

27 September 2019

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Our Ref: SJG/MS/JC

Dear Sir/Madam

### **Consultation on Revisions to the Ethical and Auditing Standards 2019**

We are pleased to provide Crowe's response to the questions posed in the above consultation.

Crowe is one of the top 10 audit firms in the UK by audit fee income with more than 800 people nationally. We audit over 50 listed companies, most of whom are listed on the AIM market and we are consistently ranked in the top 10 list of auditors by number of listed company audits in the quarterly Corporate Advisers Rankings Guide. Crowe is also the leading auditor of charities, topping the Charity Finance and Charity Financials Audit Survey for 11 successive years. We are also widely regarded as one of the leading auditors to pension schemes.

The firm is the UK member of Crowe Global, the eighth largest accounting network in the world with revenues of \$4.3 billion and more than 36,000 partners and professionals in 130 countries. Crowe Global is a member of eh Forum of Firms.

We agree that there are problems with confidence in the audit of public interest entities and we accept change is needed in a number of areas. We do not agree, however, with a number of the proposed changes to the Ethical Standard and the Auditing Standards in the timetable envisaged.

The FRC points out in the Feedback Statement and Impact Assessment that there have been a number of reviews established over the last 18 months which have had the topic of audit quality on the agenda. These started with the Kingman Review of the FRC, followed by the review of the Statutory Audit Market by the Competitions and Markets Authority (CMA), the 'Future of Audit' inquiry by the Department of Business, Energy and Industrial Strategy (BEIS) and then the Brydon Review into the quality and effectiveness of audit. That last review has not yet concluded and BEIS have also only recently closed their own consultation on the proposed remedies put forward by the CMA.

We recognise the desire of the FRC to take action as soon as possible to address matters which it believes necessary in order to improve audit quality and it recognises that it would not be appropriate to 'cut across' the scope and results of those review. We remain concerned, however, that some of the proposals do just that. Further, we do not believe the case has been made adequately to demonstrate that flaws in the Ethical Standard or Auditing Standards were the root cause behind recent corporate scandals. Changes to the Ethical Standard and Auditing Standards are not, therefore, necessarily the appropriate response to the problem.

We believe that some of the proposed changes are premature and risk the need for further changes to the standards in due course. We contend that it would be more appropriate to wait until the conclusion of all the reviews and then to have a single set of changes which could be introduced as a 'package', along with any potential changes to company law.

Finally, we have concerns about whether due process is being followed with this consultation as the time between closing the consultation and the proposed implementation date of the standards is far too short. There is not a reasonable period for respondents' views on the significant changes included to be appropriately considered and taken into account before the FRC seeks internal approval of the changes to the standards.

We provide our detailed responses to the consultation questions in the schedule to this letter and we trust that you will find our contribution of assistance.

Yours faithfully

**Crowe U.K. LLP**

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Consultation question	Crowe response
<p>1. 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?</p>	<p>We agree that the revised definition provides more clarity when applying this test. The proposed third party is not a practitioner but is informed about the roles and responsibilities of an auditor, those charged with governance and management of an entity.</p> <p>This definition is consistent with an informed investor or shareholder. We note, however that the guidance also refers to an “other public interest shareholder”. The footnote to Paragraph 114 of the Exposure Draft of the Revised Ethical Standard 2019 states that this test includes the stakeholders for the purpose of considering directors responsibilities under s172 of the Companies Act 2006. This wording would appear inconsistent with the proposed definition as, in our view, many such stakeholders would not meet the definition of an informed third party.</p> <p>We recommend that the reference to directors’ responsibilities under s172 is removed as it is inconsistent with the definition. The guidance can achieve the desired goal by simply clarifying that the ‘informed third party’ does not need to have a financial interest in the entity to be considered.</p>
<p>2. 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?</p>	<p>We welcome any steps to enhance and clarify the role and authority of the Ethics Partner.</p> <p>This question as worded suggests a lack of authority currently with Ethics Partners that results in ethical outcomes that are not in the public interest. We are not aware of any public evidence to support this view.</p>
<p>3. 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?</p>	<p>We welcome the intent to restructure the Ethical Standard in order to provide clarity.</p> <p>The stated goal is to deliver a higher standard of compliance but we are not aware of areas of the Ethical Standard where there is significant non-compliance and therefore we cannot comment on whether these changes are likely to provide a higher standard of compliance.</p>
<p>4. Do you agree with the introduction of a permitted list of services which the auditors of PIE audits can provide?</p>	<p>We agree that a permitted list of services provides clarity in this area.</p> <p>We believe the list of corporate finance services permitted could be clarified as it is capable of different interpretations regarding whether the auditor can act as a Reporting Accountant.</p>
<p>5. 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?</p>	<p>We do not agree with the additional prohibitions you are proposing to introduce.</p> <p>We support the principle that greater restrictions on providing non-audit services should be implemented, however the proposed approach is, in our view, fundamentally flawed for the following reasons.</p> <ul style="list-style-type: none"> <li>• The definition of an ‘Other Entity of Public Interest’ (OEPI) refers to entities that are of significant public interest to stakeholders. This definition is imprecise and highly subject to interpretation. Any such extension of entities within public interest scope should be clearly</li> </ul>

