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By email only to AAT@frc.org.uk

Dear Mr Ferris

POST IMPLEMENTATION REVIEW OF THE 2016 AUDITING AND ETHICAL STANDARDS

Introduction

Thank you for the opportunity to comment on the proposed changes to the auditing and ethical standards.

The consultation comes at a time of great change in the audit market, with the CMA and Kingman recommendations currently being considered by BEIS and the Brydon Review ongoing, and in a context of profound national uncertainty. Against this background, it is very important that changes to the auditing and ethical standards improve market confidence in audit and companies; align to other changes in the corporate reporting ecosystem; do not put UK companies at significant disadvantage; and are proportionate.

This letter sets out our overall thoughts on key elements of the proposals; our responses to the individual consultation questions are shown in Appendix 1 and we also attach two further appendices of suggested editorial amendments to the standards which we believe achieve the FRC's intent whilst making the standards clearer and promoting consistent application.

Previous communication

We wrote to you in August setting out concerns about the extraterritorial reach of non-audit restrictions to non-UK parents, the effective date of the revised Ethical Standard and the drafting of the proposed whitelist of permissible PIE non-audit services. Our subsequent meeting with Mark Babington was very helpful. It was clear from the meeting that we are broadly aligned on many aspects of the underlying principles driving your proposals. However, the concerns set out in our earlier letter remain. Whilst we support a broad, principles-based approach, there is a need for more clarity in drafting to enable consistent application by boards and audit committees, investors and auditors. Without the additional commentary from the meeting, we are concerned that the points we highlighted are inappropriate and/or ambiguous, will not benefit audit quality, will be very challenging for companies to implement and will put UK companies at an international disadvantage. We hope that our appendix on suggested redrafting is helpful in this regard.

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Overall concerns

Our overall concerns cover eight areas:

1. **Focus of proposals**: We believe that the proposals focus too closely on Non-Audit Services ("NAS") restrictions. In practice, there are already significant restrictions in place, and audit committees generally steer clear of using their auditors for any non-audit work. In general, when they do use them, it is because auditors are unequivocally the best placed or only possible suppliers. Additionally, we think that further attention must be given to the broader corporate reporting ecosystem, including the scope of the audit, and corporate governance.

2. **Timing**: Given the effective date of periods commencing on or after 15 December 2019, we worry that many audited entities will struggle to manage the required changes in an orderly manner, resulting in disruption in the market for both audit and NAS and an increase in unnecessary breaches that would harm confidence in audit. Mid-tier audit firms and Other Entities of Public Interest ("OEOPI") that have previously not needed the systems or knowledge to comply with the proposed prohibitions, will be under particular pressure.

3. **Extension to non-UK parents**: Paragraph 12 of the consultation paper explains that you intend to align the standards with the legislation passed to support the UK's exit from the EU. This should include inserting "UK" before "parent undertaking" in 5.40. If this change is not made, then the current draft would require UK public interest entities to enforce UK specific rules at non UK parent entities, which is impractical if not impossible, especially for parents outside the EU. A UK auditor is likely to have little or no ability to influence the parent entity or their auditor.

4. **Whitelist approach to restricting NAS**: As we wrote to you earlier in the year, we believe that restrictions or prohibitions of services that can be delivered by the auditor should be principles-based. Our concern with a whitelist approach is that it may hold back innovation, because it may not allow elements of the audit of the future to be carried out in advance of new statutory requirements being introduced. In addition, we believe that the proposed whitelist is overly restrictive on broader independent assurance services commissioned to respond to stakeholder needs. There is a danger that without further guidance or amendments a number of assurance services that are in the public interest will be prohibited.

5. **Alignment with other reforms**: The proposed extension of NAS prohibitions to non-UK parents and the application of those prohibitions to a wider group of entities has the potential to cut across other imminent reforms arising from the Kingman, CMA and Brydon reviews. It will force audit committees to have to decide whether to change auditor or NAS provider, which may not allow time for a proper tender, or to give challenger firms time to cope with the increased number of consultations in a short period. The FRC should defer these changes to align both the impact and timing of significant changes it wishes to make with the other reforms.

6. **Reporting accountant work**: The application of the standard to reporting accountant engagements has become much more ambiguous, and therefore subject to potential inconsistencies and misunderstandings. Whilst we understand that it is the FRC's intent that reporting accountants should apply the standard to investment circular reporting engagements in a proportionate way and to allow private reporting, the standard does not currently articulate this and would require further guidance or redrafting to clarify. We have suggested drafting changes to accurately reflect the intention indicated to us by the FRC.

7. **Indirect services**: The drafting should be clear that the whitelist does not apply to indirect services. To avoid market disruption the existing staff guidance note on Restructuring Services to Lending Syndicates should be more clearly incorporated in the updated standard in relation to any type of lending.

8. **Wider consideration of private companies and OEOPI**: The application of different rules to new segments of the market is confusing. At a high level, if an entity works in the public interest, it should be subject to public interest requirements. The development of different categories of public interest entities ("true" Public Interest Entities ("PIEs"), OEOPIs and large private companies) with different requirements creates the danger of loopholes and disproportionate treatment of some entities.

We would be happy to discuss our views with you, if you feel it would be helpful.

Stephen Griggs
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Managing Partner Audit & Assurance and Public Policy

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Appendix 1: Responses to consultation questions

Question 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?

Yes. This change codifies and articulates what we already consider to be commonly understood and applied in the market.

There needs to be acknowledgement that the third party test for audit and Investment Circular Reporting Engagements ("ICREs") is different, given the different nature of these roles and the price sensitive and confidential nature of ICREs. We have suggested changes to paragraph I14 to address this in appendix 2 to this response.

Question 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?

Yes. We agree with the proposed measures. We are not aware of any situations where our firm has disregarded the advice of the Ethics Partner. Accordingly, whilst this may not lead to any actual changes in ethical outcomes, it will improve the perception of ethical outcomes.

Question 3: Will the restructured and simplified Ethical Standard help practitioners understand requirements better and deliver a higher standard of compliance? If not, what further changes are required?

For audit engagements, in general the Standard is clearer, however:

Whilst we support a broad, principles-based approach, there is a need for more clarity in drafting. Investors, audited entities and/or auditors have raised areas with the FRC (most notably through the Technical Advisory Group ("TAG")) as ambiguous or otherwise in danger of inconsistent application. Without the additional guidance provided by the FRC in TAG and other meetings, these may be challenging for audited entities and auditors to implement and apply consistently. Where applicable we have suggested some drafting changes which we hope are helpful in this regard.

Proposed paragraph 2.4 extends the application of the full Ethical Standard for all audited entities to non-network firms whose work is used in the audit. This is likely to be impractical to do, particularly in respect of the personal independence requirements. The IESBA Code is globally understood and followed by the 30 largest networks as part of a commitment to IFAC as well as by many other firms where the IESBA Code has been adopted into local law or standards. The Code provides a high benchmark in many areas; and in the area of Non-Audit Services (the area where UK requirements go significantly beyond the IESBA Code) audited entities tend to impose their own group policy anyway. Requiring compliance with the additional UK requirements to non-network firms whose work is used in the audit increases the risk of such firms, particularly in small jurisdictions, being unable to confirm their compliance, or suffering breaches which will create issues for reliance in the audit. Any such reliance issues will increase the cost of the audit unnecessarily by forcing UK teams to repeat the audit work. For example:

- It would be unrealistic to expect a UK firm to monitor a partner in an Australian non-network firm (caught under the covered person definition as a result of being in a management or governance role (chain of command)) to ensure that a 'relative' who is living with them, but is not an immediate family member, does not hold a financial interest in the audited entity in order to satisfy the persons closely associated definition and the application of clause 2.3D.

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- Requiring a non-UK component auditor that is not a member of the group auditor's network (and, in some cases, not a member of any network with a UK member) to appoint an Ethics Partner who is familiar with the UK Ethical Standard is likely to be hard to achieve. The most significant risk – that of provision of an independence-impairing NAS – will have already been dealt with by asking the UK group audit partner to approve NAS; that UK partner will already consult with their own firm's UK-based Ethics Partner in cases of difficulty.

