition, with the target company as they have no responsibility for the investment circular. Paragraph 1.64 of the extant Ethical Standards provides that it may be agreed that communication is only with certain parties. Often there are many parties to an engagement agreement and paragraph 1.64 provided a pragmatic way of dealing with this. However, this has been removed in the Exposure Draft. We would suggest that it is retained.
1.55/1.56	It is not clear how these paragraphs relate to "any other persons or entities the firm is instructed to advise" as it is unlikely that the audit committee of a sponsor, for example, would consider the independence of a reporting accountant.
1.58	Not all parties relevant to an engagement in respect of an ICRE will necessarily be public interest entities or listed entities so this paragraph creates a dual approach in respect of ICRE for no obvious reason.
2.36	It is not clear how the prohibition on staff loans should be made in the context of an ICRE. It appears that, applying I8(b), it is a complete prohibition. However, consider the following situation. Company A is audited by Firm A and engages Firm B to provide a staff loan. Subsequently Company A then enters into a class 1 acquisition to acquire Company B which is audited by Firm B. It would not be unusual for Company A to wish to engage Firm B to report on the historical financial information of Company B in the investment circular to be issued by Company A – often for reasons of timing and/confidentiality. Paragraph 2.36 would now prevent this happening for no obvious reason.
4.10	As with paragraph 2.36, this paragraph also appears to apply to the firm (and its network as a whole). Taking the example regarding paragraph 2.36 above – if a network firm of Firm B had an engagement on a contingent fee basis with a subsidiary of Company A then Firm B would be prohibited from accepting the engagement.
4.43	The reference to "likely to subsequently become an entity……." is unclear in the context of an ICRE. A firm might from time to time provide reporting accountant services to a client that is not an audit client and it might anticipate that it could be appointed to do so at a future date if there were to be an ICRE. Would paragraph 4.43 apply in those circumstances or would it only apply once a specific potential ICRE was identified?
5.18	The reference to "audit firm" would mean that this does not apply to a firm performing an ICRE where they are not the auditor. Is that the intention?