FRC TECHNICAL ADVISORY GROUP – ROLLING RECORD OF ACTIONS ARISING

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15 June 2016 Meeting – Ethical Issues		
2	Date that the non-audit services fee cap become applicable	FRC has amended the footnote to paragraph 4.34R to state that the cap applies in the fourth financial period commencing on or after 17 June 2016, or the fourth financial period after that date for the appointment of a new auditor.
2	How to deal with breaches for audit reporting purposes	ISA (UK) 700 paragraph 45R-1 requires the auditor to provide a declaration in their audit report that they have not breached non-audit services requirements. Where those requirements have been breached, but where the auditor believes that an 'objective, reasonable and informed third party' would not conclude that the auditor's independence had been compromised (perhaps because the breach was minor in nature), then the auditor should issue the auditor's report, disclosing within it: (i) the nature of the breach; (ii) confirming the auditor's assessment that their independence had not been compromised; and (iii) stating what had been done to address any risks arising impacting on the independence of the auditor. Before the auditor's report is signed, this should be discussed and agreed with the audit committee of the entity concerned.
2	Tax – direct effect meaning	The FRC explained in the meeting that prohibited tax services cannot be provided where they have a direct effect on the financial statements. However, in

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		accordance with the derogation (paragraph 5.168R), where they had an indirect effect, and the impact of this would be inconsequential, such services would be permitted. There may, as a result, be limited circumstances where the derogation can be used. **[Superseded by 3 May 2017 Meeting]**
2	Tax – meaning of inconsequential	The FRC explained that the references to inconsequential should be considered from the perspective of the objective, reasonable and informed third party. If such a person would have doubts that the service being offered might be inconsequential, then it would be unlikely to meet the definition of inconsequential.
3	Pre-approval of non-audit services	Paragraph 71 of the revised Guidance on Audit Committees contains material to support audit committees in their application of the revised requirements. In view of the changes, **the FRC is willing to be consulted where stakeholders have any questions**.
3	Non-audit services provided to non-EU subsidiaries	The FRC confirmed that because of the drafting of the Regulation, it would be possible for a UK or network firm to offer prohibited non-audit services to entities outside of the EU. However, the 70% cap will still apply on a global basis. Also, the FRC's other restrictions on the provision of non-audit services will apply where the auditor proposes to place reliance on the work of that network firm. **[SGN 01/16]**
3	Definition of relatives	The definition of relatives in the SATCAR regulation, which draws on the language in EU law is very broad. The FRC suggests that pending wider agreement at a

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		European level over the application of this requirement, audit firms should use the HMRC definition of relative, which is a linear definition: ***"A relative is a brother, sister, ancestor or lineal descendant. This means that people like cousins are not relatives for the purposes of this definition. This also captures a spouse or civil partnership."*** For the purposes of a staff member reporting to their audit firm investments held by a relative, in certain circumstances it may not be possible for the staff member to have actual knowledge of the investments held. Where that applies, the staff member should provide written confirmation stating that they are 'not aware' of investments that might be held.
21 July 2016 Meeting – Ethical Issues		
2	Scope and Authority of FRC Pronouncements	The FRC has updated the Scope and Authority to reflect amendments to the new standards. In doing so the FRC has added an additional paragraph to make clear the requirements of the Audit Regulation are only applicable to those entities as defined in Directive 2006/43/EC as amended. This is intended to address concerns that the FRC standards expanded the definition of public interest entity beyond that in the Directive and Regulation. This is not the case, and this should address any risk of the wording in the SATCAR Regulations which amends the Companies Act might be misinterpreted.
2	Definition of those in a position to bind a firm in respect of a	The FRC has updated the definition of partner to in the Glossary to that used by the IAASB. As a result it catches those individuals who are in a position to bind an

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	professional services engagement	audit firm because they sign either audit reports or letters of engagement for professional services engagements on behalf of the firm. **This was further discussed at the September meeting.**
2	Persons in a position to influence the outcome of an engagement	In revising the Ethical Standard, the FRC has replaced the 'chain of command' definition, with a new definition of a 'covered person'. In discussion with stakeholders, there are a number of areas of interpretation which have caused some confusion which is it helpful to be able to clarify: • In paragraph (a)(i) of the definition, in smaller audit firms with smaller audit engagements, the person responsible for the day to day direction and supervision of the engagement may in certain circumstances be either newly, or even part qualified; • Paragraph (c) b of the definition is intended to apply to those who have a direct role in the preparation and approval of a performance appraisal. This is not intended to create a 'catch all' situation where staff participating in a moderation meeting for a cadre of staff were all automatically to be considered as persons in a position to influence the outcome of the engagement; • Paragraph (d) of the definition is intended to cover senior people in the firm or network firm who may be, for example, acting in a mentoring role, either for a newly appointed partner, or others in the team who that mentor might be able to influence; and • The covered person definition (a) (ii) will apply also to those in a PIE group engagement, where that work is used for the purposes of the group audit. It is important that group auditors understand the difference between work performed by network firms and other auditors for the group audit, and work performed to audit the statutory accounts of any group components. Part (a) (ii) of the definition