We don't think it was your intention, however paragraph 2.4 can now be read as applying the UK Ethical Standard to all network firms who are not used in the conduct of the audit. In order to correct this please reinstate the clarifying language in the second bullet point of the current paragraph 2.4.

The same is true for the application of the NAS restrictions for Public Interest Entities ("PIEs") and Other Entities of Public Interest ("OEOPIs") to non-UK parents of UK audited entities, if the amendment referred to in point 3 of our cover letter is not implemented[1] – for example, it is hard for a UK entity to tell its non-UK parent who they can and cannot buy NAS from. We believe that requirements imposed on parents that go beyond the IESBA Code should be restricted to UK parents only (EEA parents whilst EU law still applies). We agree that certain prohibitions which only applied to EEA subsidiaries of UK public interest entities should be extended worldwide; in practice most audit committees have already done this and firms were declining work, but there was a (wrong) perception that auditors were seeking to do as much work as possible for non-EEA subsidiaries. Extending the ban will, in most cases, reflect reality.

With the movement of the legal blacklist of NAS for PIEs to an appendix, both the blacklist and the cooling in period application no longer appear in the body of the standard. The cooling in requirements (whether or not extended to internal audit services as proposed – see our response to question 5) are hard to find and reconcile to the whitelist. Whilst it is clear that they apply to an auditor seeking appointment for the first time of an existing PIE, it is unclear what happens if an auditor of an entity that has just become a public interest entity provided a service in a prior year when the entity was not a public interest entity can continue to serve. We suggest that the cooling in restrictions be moved into the body of the standard below paragraph 5.44 and clarified to provide clear direction. This could be done with a new paragraph above the proposed Section 5C heading saying "The restrictions above only allow permitted services to be provided during the period set out in paragraph 2.1 of Section A of this standard. In addition, the services set out in subparagraphs (e) and (h) of the second sub-paragraph of Appendix B are subject to 'cooling in' restrictions and may not be provided in the financial year (or period if longer than one year) immediately preceding the period set out in paragraph 2.1 of Section A."

For ICREs and other public interest assurance engagements ("PIAEs") significant concerns remain due to the current drafting:

In the absence of changes to the drafting, guidance is needed on how the provisions apply for the Firm conducting ICREs, particularly with the new universal bans on internal audit, secondment, accounting services and contingent fees. Currently as drafted it could be read that any such services would preclude firms from acting on an ICRE even when there is no link to the covered persons or the subject matter of the ICRE (including where the service has recently completed) – for example where a tax service has been provided to one division of a company and an entirely separate division is to be demerged and listed separately. This would have a significant adverse impact on choice of ICRE providers for non-audit clients. As we do not believe this is the intent of the FRC we have suggested changes to paragraph I8 to address this in Appendix 2.

There remain 26 references to "other public interest engagements" throughout the standard which appear to extend the requirements of the firm beyond the principle-based boundary of covered persons and subject

[1] You have indicated that you are intending to amend 5.40 by inserting "UK" before "parent undertaking".

matter. We suggest the removal of such references, given the FRC's blanket reference to application of these in the introduction – we think it is clear that the auditor carrying out an interim review or CASS audit must apply restrictions applicable to "auditors" and an "audit firm" already.

Due to the current drafting, the independence assessment of the investment banks, underwriters and lead managers involved in the transaction is now unclear. Previous clarifying statements that relationships with sponsors and lead managers in the ordinary course of business would not normally give rise to a significant threat have been deleted. Therefore the current drafting might imply that such entities, acting in the ordinary course of business, may need to be fully independent under the Ethical Standard where they rely on the work of an auditor. This will adversely affect choice and the smooth running of the capital markets process if the company has to avoid using any investment bank that their reporting accountant firm is auditor to, or conversely has to select a reporting accountant who is not auditor to their sponsor. Whilst we do not believe this is the FRC's intent it would require further guidance or redrafting to clarify. Previously paragraphs 1.39 to 1.44 and 1.67 relating to ICREs provided useful clarification. These should be reintroduced as an appendix to assist practitioners. Particular challenges may arise where an entity chooses to appoint an additional sponsor or underwriter part way through a transaction; it would be unhelpful if this made a reporting accountant who had already started work ineligible.

Question 4: Do you agree with the introduction of a permitted list of services which the auditors of PIE audits can provide?

The current drafting of the whitelist poses significant questions of interpretation and may hold back innovation, because it may not allow elements of the audit of the future to be carried out in advance of new statutory requirements being introduced.

The current list appears in some parts overly prescriptive and in others could be left open to quite significant differences in interpretation. In order to provide a more consistent outcome, an alternative, broader and principles based definition that results in the auditor maintaining independence and objectivity, and where the services themselves have a regulatory or public interest benefit should be put in place. We suggest such changes to 5.39 and 5.40 in Appendix 2.

We understand from the FRC that, in order to avoid disruption to the capital markets, reporting accountant work (including private reporting) is to remain permissible, however the current drafting implies not only that some such services are not permissible but also that different parts of reporting accountant work are/are not subject to the fee cap. If elements of private reporting are subject to the fee cap this could disadvantage challenger firms by encouraging their audit clients to engage the Big 4 firms for 'restricted' reporting accountant work. Should the cap cause an indirect prohibition of reporting accountant work this would damage the UK capital market by indirectly requiring companies to appoint multiple reporting accountants for the same transaction, delaying appointment and increasing the complexity of execution. There are significant advantages to companies listing in the UK to be able to use their auditors for all work associated with the listing which is independent in nature (assurance reporting, comfort letters and related long-form reporting).

Other services that appear, due to the current drafting, to be prohibited include: Agreed Upon Procedures ("AUP") engagements (as they are not required by law and regulation), Independent Business Reviews, due diligence ("DD"), and other (often industry specific) assurance engagements such as service auditor reporting, joint venture cost audits and circulation audits.

- Much of the regulatory reporting to Ofgem in the energy and utilities sector is performed on an AUP basis (regulatory accounts, adequacy of financial resources, no cross subsidy, etc.). The current ambiguity in drafting would create permitted AUPs, non-permitted AUPs and a grey area in between, increasing the potential for differences in interpretation and application.

- If service auditor reporting work and similar assurance engagements are prohibited from being provided by the external auditor (and potential replacement external auditors), this seriously reduces choice in the market, for services that require a level of independence that the statutory auditor already has. These assurance reports are increasingly critical for company financial reporting and control as companies move to cloud-based financial systems. This issue is further exacerbated where there are subservice organisations – you could end up with a situation where all the external auditors of the service organization and subservice organisations were prohibited from providing this service. This could result in systems and services fundamental to the economy being "audited" by much smaller providers without the technical capabilities, skills or resources for large, complex engagements.
- In our suggested drafting changes to 5.40 we are therefore proposing to include in the whitelist table assurance engagements that are delivered under an international standard for assurance services issued by the IAASB (or equivalent national standard issued by, inter alia, ICAEW, AICPA), e.g. ISAE 3000, ISAE 3402, SSAE 18, AAF 01/06.
- The whitelist prohibits services previously considered to be audit related services, such as advising on the application of accounting standards. We acknowledge the potential for self-review in giving such advice. However, it should be clear that this would not prevent an auditor providing an opinion as to whether an accounting treatment proposed by the audited entity is appropriate. This position would align with that adopted by the SEC and PCAOB. It is in the public interest that an entity correctly apply accounting standards to reflect a true and fair view. For smaller entities that are neither PIEs nor OEOPIs enabling appropriate support is particularly important, as acknowledged by the FRC's own work on reporting by smaller quoted entities, provided always that appropriate safeguards are considered.

The reason it is normal practice for companies to engage their auditor to provide these services is that the auditor is already familiar with the financial reporting processes, systems and controls, will have access to board minutes and management accounts as well as other key documents, which would not usually be available to underwriting banks, regulators, joint ventures or other third parties. Many of the procedures required to undertake such engagements overlap significantly with external audit work. The primary (and in most cases, only) purpose of such engagements is to provide independent assurance of comfort and these services do not involve any management role or advocacy on behalf of the audited entity.