Consultation question	Crowe response
	<p>defined so there is no potential ambiguity as to whether an entity is within or outside the scope.</p> <ul style="list-style-type: none"> <li>• The question references BHS (with the implication that BHS would be an OEPI) however it is not clear that BHS would fall within the proposed definition. BHS was a private company and, within the current framework, would not fall within the scope of the FRC’s Audit Quality Review (AQR). Without a clear and unambiguous definition each audit firm will need to make its own judgements on which entities fall within this definition, leading to inconsistency and the risk to the audit firms that their policies may be subject to challenge by a regulator that forms a different judgement.</li> <li>• The proposed definition states that all entities within the scope of the FRC’s AQR will be considered an OEPI. Although, broadly, we agree that the entities within public interest scope are those reviewed by the AQR, we do not believe that having this as part of the OEPI definition is appropriate. This would mean the scope of the Ethical Standard would change in the event that the AQR changed the scope of its inspections. The scope of the Ethical Standard should not be subject to such a variation.</li> <li>• We agree that the definition of ‘public interest entities’ should go beyond listed entities, however this matter is already under consideration in the Brydon Review and in our view any changes to scope should await the outcome of this review and be aligned with its recommendations.</li> <li>• The proposed Ethical Standard prohibits both contingent fees and internal audit services for all audit clients. This is a wide ranging change and we do not see any clear evidence that these arrangements affect audit independence. We agree that these changes are appropriate for listed entities, but we do not believe these prohibitions are of benefit or are a proportionate response for private businesses. The previous requirements were measured and prohibited those activities where a threat arose. The standard could benefit from further guidance on the application of these requirements but, in our opinion, an outright ban is not warranted.</li> </ul>
<p>6. 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)?</p>	<p>No, we do not agree with the removal of the relief for Listed SMEs in Section 5. The relief is a sensible piece of proportionate regulation and should be not removed without clear evidence that its use is being abused and damaging public trust in business; there is no such evidence.</p> <p>In respect of Section 6 of the Ethical Standard we do not think that one of the main reliefs provided is consistent with auditor independence. In our opinion auditors should not undertake a management role in an audit client in any circumstances. We believe this relief should be removed from this section.</p>

Consultation question	Crowe response
7. 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?	We agree with the proposed removal.
8. Do you agree with the inclusion of FRC staff guidance within the application material, and has this improved clarity of the requirements?	We agree with the inclusion of FRC staff guidance within the application material. All key guidance in applying the Ethical Standard should be in one place.
9. 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?	We agree with the inclusion of FRC staff guidance within the application material. All key guidance in applying the Auditing Standards should be in one place.
10. 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.	<p>No, we do not agree that extending the requirement for auditors to report on the extent to which their audits are capable of detecting irregularities will improve audit reporting. In the context of most audit opinions this will simply result in boiler plate wording being added to the audit report.</p> <p>In addition adding such wording is likely to increase the expectation gap on reliance on auditors in identifying fraud and other irregularities.</p> <p>We believe the narrative audit reports (prepared under ISA (UK) 701) have added value in the audit of listed entities. It would be more appropriate to consider whether it is appropriate to extend the requirements in that ISA that apply only to PIE audits to all narrative audit reports.</p> <p>In our opinion the FRC should wait for the Brydon Review to report before making changes in this area.</p>
11. 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?	<p>Broadly we agree with the proposed additional reporting requirements.</p> <p>We do not believe, however, that there is any benefit in disclosing performance materiality. For most users of financial statements providing two different measures of materiality will create confusion.</p>
12. 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?	<p>We are not convinced that the proposed changes will result in any real benefit to the readers of the audit report.</p> <p>In addition the auditor's responsibility in respect of other information is currently an element of the Brydon Review. In our view it would be more appropriate to wait for the outcome of that review and bring the ISA (UK) 720 in line with any recommendations.</p>

Consultation question	Crowe response
<p>13. 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?</p>	<p>No, we do not believe this date is appropriate for the Ethical Standard.</p> <p>We do not see how the proposed date will allow adequate time for the FRC to consider the responses to this consultation or give enough time for companies and their auditors to make changes that might be required.</p> <p>If these changes are implemented in accordance with this draft then appropriate transitional arrangements need to be implemented to allow audit firms and the entities they audit adequate time to understand the changes and to make the necessary changes to contractual arrangements and, in some cases, find alternative suppliers for professional services. In our view the current arrangements do not provide adequate transitional provisions.</p> <p>In respect of the changes to the Auditing Standards, although we have reservations as to the benefits of the proposed changes, we have no reservations as to the practicality of implementing these changes.</p>