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		will also apply to staff drawn from other jurisdictions/ network firms, who join the engagement team.
3	Defining and applying 'area of business'	The FRC has provided a Glossary Definition and inserted Footnote 28 in the Ethical Standard to clarify what is meant by 'area of business' (ES 2.4 (a) refers). This and the overarching requirement for the auditor to be able to demonstrate their independence should allow audit firms to effectively address any risk posed by this requirement. The Group agreed that it would be reasonable to expect that **audit *firms* should develop a policy** setting out how they will ensure that their staff remain independent and that they do not hold a material financial interest in an entity relevant to an engagement in the area of activity they are involved in.
3	Definition of 'playing any part in management or decision making'	"Services that involve 'taking any part in the management or decision-making of the entity' include working capital management, providing financial information, business process optimization, cash management, transfer pricing, creating supply chain efficiency and the like.[1]" The FRC considers that the prohibition in the Regulation of '… playing any part in the management or decision-making of the audited entity' should be interpreted as including that when the auditor is overseeing, directing or supervising the personnel of an audited entity, or when the auditor makes decisions for that audit entity or plays a significant part in management's decision making. This would involve them 'playing a part in the management or decision making of the audited entity' and therefore such activities are not permitted.

[1] Source: European Commission Q&A, September 2014

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		The auditor should also be aware of the perception risk and consider whether acting in a certain way would lead an objective, reasonable and informed third party to conclude that the auditor's independence had been compromised. Note that junior staff secondments to an audit client are covered by the requirements in ES paragraph 2.39. Accordingly, in the context of providing a permissible service the auditor should refrain from making any decisions, should avoid any activities that involve overseeing, directing or supervising the personnel of an audited entity, and should avoid giving any approvals on behalf of management during the course of the engagement. The engagement partner must always be satisfied the audited entity's management makes all judgments and decisions that are the responsibility of management. **[SGN 02/16]**
3	Tax advocacy services	There is an overarching principle in the Audit Directive that a firm shall not carry out audit if there is any threat of advocacy created by relationships between the firm, its network and any person in a position to influence the outcome of the audit as a result of which an objective, reasonable and informed third party, taking into account any safeguards applied, would conclude that the auditor or audit firm's independence is compromised (see ES SEP 2.3D). The explanation in the ES of what an advocacy threat is (at ES 1.30) is not substantially changed. **The absolute prohibition applies to representing the audited entity as an advocate before a tax authority, where the matter relates to issues which are material to the financial statements being (or which will be) audited, or where the outcome of the tax issue is dependent on a current or future audit judgment. However, the provision of information to the tax authorities about the issue under enquiry or explaining to the tax authorities the technical basis for the tax filing position or advising the client on the matters under enquiry is not acting as an advocate. In all instances which might involve, or reasonably appear to involve, the promotion by the audit firm of a position**

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		being taken by an audited entity, an advocacy threat should be considered to arise.
3	Prohibited tax services	The Audit Regulation sets out those tax services which the auditor is prohibited from providing to public interest entities – these are set out in the Ethical Standard at paragraph 5.167R. The FRC consulted publicly, and received widespread support, for the proposal not to develop a white list of permitted services, and to instead only have a black list which we have not expanded beyond the specific requirements in the Regulation. The FRC's preference, therefore, is that any additional guidance should be principles-based. This is being reworked for discussion at a future TAG meeting, to see if it can be made suitably principles-based. **[See record of 5 December 2016 meeting]**
8 September 2016 Meeting – Ethical Issues		
2	Partner definition – ability of an individual to bind the firm	The TAG discussed at an earlier meeting, whether the wider IFAC definition of a partner, meaning those in a position to bind the audit firm, should apply only in respect of audit or other public interest assurance engagements using performance standards issued by the FRC. The FRC has now confirmed that the definition should apply to all engagements where a member of staff is able to act in place of a partner and bind the firm. This is because the personal financial independence requirements incorporated into the Ethical Standard from the Directive are applicable to all partners, and therefore

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		has a wider coverage than just audit and assurance engagements. This is also consistent with the definition used internationally by IFAC. For the definition to apply to an individual, they should have the authority to bind the firm without further reference to another individual in that firm.
2	Definition – 'services linked to financing, capital structure and investment, and investment strategy'	This prohibition is set out in paragraph 5.167R (i) of the Ethical Standard. Services linked to financing, capital structure and investment are clearly understood, however, services linked to an entity's investment strategy appear to be less well understood. For instance, where an entity commissions non-audit services from their auditor, and uses that work either to develop their investment strategy, or to change a proposed approach with view to making the strategy more likely to succeed, then it is likely that service would be prohibited by the Regulation. In addition, an objective, reasonable and informed third party may well consider that the provision of information and insight, for what they consider to be a significant cost may well have significant influence over the decision making process operated by management. The FRC is seeking clarification from the CEAOB. Pending that clarification, it may be prudent for audit firms to assume that services linked to the investment strategy are, therefore, prohibited. **[Superseded by SGN 01/17]**
2	Application of the non-traded exemption in the context of the listed entity definition	The FRC has updated the definition of a listed entity. Listed entities are those that are quoted or listed on a recognised stock exchange. The revised definition provides relief from certain requirements applicable to listed entities where an entity has quoted or listed shares, stock or debt, but that these are not freely