If the whitelist is not amended, and the interpretation above stands, there will be an impact on quality, the costs incurred by audited entities, confidentiality, and timing, with a resultant effect on the competiveness of the UK corporate environment.

Prohibiting other assurance also has the potential to drive unintended negative behaviour by leading companies to opt out of having such assurance work performed, even when they would otherwise be willing to have it undertaken. This would not be in the public interest, particularly in an environment that is seeking additional forms of assurance to augment historic financial reporting.

In terms of the other reforms that are currently being considered by the government, the whitelist as currently drafted will likely impede innovation in audit and potentially pre-empt the results of the Brydon review. Under the proposed drafting items such as assurance on CSR reporting in the annual report is permitted for the auditor, but where a company produces a separate CSR report it would be prohibited, which seems illogical. For many companies it's not an either/or (within the annual report or a separate report). Many companies report Key Performance Indicators in the annual report and a wider set of metrics in a separate report, so this could easily lead to duplication of assurance effort or, if a further provider appointed for both, a disconnect from the rest of the annual report which could reduce the robustness of the assurance over the separate report.

In order to allow for the evolution of corporate reporting and to encourage best practice the FRC must allow assurance on more than the annual report alone.

Whilst we are aware that the FRC has indicated it is not their intent to prohibit AUP engagements, Independent Business Reviews, DD, and other assurance engagements, either further guidance or amendments to the current drafting will need to be made to reflect this intent. We have suggested such amendments to 5.40 in the appendix 2 to this response.

Question 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?

Within the consultation document the FRC proposes the extension of NAS prohibitions to OEOPIs and poses the question of which (other) entities should also be subject to those requirements. We will refer to the second group as "Other Private" entities. Overall, we support a single, stable, proportionate and clear PIE definition that does not deter firms from the market and aligns with other reforms in terms of timing and substance. For example, if the FRC chooses to extend ethical requirements on the grounds of public interest, we believe that the FRC should also extend PIE auditing standard requirements to the same entities and that this is more likely to contribute to audit quality and therefore to the quality of corporate reporting.

Will extension of NAS prohibitions alone improve audit quality?

Recent disciplinary cases have not posed an actual threat to independence as a result of the provision of a NAS that complied with the current regulations. This extension appears to be in response to the perceived threat rather than an actual threat.

We believe a bigger improvement in the quality of and confidence in corporate reporting by OEOPIs would be achieved by extending some of the public interest entity requirements of auditing standards (e.g. the provision of an enhanced auditor's report under ISA (UK) 701 and, we understand, some of the provisions of ISA (UK) 570 relating to going concern) to OEOPIs rather by extending the NAS prohibitions. Such a proposal would be best done in a co-ordinated set of changes to corporate reporting requirements, auditor oversight, auditing standards, corporate governance and ethical standards, rather than by making piecemeal changes in quick succession. The burden of such piecemeal changes will fall disproportionately on smaller audit firms, harming competition and choice. Doing this in a co-ordinated approach would also give Those Charged With Governance ("TCWG") of OEOPIs sufficient time to carry out orderly tenders for audits and/or NAS.

Definition of OEOPI

If the NAS prohibitions (or, as we suggest, other changes to the corporate reporting, corporate governance and audit ecosystem) are to be made then it will be important that TCWG of audited entities, their auditors and their wider stakeholders have sufficient certainty as to whether or not an entity will be an OEOPI for the forthcoming year – recognising that auditors may need to cease NAS by the start of the financial year being audited which will require some months' notice for an orderly transition.

As drafted, the FRC refers to entities within the scope of the AQR, rather than entities within the FRC's published "Scope of Inspection". These two differ as the former includes entities incorporated in the crown dependencies admitted to trading on an EEA regulated market and major local public audits, as well as any specific audits "reclaimed" by the FRC from the relevant recognised supervisory body – and may do so after the start of the financial year being audited. The FRC has also historically only published their "scope of inspection" two or three months prior to the commencement of the audit inspection periods they cover.

Accordingly:

- We suggest that a clear definition of OEOPIs is included in the Glossary of Terms (Auditing and Ethics), with future changes subject to public consultation including an impact assessment, with changes made with sufficient notice to allow audit committees and their equivalents to change auditors or non-audit providers before the start of the audit year.
- In order to avoid a delay to the first set of changes, large AIM companies, Lloyd's Syndicates and potentially Crown Dependency entities listed on the main market together with major local public audits could be included now, but with a suitable transitional period to allow TCWG to take the necessary actions.
- Any definition of large AIM and NEX traded entities should use the existing size limits for SME listed entities in the Glossary, which use a three year rolling average and therefore should enable TCWG to anticipate becoming an OEOPI.
- Paragraph 1.27 of the standard should be amended to apply to OEOPIs as well as PIEs.

Other Private entities

Private companies should be able to procure services without undue regulatory interference. In the current macro-economic environment, the UK needs to encourage a dynamic and entrepreneurial economy, free from unnecessary regulatory interference. Extension of NAS bans, along with internal audit cooling in restrictions, contingent fee restrictions and secondment prohibitions inhibit this.

The imposition of NAS prohibitions on Other Private entities could have a disproportionate effect on mid-tier audit firms. Many Other Private entities are audited by mid-tier audit firms, however both these types of company and these audit firms have not previously been subject to such restrictions. Many entities (and potentially their auditors) will not have the knowledge and systems to be able to deal with the proposed regulation if it is extended, particularly to comply with the proposed 15 December 2019 implementation date.

As with OEOPIs, we believe that the most significant action the FRC could take to improve actual and perceived audit quality would be instead to extend the relevant audit standards (e.g. mandating an EQCR review by a partner and potentially the transparency offered by an enhanced auditor's report under ISA (UK) 701).

If, nevertheless, the FRC does decide to implement this decision, we believe it should be the FRC's aim to set any limit for NAS restrictions for privately-owned companies at a similar size to their proposal for OEOPIs. Although market-capitalisation is not going to be readily available for a privately owned company, we suggest a suitable size limit might be those which have more than 10,000 UK employees (whether in public or private ownership) – this being the limit applied to determine a large private company in the BHS tribunal case. This should be subject to a rolling three year average similar to the SME listed definition to avoid companies regularly changing status into or out of this category every year.

We believe that setting a lower limit would have a disproportionate impact, particularly for international groups. It may also encourage smaller audit firms (many of whom may be smaller than the current challenger firms) with a small number of clients caught by a lower limit to exit that part of the market, reducing choice in the audit market at a time when reforms are focused on increasing it.

Extension of the internal audit cooling in restrictions

We acknowledge that internal audit work and advice can carry a greater risk of breaching the design and implementation cooling in restriction. However, as currently drafted, the far wider ban of all services "related to the internal audit function" without considerations of materiality will impact choice in the audit market if

implemented as a cooling in restriction. This is because firms will be precluded from the external audit even for incidental non-financial internal audit related advice that does not constitute design or implementation.

Joint audits, if and when implemented, will make choice even more limited when considered in conjunction with this internal audit cooling in prohibition. It has the potential to rule up to four firms offside (the two current joint external auditors, the current internal auditor, the current tax services provider will all be offside in an in-year audit tender situation, leaving the entity with very little choice).

We propose that, similar to the SEC, the FRC should have powers to ratify the appointment of an auditor in "hardship cases" where all firms with the required level of skill and expertise are conflicted albeit in an inconsequential way. Alternatively, the FRC could provide application material that clarifies when internal audit services do/do not constitute design and implementation (and therefore prohibited in the prior year) rather than instituting a full cooling in ban for any internal audit function related work. If the cooling in amendment is to be retained it should be included in the body of the standard and drafted in a concise manner to ensure consistent application of the restriction.

If this restriction is implemented we think greater guidance should be given to Audit Committees and TCWG about the need to tender audits in the region of two years in advance (if they do not want to limit their choices) and the inability to change auditor during the year of audit.