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		transferrable by members of the public. In practice this will mean that the listing an entity has is likely to be for structural reasons. For an entity to claim that it does not meet the listed definition, it is not enough that a quoted instrument has not been traded recently. Rather the trading of that entity's listed shares, stock or debt should also be subject to restrictions which means that they cannot be traded by members of the public.
2	Audit Committee reporting on the audit tender process	A public interest entity tendering for the appointment of an auditor should follow the requirements in Article 16 of the Audit Regulation, whereby the audit committee of such an entity makes a recommendation to the Board for appointment of an auditor. These requirements apply except where the entity seeking tenders meets the definition of a small or medium sized company. UK legislation requires the Audit Committee to validate or approve a report on the tendering and appointment process. That report is to allow the audited entity to demonstrate to the Competent Authority that the process has been carried out independently and fairly, and in accordance with legislative requirements. It is a decision for the Board of the audited entity if it wishes to make such a report public. The FRC considers that the legislative requirements can be satisfied by a combination of some or all of: (i) the paper prepared for the audit committee to support the committee's deliberations and recommendation to the Board for appointment; (ii) the Board paper which sets out the Committee's assessment and recommendations; and (iii) material contained in the annual report of the audit committee in the entity's annual report, as that will set out the main areas of focus of the committee during the year being reported on.

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3	Prohibited tax services – services deemed to have a direct effect on the financial statements	The TAG has again discussed this issue, and has sought to determine whether it is possible to develop a principles based approach to identify which of the prohibited tax services might be permissible under the derogation as having an indirect and inconsequential effect on the financial statements. This work is ongoing, and will be considered further at the December TAG meeting. **[Superseded by 3 May 2017 Meeting]**
3	Quality assurance reviews of internal audit services	The Audit Regulation prohibits an audit firm from providing 'services related to the audit client's internal audit function'. Global standards issued by the IIA require an independent QA review of an internal audit function, and state that: "*An independent assessor or assessment team means not having either a real or an apparent conflict of interest and not being a part of, or under the control of, the organization to which the internal audit activity belongs*". Undertaking an assessment of this kind is likely to be considered a 'service related' to the internal audit function as it is not directly relevant to a statutory audit engagement, and is therefore, **prohibited**[2]. This prohibition does not extend to **an evaluation of the internal audit function and reporting to those charged with governance in accordance with ISA 610 (UK)** *Using the Work of Internal Auditors*, as part of a statutory audit engagement.
3	Rotation arrangements for key audit partners	A key audit partner is defined in the Ethical Standard as one designated by an audit firm to carry out a particular audit engagement (referred to as the engagement partner). In a group engagement, those partners responsible for the audit of material subsidiaries are also key audit partners, as are statutory auditors

[2] The prohibition is absolute – the derogation in paragraph 5.168R cannot be applied in these circumstances.

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		responsible for signing an auditor's report. **These requirements apply to periods commencing on or after 17 June 2016, and no transitional provisions apply**. For a public interest entity, key audit partners should hold their position on a statutory audit for a period of no more than **five years** from their date of appointment. This requirement is set out at paragraph 3.10R of the Ethical Standard. Where the audit committee of an entity decides it is necessary to extend the rotation period of an engagement partner, for instance to maintain audit quality, it may do so to a period of not more than **seven years**, subject to the conditions in paragraph 3.15 of the Ethical Standard. Once a key audit partner completes their appointment, they must not participate in that audit again, until a period of **five years** has elapsed. **Requirements for other key partners are set out in the table attached at Appendix 1 to this paper.**
3	Other relationships – a definition	Article 22.4 of the Audit Directive requires auditors to avoid conflicts of interest arising from business or other relationships. Business relationship is a defined term, and exist where two parties have a common commercial interest, and examples of such are set out in paragraph 2.27 of the Ethical Standard. Other relationship is not a defined term, however, given the focus on the commercial nature of business relationships, other relationships may be non-commercial in nature. For example if an audit firm made regular donations or gifts to a charity, or provided material support to that entity by allowing staff to volunteer in support of it, then it should not tender to provide the audit for that entity for the period that relationship is maintained.

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		Other relationships may also exist where an auditor or audit firm does not have a relationship with the audited entity, but it does have a relationship with a related party or connected party to that entity.
3	Contingent fees	The Ethical Standard prohibits the use of contingent fees for non-audit or additional services provided to an audit client (4.6R), where the contingent fee is material to the audit firm, or any part of that firm which is used to calculate the profit share of the partner or partners involved (4.14). Contingent fees are also prohibited where the fee that will ultimately be paid for the engagement depends on an outcome related to an amount[3] that will be included in the financial statements of an audited entity, on which the auditor will have to exercise judgment. Where that amount is material in the current financial year, or subsequent financial years, contingent fees may not be used. The prohibition on contingent fees is not new, however, it has been redrafted to help practitioners to clearly understand their responsibilities, rather than interpreting the requirement in a way that is unhelpfully narrow and does not effectively safeguard independence. When considering their independence, the auditor should not only consider the materiality of the transaction or impact on the financial statements in the current financial year subject to audit, but should also consider the likely impact on future years (for example – a material impairment to an acquisition might only be revealed over time) when considering whether a contingent fee for non-audit or related services is permissible. Auditors should

[3] This could be the proceeds of a sale, cost of an acquisition or valuation of assets and or liabilities where they are material to the financial statements of the audited entity.