We are already seeing the difficulties faced by companies in the current market where a company needs to change auditor in a short timeframe and these changes will further exacerbate those challenges.

New prohibitions applicable to all entities

Within the draft Ethical Standard several prohibitions have been extended for all audited entities, regardless of level of public interest or size.

Whilst we support some of these, the extension of the contingent fee prohibition from tax NAS to all NAS for all audited entities is particularly wide and will cause some difficulties for entities wishing to procure services, in particular in the corporate finance market. Entities (including medium-sized entities as defined in the Companies Act 2006) use a contingent fee basis primarily to mitigate their "downside" risk of incurring significant costs on transactions or projects that do not complete. It provides entities with much needed flexibility and it is market practice for corporate finance firms to operate in this way. To impose a restriction on only certain players in that market will skew competition and also limit choice by creating an inadvertent ban on entities using the corporate finance team in their auditor's firm for these services, which could be confidential and urgently needed by the company. We would also suggest that the discussion in 4.18 of the existing Ethical Standard which clarifies that risk-related variations do not constitute contingent fees be re-instated to help practitioners.

Question 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)?

Yes. We believe that most of the firms in the market are members of networks that are in the Forum of Firms, and therefore cannot take advantage of the reliefs anyway. Therefore they could give the perception of a softer regime than is actually the case, harming confidence in audit.

In order to assist smaller entities in the market, if the contingent fee ban is implemented then it should be dis-applied in section 6. This will allow smaller entities to remain flexible and protect themselves from downside risk with the firms they engage. This will provide proportionate regulation for those smaller firms that take

advantage of section 6 when auditing the smallest entities with little public interest, without creating a perception threat for firms such as ours which never use section 6.

Question 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?

This is largely irrelevant, given the whitelist. However, in relation to the blacklist, for indirect services that might be provided in a transactional or confidential scenario to non-audit clients, some form of derogation would assist the smooth running of the capital markets but only where the audited entity is a lender, or other interested party in the transaction and is not the subject of the engagement. To this end we suggest the following wording be included in appendix B:

"Tax and valuation services in points (a) and (f) are prohibited unless they are indirectly provided to an audited entity that is a lender (whether alone or as a syndicate member) and where the subject of the engagement is not audited by the firm (nor a member of the firm's network)."

Question 8: Do you agree with the changes we have made to Audit Regulation and Directive references within the ISAs (UK)?

While we agree with the approach of the FRC to incorporate these requirements directly into the ISAs (UK), we recommend the FRC revisits the drafting conventions used. In the previous version of the ISAs (UK), the FRC repeated in full the requirements from the EU Audit Regulation even where those requirements were similar to an existing ISA requirement. We recommend that the relevant paragraphs are revised to highlight only the incremental requirements rather than repeating the full text derived from the EU Audit Regulation. For example, paragraph 13-1 of ISA (UK) 701 does not need to require the auditor to provide a summary of the auditor's response, as that is already covered by paragraph 13(b) and similarly the requirement related to referencing to the relevant disclosures is already covered in paragraph 13.

In several places, the proposed standards refer to the EU Exit Regulations (SI 2019/177). Such references should be to the original EU Audit Regulation as retained in UK law (and, if the UK has left the EU without a deal, as amended by the EU Exit Regulations) rather than the EU Exit Regulations themselves which only contain changes to be made to the retained requirement in the event of a no-deal exit. These include ISQC (UK) 1.27-2 and footnote 5c to ISA (UK) 510.A7-1.

Question 9: Do you agree with the inclusion of FRC staff guidance within the application material, and has this improved clarity of the requirements?

Yes. We agree that the inclusion of this material improves clarity and will make application easier, particularly for firms with less extensive technical resources. However, we note that not all of the material that will remain relevant after taking account of the FRC's proposed changes to the underlying standards has been retained from the related Staff Guidance Notes ("SGN"s) and the Rolling Record.

Ethical Standard

We suggest that the following additional material be included:

- The helpful clarification that the three month transition for acquisitions in 1.27 of the existing standard could also be applied to entities which become PIEs.

- The guidance as to when the 70% NAS fee cap applies in footnote 36 only refers to changes in auditors; it should also cover the more common situation covered by the Rolling Record where an entity becomes a PIE for the first time.
- The current reference to the syndicates SGN (01/18) does not appear to be relevant where it is placed in the context of loan covenant certification and could cause confusion unless further guidance or drafting amendments are made. We have suggested drafting changes to 5.40 in appendix 2 to this response.
- A cross reference to SGN 01/17 should be added in appendix b to point (i) of the blacklist.

ISAs (UK)

- The detailed guidance on determination of material subsidiaries in SGN 01/17 would be helpful in driving consistent application.
- Other SGNs should be withdrawn or updated to remove material added to the ISAs. If the SGNs are to be retained, then the relevant ISAs (UK) should refer to them in a footnote to make clear that further guidance was available.

Question 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.

No. In relation to the proposed changes to ISA (UK) 700, we do not consider it appropriate to extend to all audits the requirement for auditors to report on the extent to which their audits are capable of detecting irregularities, including fraud. This is also more likely to widen the expectation gap for entities where the auditor is not required to report on key audit maters, as the audit report will disproportionately focus on the work related to irregularities without any context to the significant areas on which the audit was focused or the materiality used in the audit. We believe that this change would also unnecessarily lengthen the audit report and introduce more boilerplate.

We recommend instead that this requirement be extended to all entities within scope of ISA (UK) 701 that are already required to report on key audit matters – i.e. extending the requirement out from public interest entities to other listed entities and any other entities that choose or are required (e.g. certain public sector entities) to have an enhanced auditors' report.

We note that some of the changes the FRC has proposed to ISA (UK) 250A involve renumbering paragraphs from the standard as issued by the IAASB. As we noted in our response to the consultation on ISA (UK) 570, we disagree with this approach. Instead of renumbering paragraphs, such as A18 to A11-1, the FRC's aims could be achieved more simply by referencing the original IAASB paragraph number against the additional requirements for which it is relevant.

Question 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?

Yes. As explained in our response to question 8 above, these could helpfully be simplified to include only UK material that goes beyond the IAASB's requirements.

Question 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?

Yes. We believe it is helpful to incorporate the material on the expectations of the auditor's work effort and add the material that was previously only included in the FRC's thematic review on other information.

We note that paragraph A53-2 suggests that the auditor's responsibilities in relation to other information can be referenced to a website. Given that this is a key area where the auditor's responsibilities are currently misunderstood, we do not believe it helpful to move this outside the main audit report.

We also recommend that the FRC revisits the requirements on matters to report on by exception. The wording for this area of the audit report can get quite confusing and involve double negatives such as "We have nothing to report in respect of the following matters in relation to which the Companies Act 2006 requires us to report to you if… adequate accounting records have not been kept". We believe if would be more helpful to users of the financial statements if the requirements could be revised so that the auditor could report in a more positive and understandable manner; we believe such a change could be made in the ISAs (UK) (as the Act itself only tells you how to report if you have an issue and does not require any reporting if you do not). If the FRC disagrees and thinks that legislation is required, this should be discussed with BEIS as the Kingman, Brydon and CMA changes are implemented.

Question 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?

Yes, in respect of the changes to ISAs (UK) and ISQC (UK) 1. No, in respect of the Ethical Standard, where we believe it would be more appropriate to apply the changes for periods commencing on or after 15 March 2020, potentially with a transitional provision to avoid retrospective application.

In respect of Ethical Standard changes:

For a December year-end company, the FRC's proposed effective date means ceasing newly prohibited services by 1 January 2020. This will present some acute practical challenges especially for TCWG of entities that will be newly caught by the standard (as drafted) and were not given prior notice: these entities include OEOPI, parent companies outside of the UK and non-network firms. This will be exacerbated by any further extensions or changes made through the consultation process, but only finalised either late in the process or at its end. Examples of the issues faced are:

- The apparent retrospective application of the extending cooling in requirements to 1 January 2019. This is a practical issue for both live audit tenders and some that concluded earlier in 2018 or 2019 but where appointment does not take effect until 2020. Whilst we understand it is not the intention of the FRC to introduce retrospective regulation, the current drafting does not make clear how the new cooling in restrictions might/might not apply to current or recent tenders.
- TCWG and Audit Committees of OEOPI will need time to understand the restrictions and transition in an orderly manner from one supplier to another. In some cases this needs to allow for a tender process to be conducted (e.g. for internal audit or tax work).
- The lack of clarity over the definition of OEOPI and when firms may transition into or out of this category, as discussed in question 5 will cause TCWG concern as to which set of rules they might need to follow in a short period of time.

The lack of transition period or the forced implementation date of 15 December 2019 is not in the public interest, would undermine confidence in audit and will create:

- Unnecessary breaches. Breaches undermine confidence in the audit, which is not in the public interest. We believe the lack of transition period will cause the following types of unnecessary breaches:
    - Those caused by a lack of time for an orderly transition between suppliers (which may include the need for a tender process)
    - Those caused by the extension of rules to parents, which was previously not suggested and to non-networks who may not have the correct time, knowledge or systems to comply
    - Those caused by the extension of the rules to the new category of OEOPI which were not previously covered by prohibitions, which will require time for TCWG to understand and apply the restrictions in their procurement process
- The reopening of tenders. These may or may not be able to be concluded prior to the period the entity requires to be audited, potentially delaying auditor rotation, potentially causing breaches of the CMA rotation requirement

The implementation date of this Ethical Standard should be moved to periods commencing on or after 15 March 2020 (aligned to the three month transition allowed for transactions) and/or a transition period included in paragraph 1.70 to allow for the acceptance of first year audits under the current standard and the completion of any previously commenced work (including the collection of fees and internal audit work completed before the end of the preceding financial year) as at the effective date.

A suitable transitional provision could be as follows:

"*Transitional provisions*

- Paragraphs 5.40, 5.40B and 5.40C shall not apply to Other Entities Of Public Interest [and, if included, large private companies] for financial years commencing prior to 15 March 2021;
- In respect of Appendix B, the cooling in requirement in paragraph (b) of the first sub-paragraph shall not apply to services listed in paragraph (h) of the second sub-paragraph not already prohibited by paragraph (e) of the second sub-paragraph or otherwise prohibited by the previous Ethical Standard provided during financial years commencing prior to 15 March 2020;
- Paragraph 4.5 shall not prevent billing and collection of contingent fees in a financial year commencing on or after 15 March 2020 provided that the factor(s) affecting the amount of that contingent fee have been determined prior to the first financial year commencing on or after 15 March 2020 provided that such services were not prohibited under the previous Ethical Standard.

In each case the auditor should consider the need for additional safeguards and, if such safeguards are necessary, implement them."

In respect of the auditing standards changes:

We agree that these changes should be aligned with the date the changes to ISA (UK) 570 are applicable.

Appendix 2 – Suggested drafting changes to specific paragraphs in the Revised Ethical Standard 2019

In this appendix we suggest some redrafting of the Ethical Standard which we believe more clearly reflects the FRC's stated intentions. In this appendix (and the next) underlined text is a suggested addition and struck out text a suggested deletion.

Investment Circular Reporting Engagements
Application

I8 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 ("Investment Circular Reporting Engagements"). The application of this Ethical Standard in those *engagements* reflects the particular nature of the work to be undertaken. Because investment circulars may relate to transactions that are price sensitive and therefore confidential, the fact that a *firm* has been engaged to undertake an *investment circular reporting engagement* is likely to be known by only a limited number of individuals within the *firm* and will cover a specific transaction, *subject matter* and *subject matter information* that is described in the *engagement letter*. For this reason, for such engagements, the supporting ethical provisions and requirements of this Ethical Standard apply only to:

(a) persons with actual knowledge of the engagement as described in the definition of *covered persons* applicable to an *investment circular reporting engagement*; and

(b) where required by this Ethical Standard in relation to policies, procedures, quality control, monitoring systems, and effective organisational arrangements, the *firm*; and

(c) the specific transaction, subject matter and subject matter information of such an engagement.

The provisions in I8-1 to I8-5 and the rest of this Ethical Standard are applied in this context.

Our suggestion clarifies the way in which restrictions should be applied to the firm and the team/subject matter. It avoids the situation where, for example, the unamended (b) would apply the contingent fee ban in respect of a tax engagement for a private company entirely unrelated to the transaction that is the subject of the reporting accountant engagement, which may indeed have already crystallised so that there is no longer any contingency.

I14 Consideration of whether the ethical outcomes required by the overarching principles and supporting ethical provisions have been met should be evaluated by reference to the perspective of an objective, reasonable and informed third party (see the definition of *independence*). Such a person is informed about the respective roles and responsibilities of an auditor or *reporting accountant* (as the case may be), those charged with governance and management of an entity, and is not another practitioner. The perspective offered by an informed investor, shareholder or other public interest stakeholder[5] best supports an effective evaluation required by the third-party test, with diversity of thought being an important consideration. The assessment that a firm makes when applying the third-party test, is:

- principles-based, covering both the spirit and the letter of the requirements in this Ethical Standard;

> - carried out using both qualitative and quantitative factors, and includes issues arising on an engagement or issue specific basis, and in the context of wider publicly available information that an informed person would be aware of and would bring to bear on their assessment – it is based on the information available at the time, and not hindsight;
> - an overarching assessment of risks that the third party might consider would have an impact on the audit firm's independence and not a narrow or formulaic assessment. In relation to an audit, such an assessment might include the factors shareholders use when assessing the independence of an auditor proposed for appointment; and
> - alive to the risk that arrangements, policies or procedures implemented by a *firm* to address any threat to independence may be construed as a way to circumvent the overarching principles and supporting ethical provisions of this Ethical Standard.
>
> In making such an assessment, the cumulative impact of a series of ethical issues, which taken together would lead the third party to have concerns about a *firm* are also considered.

We suggest that footnote 5 should be deleted because it could otherwise require auditors and reporting accountants to consider all of the factors in s172 Companies Act 2006. This is, in part, because s172 does not directly apply to the duty to prepare the financial statements or circular that are the subject of the engagement. Otherwise, for example, an auditor or reporting accountant might be required to consider the risk of job losses if a transaction goes ahead as a reason to refuse to carry out a non-audit service. We do not believe this is what the FRC intended.

Our other suggested changes deal with the application of the objective, reasonable informed thirty party test to ICREs because the third party needs to be informed as to the role of the reporting accountant which is different to that of an auditor – and because shareholders do not appoint reporting accountants.

> 1.21 Whenever a possible or actual breach of this Ethical Standard, or of policies and procedures established pursuant to the overarching principles and supporting ethical provisions and requirements established in it, is identified, the engagement partner, in the first instance, and the Ethics Partner, where appropriate, shall assess the implications of the breach, determine whether there are safeguards that can be put in place or other actions that can be taken to address any potential adverse consequences and considers whether there is a need to resign or withdraw from the engagement. The firm shall report all breaches of this Ethical Standard to the Competent Authority on a quarterly basis and to those charged with governance of an entity relevant to an engagement, where a breach relates to a specific engagement or engagements in a timely manner.

To clarify the reporting requirements

5.9 There may be circumstances where the *firm* is engaged to provide a *non-audit / additional service* and where that service and its scope are determined by an entity which is not audited or relevant to an other *public interest assurance engagement* by the *firm*. However, an *entity relevant to an engagement*, whilst not receiving the non-audit / additional service may gain some benefit from that *non-audit / additional service*[43]. In some circumstances, there may be no threat to the integrity, objectivity and independence of the *firm* and *covered persons* at the time the audited entity gains that benefit ~~of appointment~~. However, the *firm* considers how the *non-audit / additional service* may be expected to develop, whether there are any threats that the *firm* may be subject to if additional relevant parties which are *entities relevant to an engagement*, are identified, and whether any safeguards need to be put in place.