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		also consider when tendering for appointment, whether contingent fee services they have provided prior to tendering for appointment impact on their independence to be able to accept appointment. (**Also see Appendix 3 of this document for further information**.) **Superseded by 5 October 2017 Material**
11 October 2016 Meeting – Auditing Issues		
2	Disclosing the period of engagement (ISA (UK) 700 45R-1(b))	The Audit Regulation requires the auditor's report to indicate the date of appointment of the auditor and the period of total uninterrupted engagement, including previous renewals and reappointments of the auditor. The FRC has developed three illustrative examples in **[SGN 03/16]** which will assist auditors to comply with the requirements in the ISA. Auditors are, of course, able to provide additional disclosures covering matters relating to the appointment and period of engagement in more detail should they consider that doing so would be helpful to users of the financial statements.
2	Should fraud always be considered a key audit matter for a Public Interest Entity?	Paragraph 13R-1(a) of ISA (UK) 701 requires the auditor to report on the most significant assessed risks of material misstatement (whether or not due to fraud). The ISAs (UK) require the auditor to assess the following risks of material misstatement due to fraud as significant risks: • the risk of management override of controls; and • risks of fraud in revenue recognition (subject to a rebuttable presumption). However, ISA (UK) 701 paragraph A21, notes that these risks may not have required significant auditor attention or had the greatest effect on: the overall audit strategy; the allocation of resources in the audit; and directing the efforts of the engagement team. Where that is the case, the auditor may determine that such risks are not key audit matters. This approach is strongly supported by

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		stakeholders, particularly investors, as reporting on all significant risks due to fraud, where such risks do not require significant auditor attention, could lead to boilerplate reporting which has little value to users of the financial statements.
2	Reporting matters to regulators for non-financial services Public Interest Entities	ISA (UK) 250 Section B requires the auditor of a public interest entity to report promptly to a regulator any information concerning a public interest entity (or an undertaking having close links with a public interest entity) regarding: (i) non-compliance with law or regulation; or (ii) a material threat or doubt concerning the continuous functioning (going concern) of the entity; or (iii) a refusal to issue an audit opinion on the financial statements, or the issuance of an adverse or qualified opinion. For PIEs in the financial sector, the report is likely to be either to the Financial Conduct Authority (FCA) or the Prudential Regulation Authority (PRA). If the non-compliance relates to the Listing Rules, then the report should be made to the UK Listing Authority (UKLA) within the FCA. Auditors should follow the principle, when addressing this requirement, that any report should be made to the regulator that has the statutory powers to be able to act on the information provided in the report filed by the auditor. In some cases, the auditor may be required to report to multiple regulators. For non-financial services PIEs it may be less clear what reporting requirements to regulators apply to an entity or sector. Nevertheless, the auditor should ensure that they obtain a general understanding of the legal and regulatory framework applicable to the entity and the industry or sector in which the entity operates in accordance with paragraph 12 of ISA (UK) 250 Section A.

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		There may be occasions where there is no readily identifiable regulator to which the auditor can make a report, or the matter to be reported would not be of interest or relevance to the UKLA. In that case, the auditor may make a report to the FRC as Competent Authority. The FRC will be setting up a reporting facility via the FRC website. **The auditor should make their report to the appropriate regulator as soon as practically possible.**
2	Hierarchy of Key Audit Matters and Emphases of matter	***Interaction between Key Audit Matters (KAM) and Emphasis of Matter (EOM) paragraphs*** Where the auditor is required to, or chooses to adopt ISA (UK) 701, the ISAs require that an item reported on as a key audit matter is not also reported as an emphasis of matter. Reporting an issue as a key audit matter provides greater contextual information to better support the users of the financial statements. Where a key audit matter is also, in the auditor's judgment, fundamental to users' understanding of the financial statements, the auditor may wish to highlight or draw further attention to its relative importance. Paragraph A2 of ISA (UK) 701 notes that this may be achieved by presenting the matter more prominently (i.e. first) than other matters in the KAM section or by including additional information in the description of the KAM to indicate its importance to users' understanding of the financial statements. Section 495 (4) of the Companies Act 2006, requires the auditor to include in the auditor's report a reference to any matters to which the auditor wishes to draw attention by way of emphasis. Where a matter would meet the requirements in paragraph 8 of ISA (UK) 706, for inclusion in an "Emphasis of Matter paragraph", but for the fact that it has been determined to be a KAM, section 495(4) would