Given the interaction with para 5.40, it needs to be clarified that where audited entities benefit from the deliverables prepared under the instruction of a non-audit client, such benefit does not constitute the delivery of services. In relation to the vendor due diligence scenario set out in footnote 43, it is often the case that purchasers require updated or further due diligence work in addition to that already prepared. For this reason to avoid the position where the purchaser is obliged to bring in a new firm if their audit firm happen to be the VDD provider, an amendment is needed to para 5.40.

Evaluation of Specific Non-audit Services and Additional Services

5.39 There are services other than 'audit related services' (see paragraphs 5.35 – 5.38) for which the auditor of the entity is an appropriate provider, particularly where those services are required by UK law or regulation. However, the threats to independence arising from such services are not necessarily clearly insignificant and the *firm* considers whether such services give rise to threats to independence and, where appropriate, the need to apply safeguards. Such services include:

•a) Reports, that are not 'audit related services', required by the 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 an appropriate choice for service provider.

•b) ~~Audit and other s~~ Services provided as auditor of an 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. These might include, for example:

(i) audit and other services relating to public reporting as reporting accountant on financial or other information of the audited entity in an *investment circular* ~~a prospectus or circular (including reports that may be required by the Prospectus Rules, the Listing Rules and the Take Over Code)~~;

(ii) services, including private reporting, that are customarily performed by the reporting accountant or auditor of the entity to support statements and disclosures made in an *investment circular* by the audited entity or the directors, ~~disclosures in a prospectus or circular or, in the case of premium listed issuers~~ to support confirmations provided by the sponsor or nominated adviser ~~to the FCA~~;

~~iii~~c) Other audit and other assurance services relating to public reporting on other information issued by the entity, such as reports on information in the front of annual reports not covered by the auditor's report on the financial statements.

The above list is not intended to be fully comprehensive and does not preclude other services being provided. ~~Such services provided to public interest entities, other than those required by UK law or regulation, are still subject to the 70% cap (see paragraphs 4.15 and 4.16 of Part B of this Ethical Standard) and still require approval by the audit committee.~~

We think that:

- our proposed drafting of (b) is clearer as all ICREs are done in accordance with the SIRs;
- (c) more accurately reflects the idea that auditors can provide independent assurance (e.g. on a separate sustainability report as well as on sustainability KPIs in the front half of an annual report); and
- moves the material relating to PIEs to 5.40 – see below.

SECTION 5B - Approach to Non-audit / Additional Services Provided to Public Interest Entities and Other Entities of Public Interest

Permitted Non-audit / Additional Services for Public Interest Entities and Other Entities of Public Interest

5.40 **An *audit firm* carrying out the *statutory audit~~s~~* of a *public interest entit~~ies~~y or Other Entity of Public Interest* and, where the *audit firm* belongs to a network, any member of such network, shall not provide to the *audited entity*, to its UK parent undertaking or to its controlled undertakings, services other than those set out in ~~the rest of this paragraph~~ paragraphs 5.40A and 5.40B, 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];**
- **in the case of services in paragraph 5.40B provided to a public interest entity, its UK parent undertaking or to its controlled undertakings, the 70% cap (see paragraphs 4.15 and 4.16 of Part B of this Ethical Standard).~~:~~**

Our suggested changes:

- split the list into two separate paragraphs, 5.40A and 5.40B, to aid cross-referencing;
- avoid the risk that the original drafting could be read as meaning the whitelist applied to all audited entities (PIEs and non-PIEs) audited by the firm if the firm audits any PIEs at all – the whitelist should just apply to the PIE or OEOPI and related undertakings;
- add OEOPIs in to the whitelist, allowing the removal of 5.42;
- clarify that the upward scope of the restrictions should be to a UK parent of a PIE or OEOPI, rather than to worldwide parents – aligning the requirement with Article 5 of the retained EU Audit Regulation as amended by SI 2019/177. If the UK has left the EU with a deal, or has not left, this should for the time being say "EEA parent" rather than "UK parent";
- extend the requirement for audit committee (or equivalent) approval to OEOPIs; and
- move the material from the end of the draft 5.39 here. Audit committee approval was already covered in 5.40, so only the 70% cap needs to be mentioned.

5.40A Services ~~permitted by UK law or regulation and~~ exempt from the public interest entity non-audit services cap

- Reporting required by a competent authority or regulator under ~~UK~~ law or regulation for example;
  - Reporting to a regulator on client assets;
  - in relation to entities regulated under the Financial Services and Markets Act 2000 (FSMA), reports under s166 and s340 of FSMA;
  - Reporting to a regulator on regulatory financial statements or other forms of non-financial regulatory return;
  - Reporting on a Solvency and Financial Condition Report under Solvency II.
- ~~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 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;
- 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 an appropriate choice for service provider;
- Audit and other services provided as auditor of the entity, or as *reporting accountant*, as set out in 5.39(a) and (b) of this Ethical Standard ~~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~~;
- Services which support the entity in fulfilling a legal or regulatory ~~an~~ obligation ~~required by UK law~~ where:
  - § ~~the provision of such services is time critical~~, the transaction, subject matter and subject matter information of the engagement is time or price sensitive; or
  - § ~~and 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.

Our drafting suggestions:

- delete the reference in the title to services required by overseas laws and regulations, which also allows removal of the second bullet point. This change is needed as the original draft could preclude

certain services where an overseas regulator has jurisdiction over a UK incorporated entity audited by a UK firm – for example a UK entity that is an SEC registrant or SEC registered broker/dealer. We believe this is preferable to adding a new bullet point saying "In the case of a UK incorporated entity, services reporting required by law or regulation in a third country where the auditor is required to undertake that engagement, subject to the prohibition in Regulation 5 of the EU Audit Regulation (as modified by SI 2019/177).";

- simplify the drafting in relation to reporting accountant services if our drafting suggestions for 5.39 are accepted;
- allow for situations where foreign law may require reporting on a UK entity in connection with time-critical price sensitive matter (e.g. a report required by an overseas regulator in connection with the acquisition of a UK target company); and
- simplify the drafting relating to time and price-sensitive matters, removing the reference to the objective, reasonable and informed third party test as that applies in any case to all of these services.

5.40B Services subject to the public interest entity non-audit services cap

- Reviews of interim financial information; and providing verification of interim profits;
- 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;
- Additional independent assurance or agreed-upon procedures work authorised by those charged with governance performed on material included within the annual report of *an entity relevant to the engagement* in accordance with a standard issued by the FRC, an international standard for assurance or attest services issued by the IAASB (or equivalent national standard);
- Reporting on government grants;
- Reporting on covenant or loan performance agreements, which require independent verification, including reporting to third parties such as lending syndicates with whom the *entity relevant to an engagement* has a business relationship,
- Restructuring Services provided to a lender or syndicate of lenders as defined in accordance with Staff Guidance Note 01/2018[50] ;
- Provision of an opinion on a paper prepared by management on the implementation of current and proposed accounting standards. The auditor, nor any member of its network, may prepare such a paper on behalf of the audited entity;
- Due diligence services, where not covered by the provisions of 5.40(A).
- Services which have been the subject of an application to the Competent Authority in accordance with Regulation 79 of The Statutory Auditors and Third Country Auditors (Amendment) (EU Exit) Regulations 2019 (SI 2019/177).

Where such services are provided, they shall not include any elements of those services subject to outright prohibition in Appendix B Regulation 80 of The Statutory Auditors and Third Country Auditors (Amendment) (EU Exit) Regulations 2019 (SI 2019/177)[51]. No other non-audit or additional services shall be provided to the *audited entity*, its

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parent undertaking and its controlled undertakings by the *audit firm* or any member of the firm's network.

Our suggestions:

- delete verification of interim profits from the capped list as this is a requirement of the FCA or PRA rules made under FSMA, and therefore uncapped;
- expand the range of additional voluntary independent assurance and attest services that may be provided by adding agreed-upon procedures engagements and removing the requirement that these can only be in connection with material in the annual report. This allows (for example) for services in connection with other periodic reporting (e.g. assurance of sustainability KPIs in a separate sustainability report as well as those included in an entity's directors' report or strategic report), other voluntary reporting (e.g. insurance companies that are no longer required by the PRA to have their auditor report on their Solvency II SFCR report but which choose to do so voluntarily to improve policyholder confidence) and service auditor reporting (which is independent assurance and where the procedures often overlap with the audit procedures carried out, e.g. testing of general IT controls). If this suggestion is accepted we believe that you could also delete "reporting on government grants" as these would be included within this point;
- simplify the definition of the loan covenant point, and makes the reference to SGN 01/08 clear;
- make clear that auditors are prohibited from providing accounting advice, but allows them to provide an opinion on management's own proposed accounting treatment. This allows management to ask for an early "subject to audit" agreement by the auditor of proposed treatment, but does not involve the auditor giving any advice themselves. This is the same as the position under the SEC and PCAOB rules;
- delete the reference to services which have been the subject of an application under Article 4 of the EU Audit Regulation as amended by Regulation 79 of SI 2019/177. The nature of such services should already be permitted by one of the other headings in the whitelist, and paragraphs 4.15 and 4.16 already provide for the disapplication of the cap when approved by the competent authority. If you do retain the point, the words "Article 4 of the EU Audit Regulation as amended by" are needed before "Regulation 79";
- replace the reference to Regulation 80 of SI 2019/177 with a reference to Appendix B. This is needed because Appendix B is actually tougher than Regulation 5 of the EU Audit Regulation as amended by SI 2019/177 in that it (a) removes the derogation on tax and valuations and (b) imposes an additional cooling in restriction in respect of internal audit services; and
- add due diligence services because without this there will be the following unintended consequences:
    - due diligence is often carried out alongside a reporting accountant engagement. Despite using their auditor for the required reporting accountant services, companies would need to appoint a different firm for the due diligence resulting in additional cost and a more disjointed approach
    - a distortion in the M&A market in relation to scenarios where VDD has been prepared where the VDD provider happens to be the purchaser's auditor. This would mean the purchaser would have to find another firm to do the "top up" work that is normally required for them and their financiers. It would be disproportionate (in a time critical and confidential transaction) to require that for audit independence reasons, where the service (ie diligence) meets the ORITP test and the fees are capped, the purchaser must use a new provider.

5.42 [deleted]

If our suggestion in respect of 5.40 is accepted, paragraph 5.42 is not needed.

Appendix B : *Prohibited Non-audit Services for Public Interest Entities*

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 UK parent undertaking or to its controlled undertakings worldwide any prohibited non-audit services in:

(a) the period between the beginning of the period audited and the issuing of the audit report; and

(b) the financial year (or period if longer than one year) immediately preceding the period referred to in point (a) in relation to the services listed in points (e) and (h) of the second subparagraph.

For these purposes, prohibited non-audit services shall mean:

[...]

(i) services linked to the financing, capital structure and allocation, and investment strategy of the *audited entity*, except providing assurance services in relation to the financial statements, such as the issuing of comfort letters in connection with prospectuses issued by the *audited entity*. *Guidance on the application of this prohibition is included in SGN 01/2017*; [...]

[...]

Our first two proposed changes align the opening paragraph with geographic scope of the legal prohibitions in Article 5 of the EU Audit Regulation that will be retained in UK law as modified by SI 2019/177. If the UK has not left the European Union without a deal then the parent undertaking reference should be the "EEA parent". The change to "worldwide" controlled undertakings should be made anyway as a UK parent can tell its subsidiaries not to purchase services from the auditor or a member of its network.

Our final suggestion adds a reference to the applicable Staff Guidance Note which will help firms and audit committees less familiar with the FRC's materials.

Appendix 3 – detailed comments on the changes to the ISAs (UK) and the Glossary of Terms (Auditing and Ethics)

Pervasive comments

- Some, but not all, of the paragraph numbers with a "D" in the paragraph number have been renumbered, and the FRC has not included all "D" paragraphs in the consultation draft. A consistent approach should be taken. For example, a D remains in ISQC (UK) 1.30D-1.

- The track change versions all refer to the extant versions of the ISAs, such as ISA (UK) 220 (Revised June 2016). We do not believe that the date of revision is necessary, as will be implicit from the period under audit which version of the ISA will apply. If the FRC retains these references to the date of revision, then all such references will need to be updated.

- The ISAs (UK) have been updated for the new UK Corporate Governance Code, but the relevant FRC Bulletins are now considerably out of date and refer to superseded versions of the Code. We would recommend that at the same time as updating the ISAs, Bulletins 2006/5 and 2009/4 are updated and combined to refer to the latest version of the UK Corporate Governance Code as well as giving guidance on how auditors should respond to the Wates Corporate Governance Principles for Large Private Companies.

- As we recommend in our response to question 8 in the consultation, given that the ISAs (UK) now refer to UK law and not the EU Audit Regulation, we recommend that the relevant requirements taken direct from the EU Audit Regulation be redrafted. This redrafting would make it easier for auditors to identify clearly the incremental requirements rather than repeating the full text of the original EU Audit Regulation and requiring auditors to interpret whether there are any differences. To go alongside this, the FRC could prepare an appendix that reconciles how the relevant legal requirements are dealt with in the ISAs (UK).

ISQC (UK) 1

Paragraph 12

- We do not believe it is appropriate for changes in paragraph 12(b) to widen the scope of "engagement documentation" to include information, records and other data required by ISQC (UK) 1, as this will include work performed at a whole firm level.

- Paragraph 12(h)-1 footnote 3b refers to Paragraph A2-1 of ISA (UK) 220 (Revised June 2016). There is no paragraph A2-1 in either the June 2016 or proposed revision. Instead of being explained only through footnotes and application material, we recommend that the Glossary and the relevant ISAs include a definition of material subsidiary.

Paragraph 48-2

- Paragraph 48-2(a) has been revised to refer to work performed by any component auditor from a non-EEA member state. This is inconsistent with the proposed change (though not marked as such) to paragraph 48D-2(b) which has deleted a reference to non-EEA member states. An EEA/non-EEA split is not necessary as if the UK leaves the EU without a deal, the law will apply equally to EEA entities,

and if the UK has not left, or has left with a deal, the FRC would not ask for such information as they would ask the relevant EEA competent authority (and therefore the provisions could still apply).

Paragraph A1-1

- We recommend that this paragraph be deleted rather than amended. The previous version simply stated that the auditor had to comply with requirements for audits required by legislation. This was unnecessary, especially as the specific legal requirements had been added to the relevant ISAs (UK). If it is retained, it should be clear which entities this applies to – these legal requirements apply to entities listed in section 1210 of the Companies Act 2006 but not to other statutory audits (e.g. those of pension funds and unincorporated charities). A consistent approach should be taken by the FRC as to whether they wish to apply these provisions to all audits (statutory or otherwise), or just to those entities listed in section 1210 of the Act.

- The new paragraph refers only to requirements that derive from UK legislation that have been included in ISQC (UK) 1 and not all of the other requirements in other ISAs (UK). If the paragraph is retained, we recommend that it refers to all relevant requirements, not just those in ISQC (UK) 1. In addition, we recommend that either the paragraph be moved to before paragraph A1 or has a new sub-heading, as currently it appears under the sub-heading "Considerations specific to smaller firms".

Paragraphs A30-1 and A30-2

- Paragraph A30-1 states that a material subsidiary is a component as defined in ISA (UK) 600. This is inconsistent with the previous advice in SGN 02/2018, which stated that material subsidiaries were a subset of components. This statement is then contradicted by the next paragraph, A30-2, which discusses situations where a component is not determined to be a material subsidiary.

ISA (UK) 220

Paragraph 7

- Paragraph 7(a) says that the engagement partner "may" also be a key audit partner. Given the definition in paragraph 7(f)-1, we believe that the engagement partner will always be a key audit partner if the entity is a PIE. This would be better drafted as "In the case of a public interest entity, the engagement partner will be a Key Audit Partner."

- Paragraph 7(f)-1 refers to paragraph A2-1 of ISA (UK) 220 which does not exist.