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		apply. Accordingly, the matter should be included in the auditor's report as an "Emphasis of Matter paragraph" in accordance with paragraph 8 of ISA 706 notwithstanding the provision set out in paragraph 8(b) (see explanation at paragraph A5-1 of ISA (UK) 706). The matter should also be disclosed as a KAM in circumstances where ISA (UK) 701 applies. ***Interaction between KAM and a material uncertainty over going concern*** Where a material uncertainty related to going concern has been identified, the auditor reports in accordance with ISA (UK) 570 and does not also include a KAM on going concern.
3	Group Audits (ISA (UK) 600 50D-1) The nature, timing and extent of work	The revisions made to ISA (UK) 600 in June 2016 incorporate the requirement in the Audit Directive for the group engagement team to evaluate and review the work performed by the component auditor for the purpose of the group audit. The FRC considers that the new requirements may, in certain circumstances, lead to an increase in the auditor's work effort required when compared to the previous version of ISA (UK) 600 which did not mandate the review of component auditor's work. For significant components of the group audit, the group auditor will need to review the component auditor's work that is used to support the group audit opinion. The group auditor will also need to ensure that they include in the audit documentation *the nature, timing and extent of the work carried out by component auditors, including the group auditor's review of the component auditor's working papers,* and that this documentation is sufficient and appropriate to allow the competent authority to carry out a review of the group auditor's work. In determining what material is retained on the group audit file, the auditor should ensure that they also

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		comply with the requirements set out at paragraphs 48D-2 and 48D-3 of ISQC (UK) 1.
3	The extent to which the audit is designed to detect fraud and/ or irregularity (ISA (UK) 700 45R-1(c))	The Audit Regulation requires the auditor to explain in the auditor's report to what extent the audit was considered capable of detecting irregularities, including fraud. Practitioners queried whether this requirement was met by the standard description of an audit required to be included in an auditor's report in accordance with paragraph 39(b)(i) of ISA (UK) 700, or whether this should be more detailed and bespoke to that entity, based on the auditor's professional judgment and their assessment of the risks of material misstatement for that particular engagement. The FRC does not support the use of boilerplate reporting – and this position has received broad support from our stakeholders, particularly investors. However, the FRC recognises that it is not the role of Competent Authorities to interpret the requirement of EU legislation. We propose therefore, to refer this matter to the CEAOB for consideration. Pending that clarification, the FRC recommends that in reporting, auditors remember that boilerplate reporting does little to help the understanding of users of the financial statements, and issues that are covered by such reporting are likely to be of limited value to users. **[Superseded by 28 April 2017 guidance]**
3	Meaning of 'where relevant' and 'key observations' in ISA (UK) 701 13R-1	When reporting on key audit matters in accordance with ISA (UK) 701 paragraph 13, the FRC suggests the following terms are interpreted as set out below: • 'Where relevant' means where an auditor has identified an issue that they consider would be of relevance to the users of the financial statements. In planning their audit, the auditor will have considered the user perspective; and • A 'key observation' is the conclusion drawn by the auditor in respect of a key audit matter or an indication of the outcome of the auditor's

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		procedures. In reporting on key observations, the auditor should be careful not to give the impression that a separate opinion is being conveyed on a key audit matter and not to do so in a manner that would undermine the auditor's opinion on the financial statements as a whole. Key audit matters reported on by the auditor, should be consistent with those matters reported on by the auditor in their separate report to the audit committee.
3	Assessing the independence of an external expert (ISA (UK) 620 9R-1)	Where the auditor has used the work of an external expert, the Audit Regulation requires the auditor of a PIE to obtain confirmation from that expert regarding their independence. The FRC recognises that the expert may be from a different professional body with different ethical requirements to those applicable to auditors. Although the external expert is not part of the engagement team as defined by the ISAs (UK), as someone whose services are placed at the disposal of the audit firm / team, they will be subject to the 'covered person' definition within the Ethical Standard. For all audits where the work of an expert is used, the auditor should: • Evaluate the objectivity of the expert (in accordance with the application material in ISA (UK) 620); • Obtain written representations from the expert to confirm their independence and to confirm that they do not have conflicts of interest resulting from relationships with the audited entity and its affiliates *of which the expert is aware*[4].

[4] This should cover relationships between the expert and the audited entity and its affiliates where the expert is a firm rather than an individual (i.e. not a natural person), with the representation provided by a suitably senior person at that firm.