Paragraph 21-3

- This requirement is already covered by the text in paragraph 21-2 and the relevant application material and is therefore unnecessary duplication. If the FRC considers that it must be included then it should be drafted as a requirement using the word "shall" or added as additional application material to paragraph 21-2.

Paragraph A32-1

- We recommend that rather than referring to "rare" circumstances where such a discussion is not required, the paragraph instead gives examples of circumstances when it may not be required.

ISA (UK) 250 A

Paragraph A11-1 (previously paragraph A18)

- There are two paragraphs numbered A11-1. As the second is simply a renumbering of the IAASB's paragraph A18, we do not believe it appropriate to move and renumber such a paragraph given the desire for consistency with the IAASB standards. We recommend instead that a new paragraph A11-2 be added which simply states that examples of matters that may indicate non-compliance with laws and regulations are given in paragraph A18.

Paragraph A11-2

- Depending on how our comments on A11-1 are dealt with, this paragraph may need to be renumbered.

- The second sentence is incomplete: "Even when the direct effect on the determination of amounts and disclosures in the financial statements is not quantitatively material." In addition, the final sentence should be reworded to state "For example, acts of non-compliance may not generate material fines or penalties, but may have a direct effect on disclosures because, due to the nature of the entity, disclosures of acts of non-compliance are important to users of the financial statements."

Paragraph A16-1

- We recommend that this application material be reworded to make more explicit that all instances of non-compliance should be followed up, regardless of whether the auditor identified them or they were brought to the auditor's attention by management. In addition, this guidance should be included under the heading "Audit procedures when non-compliance is identified or suspected" rather than under the heading "Written representations" as it includes non-compliance identified other than by obtaining written representations.

ISA (UK) 250 B

Paragraph 14 (previously 13R-1)

- The consultation draft will result in there being two paragraph 14s. Either paragraph 13R-1 should be renumbered as paragraph 13-1 or all subsequent paragraphs should be renumbered.

Paragraphs A35a to A35f

- These paragraphs should be numbered A35-1 to A35-6, to be consistent with the approach taken in other standards.

ISA (UK) 600

Paragraph 9

- Paragraph (b) says that the component auditor may also be a Key Audit Partner. As the component auditor may be a firm rather than an individual, and given the material in SGN 01/17 on the determination of material subsidiaries, it may also be helpful to amend (b) to say "In the case of a component of a public interest entity the component audit partner may be a key audit partner if they are responsible for a material component of the group. Guidance on determination of a material component may be found in SGN 01/17."

- The definition of a group engagement partner in paragraph 9(h) states that they "may also be the Key Audit Partner". Given the definition in paragraph 7(f)-1 of ISA (UK) 220 and paragraph (l)-1 of ISA (UK) 600, we believe that the group engagement partner will always be a (not necessarily "the") key audit partner if the entity is a public interest entity. We suggest redrafting as "In the case of a public interest entity, the group engagement partner will be a key audit partner."

Paragraphs 42-1 and A61-1

- We do not believe it is helpful to explain in the application material that the requirements in paragraph 42-1 go further than the requirement in paragraph 42(b). We recommend that rather than repeat the requirements sourced from the EU Audit Directive, that the requirement in paragraph 42-1 be reworded to make explicit the additional requirements it imposes beyond those in paragraph 42(b).

Paragraph 50-3

- We suggest that rather than deleting the second bullet in its entirety, only the reference to "from a non-EEA member state" be deleted. The FRC may have powers to obtain information directly under sections 1253A to 1253DE of the Companies Act 2006 from a non-EEA component auditor or regulator, and in the event that the UK leaves the EU without a deal, from an EEA component auditor or regulator too.

Paragraph A4-2

- We recommend in our comments on ISQC (UK) 1 that further guidance be given on what constitutes a material subsidiary because the information given in SGN 02/2018 is useful. If the FRC does not intend to provide further guidance in ISA (UK) 600, then we recommend that there is a footnote explaining that further guidance is available in SGN 02/2018.

Paragraphs A61-1 to A61-4

- The further material, in particular the decision tree, in SGN 02/2018 provided more clarity. As in our comments above on paragraph A4-2, we recommend that SGN 02/2018 is referred to as further guidance.

ISA (UK) 620

Paragraph A20-1

- This paragraph states that the external expert is subject to the FRC's Ethical Standard, which is different to the requirements in ISA (UK) 260 paragraph 16-2(c) and ISA (UK) 620 paragraph 9-1 which refer to obtaining a confirmation of the external expert's independence. We do not believe that it is practical to request for non-auditors to comply with the FRC's Ethical Standard as many other professions may not have the firmwide processes and procedures in place to do so. This requirement otherwise risks disadvantaging those smaller audit firms that do not have in-house experts (who will be subject to the Ethical Standard as they work for an audit firm) and must therefore try and find an external expert willing to state compliance with the Ethical Standard. We recommend that this application material be redrafted and refer to any relevant independence or ethical rules that apply to that external expert as well as obtaining an understanding of any conflicts of interest that may arise.

ISA (UK) 701

Paragraph 16-1

- Paragraph 16-1(b) could be simplified to "significant judgments made by the auditor in determining materiality and performance materiality".

Paragraph A53-1

- In the last sentence "statmentes" should be "statements". The paragraph might, in any case, be simpler as "For audits of public interest entities, UK legislation always requires disclosure of the matters in paragraphs 13-1(a)-(c), and therefore the public interest benefits of such communication will always outweigh the adverse consequences of doing so. Accordingly, paragraph 14(b) will not apply to such audits." This might be elevated to a requirement as paragraph 14-1.

Paragraph A59-2

- There is duplication in the third from last bullet as the section in brackets is the same as footnote 32e.

ISA (UK) 720

Paragraph 21

- We recommend that the UK additional material be reworded to clarify that it only applies where there is other information accompanying the financial statements.

Paragraph 22-4

- Paragraph 22-4 only applies to companies subject to the Listing Rules. We suggest that the paragraph be reworded as "In the case of a company with a premium listing, the auditor is required to review certain disclosures. The auditor shall…" and then remove the words "the Listing Rule requirement for the auditor to review" each time it appears. This would make the scope of the requirement clearer. In addition, we remind you that we have previously asked you and the FCA to consider if these review

duties are still required, given the audit requirements now in ISA (UK) 570 as this results in two overlapping sets of reporting requirements.

- The FCA has not yet updated the Listing Rules for the new UK Corporate Governance Code; a consequential amendment may be needed when they do.

Paragraph A53-4

- In footnote 15d we suggest that "as amended by…" is removed as the reference to section 496 would be to the version of that section in force. Instead, the following should be added: "Similar requirements apply to other types of entities, e.g. building societies."

- The text after (b) refers to the auditor being required to give an indication of the nature of each of the misstatements for "any" misstatements identified rather than for "material" misstatements.

Paragraph A53-6

- The Sourcebook's correct title is the "Disclosure Guidance and Transparency Rules Sourcebook".

Glossary of Terms (Auditing and Ethics)

General

- We have not repeated our comments on the definitions where they are discussed under the relevant ISAs (UK) above.

"Audit engagement"

- The proposed Glossary definition still refers to the EU Audit Directive and Regulation. We suggest the second sentence is unnecessary as all such audits are required by law to be carried out under ISAs (UK) and will therefore be caught by the first sentence already.

"Auditor"

- We do not believe that footnote 3 is necessary and in any case should not refer to "the key audit partner". The definition of engagement partner already has a footnote that says they are a key audit partner.

"Engagement documentation"

- This should be updated to be consistent with the revised definition in ISQC (UK) 1. The additions to that definition have instead been added to the definition of "audit documentation".

"Firm"

- The definition should no longer refer to Ireland.

Deloitte.

"Statutory audit" and "Statutory auditor"

- We recommend that these be updated as they still refer to the EU Audit Directive and Regulation; we suggest that they refer instead to UK law. We note that standards do on occasion use "statutory audit" to refer specifically to an audit required by laws that enact the Directive (i.e. those audits listed in section 1210 of the Companies Act 2006) and in other cases to refer to an audit required by any statute; the legal requirements for these may differ.