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December – Audit Issues – By Correspondence		
2	Documentation requirements for the Engagement Quality Control Review (ISA (UK) 220 25R-1 and 25R-2)	Article 8 of the Audit Regulation sets the requirement for an Engagement Quality Control Review (EQCR) to be performed on audits of public interest entities to support the delivery of high quality audit. These requirements have been incorporated into ISA (UK) 220 (Revised June 2016) in paragraphs 25R-1 and 25R-2. Some audit firms have sought clarification over the extent of the documentation required on the audit file. The FRC is of the view that the EQCR reviewer must ensure that there is a clear record on the audit file of the work undertaken as part of his or her review. It is not sufficient for the EQCR reviewer to evidence their review by sign offs on checklists and work papers alone. For example, we would anticipate seeing clear documentation setting out in summary the discussion that the EQCR reviewer is required to have with each KAP (as required by paragraph 21R-2) discussing at least the elements required by paragraph 21R-1.
2	Certain matters reported in the additional report to the audit committee for a PIE audit (ISA (UK) 260 16R-2)	Article 11 of the Audit Regulation requires the auditor to submit an additional report to the Audit Committee, over and above the auditor's report. This requirement has been included in paragraph 16R-2 of ISA (UK) 260 (Revised June 2016). When communicating with those charged with governance, the nature of the audience should be borne in mind when considering how to present the work of the auditor and any findings emerging from the audit in a way that makes them accessible, rather than just complying with a process-type requirement. Therefore, when the auditor is considering the extent of the reporting required to meet these requirements, the FRC is of the view that such reporting should enhance the value of the audit, particularly taking into account that information

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		that would be relevant to the Audit Committee in carrying out their oversight role (particularly where aspects of that role are established by the Audit Regulation). The extent of the reporting necessary should also be considered in the context of the Audit Regulation requirement to "explain the results of the audit carried out". For example, the auditor would not need to report on the valuation method used by management, where the auditor determined that there was not a risk of material misstatement for a particular class of transactions, account balance or disclosure. Reporting is not, however, restricted to only those matters that the auditor considers to be "key matters" (as noted above) as the Audit Regulation makes it clear that it is a "more detailed report on the results of the statutory audit".
2	Interaction between ISA (UK) 701 and the Audit Regulation (ISA (UK) 701 14(b)	The FRC has been asked about the interaction between the Audit Regulation and paragraph 14(b) of ISA (UK) 701. The paragraph states that: "The auditor shall describe each key audit matter in the auditor's report unless: In extremely rare circumstances, the auditor determines that the matter should not be communicated in the auditor's report because the adverse consequences of doing so would reasonably be expected to outweigh the public interest benefits of such communication. This shall not apply if the entity has publicly disclosed information about this matter." However, the Audit Regulation requires that the auditor's report for public interest entities includes a description of the most significant assessed risks of material misstatement, including assessed risks of material misstatement due to fraud (incorporated into the definition of Key Audit Matters in ISA (UK) 701), as well as a summary of the auditor's response and key observations for those risks. The Audit Regulation has direct effect in UK law and it does not provide for an exemption as foreseen by ISA 701.14(b).

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		ISAs (UK) do not override the requirements of the Audit Regulation, and this is acknowledged in paragraph A55 of ISA (UK) 200: "In performing an audit, the auditor may be required to comply with legal or regulatory requirements in addition to the ISAs (UK). The ISAs (UK) do not override law or regulation that governs an audit of financial statements." As a result, the exemption provided for in paragraph 14(b) of ISA (UK) 701 is not applicable in the audit of public interest entities. This is consistent with the Audit Regulation which does not foresee a situation where there are no key audit matters (and therefore paragraph 16 of ISA (UK) 701 would not apply to public interest entities).
5 December Meeting – Ethical Issues		
2	Ethical implications of a power of attorney	Guidance on the application of the requirements of the audit regulation and directive in respect of the ethical implications of a power of attorney is now incorporated in **[SGN 04/16]**.
2	Definition of an SME entity per MiFid II	The Ethical Standard includes a definition of an SME listed entity in paragraph 5.47. This definition draws on the definition of an SME entity in the MiFid II Directive and is based on the €200 million market capitalisation threshold in that Directive. We have received a number of queries about how this applies in respect of non-equity financial instruments, and therefore propose the following clarification. The SME definition can be applied to entities with equity and non-equity financial instruments, although for entities with non-equity financial instruments additional criteria also apply, other than the market valuation, as set out in ES 5.47 (b) (ii).

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		Financial instruments are as defined in the Glossary to the Ethical Standard, which uses the definition in EU Directive 2014/65/EU on markets in financial instruments.
2	Reliefs from certain more stringent FRC requirements from SMEs	In revising the Ethical Standard, the FRC consulted on a series of reliefs from certain more stringent FRC ethical requirements contained in section 5 of the Ethical Standard for SME audits. We have been asked whether this is affected by an audit firm's membership of the IFAC Forum of Firms. Audits of UK entities must be carried out using the FRC's Ethical Standard. We clearly explain in the Scope and Authority of Audit and Assurance Pronouncements that "The Ethical Standard was developed with the intent that it should adhere to the principles of the IESBA Code." Both the ICAEW and ICAS confirmed that they state in their Codes of Ethics that where audits are carried out in accordance with ISAs (UK), auditors should adhere to the Ethical Standard issued by the Financial Reporting Council, which should satisfy any Forum of Firms Membership Obligations. An audit firm which chooses not to make use of the reliefs in an SME audit will still be able to comply fully with all of the requirements of the Ethical Standard. A decision by an audit firm not to use the reliefs allowed by the Standard is a matter for discussion between the audit firm, and the audited entity and its audit committee.
2	Prohibited legal services	Paragraph 5.167R of the Ethical Standard prohibits the provision by the auditor of legal services with respect to (i) the provision of general counsel; (ii) negotiating on behalf of an audited entity; and (iii) acting in an advocacy role in the resolution of litigation to a public interest entity. This prohibition is absolute and no member state derogation can be applied. The ES also makes clear that:

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		(i) An audit firm carrying out that audit of a public interest entity cannot provide either an individual to carry out the general counsel role, or provide resources to carry out the functions of a general counsel to a public interest entity that it audits. This is because of the self-review risk and the advocacy and management threats that would exist should such an audit firm provide this service; (ii) An audit firm carrying out that audit of a public interest entity cannot carry out negotiations on behalf of a public interest entity that the firm audits – this prohibition is consistent with the absolute prohibition on the auditor acting as an advocate of management and does not preclude the auditor from providing advice to a client (subject to that advice not breaching the other prohibitions set out in ES 5.157R) as long as that advice is not delivered in a way that is binding on the client, or in a way that would lead to an objective, reasonable and informed third party concluding that the audit firm was playing a supporting role to management in those negotiations; and (iii) An audit firm carrying out that audit of a public interest entity cannot act as an advocate in the resolution of litigation for a public interest entity – this prohibition is consistent with the absolute prohibition on the auditor acting as an advocate of management. For other legal services, a firm should look to the principles of independence laid down in the Ethical Standard (analysis of threats) to identify threats and develop appropriate safeguards. Such threats would depend on factors such as the nature of the service and the materiality of the transaction in relation to the financial statements, among others.
3	Requirements applicable to audits of subsidiaries of a PIE where those subsidiaries are	We have been asked whether the FRC is able to clarify the interpretation of the EU Audit Regulation where non-audit services are, for example, provided to a UK audited entity which is a controlled undertaking of a PIE located in another EU member state. The circumstances we have been asked to clarify, is whether: (i)

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	located in another EU member state	the requirements of the FRC ES as applied to UK PIEs are applicable to that entity; or (ii) the requirements of the Regulation in the member state of the parent entity are also applicable to the UK subsidiary. This requirement has been referred to in the European Commission's Q&A document: "The Regulation contains several Member States' options. How do the new rules apply to groups of companies where a PIE has non-PIE subsidiaries in several Member States? Given that Member States may prohibit services other than those listed in the Regulation and that the prohibitions in Article 5 apply to the PIE, its parent undertaking or its controlled undertakings in the EU, which Member States' prohibitions apply to the PIE's subsidiaries – the PIE's home country prohibitions or the subsidiaries'? In order to determine whether the statutory auditor is allowed to provide certain service to a subsidiary of a PIE, the law of the Member State where the subsidiary is located applies……." Our understanding is that: • The Audit Regulation prohibits the provision of certain non-audit services to a PIE, its parent undertaking or its controlled undertakings within the European Union. Therefore the auditor of the PIE (and in the UK context its network firms) is prohibited from providing those services referred to in Article 5 of the Audit Regulation as transposed into the national law of the member state in which the PIE is headquartered to all components within the PIE group; • Where a UK auditor that is not also the group auditor carries out the audit of a UK (non-PIE) subsidiary they should use the FRC ES for the purposes of the engagement. Where the FRC ES includes requirements applicable to statutory audits which are more stringent than those in force in the jurisdiction of the parent entity, then the auditor should comply with these – this will allow the auditor to satisfy their obligations due under UK legislation. As the entity is not

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		a PIE, the requirements of the Audit Regulation in the FRC ES will not apply in the context of that engagement; • In developing the Audit Regulation, there is a presumption that member states do not export the effect of their law into other member states. However, the Audit Regulation sets law at the level of the European Union and therefore needs to be applied consistently; • This is a legal issue for which the FRC cannot provide a definitive interpretation. However, for now, the auditor of the UK subsidiary should liaise with the group auditor to determine whether there are any regulatory requirements that need to be taken account of, to ensure that the subsidiary auditor does not act in a way that would be viewed by the regulator of the PIE as a breach in that jurisdiction. The decision tree at Appendix 2 may be helpful in interpreting the requirement.
3	Prohibited tax services	Guidance on the application of the requirements of the audit regulation in respect of prohibited tax services is now incorporated in **[SGN 05/16]**.
3	Entities transitioning to and from PIE status	Paragraph 1.27D of the Ethical Standard explains the requirements that apply where an entity changes status from non-PIE to PIE and vice versa. The paragraph is copy out text from Article 22 of the Directive and the text focuses on changes to status as a result of mergers and acquisitions. We have been approached, however, over the treatment of a number of analogous areas which are not covered. For example, where an entity becomes a controlled undertaking of a PIE as a result of acquisition, we have been asked what happens to an audit firm providing IT systems design and implementation to that entity, and whether that audit firm will be allowed to continue as auditor. ES paragraph 1.27D provides a maximum time period of three months, for the auditor of an entity to either terminate any

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		arrangements to provide non-audit services (for example should they be prohibited under paragraph 5.157R), or put in place appropriate safeguards that reduce any threat to integrity, objectivity and independence to a level where the auditor's independence is not compromised. In such circumstances, the auditor will be required to provide within their auditor's report a statement of independence. For an entity which becomes a public interest entity, the non-audit services fee cap shall apply in the usual way from the fourth financial period of that engagement from the point that the entity became a public interest entity. Where an audited entity lists for the first time on an EU regulated market or becomes a credit institution or insurance undertaking, the provisions in the Ethical Standard applicable to public interest entities apply from that point forward, subject to the transitional arrangements contained in paragraph 1.27D. The same approach should be followed where an entity delists from such a market. We consider these scenarios to be analogous to a change of status as a result of a merger or acquisition in principle, and which should, therefore, be treated in the same way.
3	Approval of NAS by audit committees of non-PIE and/ or non-EU parents of EU PIEs to approve services to the EU PIE	The Audit Regulation brings into law a requirement for the provision of non-audit services to be approved by the audit committee in advance unless the services provided are of a trivial value. The UK Corporate Governance Code requires audit committees to develop a policy which deals with the approval of non-audit services supplied by the auditor. In addition, audit committees are tasked with undertaking appropriate oversight to ensure that their auditor has remained independent to be able to issue an auditor's report on the financial statements. Detailed guidance is contained in the FRC's Guidance on Audit Committees issued in April 2016 (paragraphs 66-74 in particular refer).

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		The approval mechanism that an entity develops will need to be sufficient to satisfy the legal requirements, and also be workable within the structure of the audited entity. A public interest entity will need to have an audit committee, but some entities have chosen to operate this at a group level rather than an entity level, and the flows of information will need to support the committee's oversight. Audit firms have asked us about the approval process that is required where either a PIE is in a group which has a non-EU parent, or what happens where a PIE has subsidiaries which are in non-EU jurisdictions. Although entities are required to comply with the law that applies in whatever jurisdiction they operate within, we are of the view that unless the audit committee of a PIE, or the parent of a PIE is involved in the approval of non-audit services, that audit committee would be unable to satisfy the requirement to oversee the relationship with the auditor with a view to ensuring that the auditor has remained independent to issue an auditor's report, approving the provision of services as required by EU and UK law, and ensuring that the non-audit services cap is being adhered to both at the level of the group and at the level of group components where non-audit services are received from the auditor or a member of the audit firm's network. This principle has been followed by those entities we have spoken with who have contacted us with regard to their own approval processes.
3	Rotation requirements for PIE audit component auditors	The TAG has previously discussed rotation requirements for UK auditors, and guidance has been added to the FRC website. We have subsequently been asked about how audit firms should apply rotation requirements to key audit partners for material components, where those components are not located in an EU member state. In particular, that there would be an inconsistency where a 5 year rotation period applies for a partner responsible for the French subsidiary contributing 20% of group profit, yet if the same requirements are not applied the partner

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		responsible for an Australian subsidiary contributing 30% of group profit could be subject to a 7 year rotation period. Our view is that the rotation requirements should apply to key audit partners responsible for all components of UK PIEs, not just for components subject to 'EU statutory audits' as defined for the purpose of ARD. The wording we have used in the Ethical Standard follows the copy-out principle and the reference to statutory audit comes from the Regulation. However, we believe that rotation requirements should apply to partners responsible for all components of PIEs, not just EU statutory audits. In relation to this we note that in the Directive the definition of key audit partners is written in terms of including "at least" statutory auditor(s) responsible for material subsidiaries and therefore recognises that the scope can be wider. From an ethical perspective, it seems more appropriate to apply the spirit of the requirement rather than seek to interpret the copy-out wording narrowly depending on the location of a material component. From a firm perspective, we are also of the view that a single rotation requirement for key audit partners would be easier to monitor against.
15 March 2017 Meeting – Ethical Issues		
2	Impact of gaps in service on auditor rotation	Paragraphs 3.10R to 3.22 of the Ethical Standard set out rotation requirements for key audit partners, engagement partners, other partners and staff involved in an engagement. Where staff have significant gaps in service, for instance, caused by a period of maternity or paternity leave, a sabbatical or long-term sickness absence, and their role is taken on by another person (e.g. a new engagement partner is assigned), the audit firm should exclude this period for the purposes of calculating applicable rotation periods. The FRC's expectation is that any periods excluded should be long-term in nature and should not comprise multiple smaller blocks of time aggregated together. If the person in substance retains their role (e.g. an engagement partner takes time out but remains responsible for signing

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		consecutive audit reports either side of the period of absence) then that period of absence **should not** be excluded for the purposes of calculating the rotation period. Such a period of absence will not 'reset the clock' for determining rotation requirements as set out in paragraphs 3.10R and 3.11 of the Ethical Standard unless it is at least equal to the required cooling off period (e.g. a partner who goes on a one-year period of maternity or paternity leave after having been engagement partner for three years cannot on returning to work commence another five year period as engagement partner for the same entity).
2	Upstream approval of non-audit services	Article 5.4 of the Regulation in effect requires that the auditor or a member of its network may provide NAS that are not prohibited to the audited entity, its parent or controlled undertakings subject to the approval of the audit committee of the audited entity, having properly assessed threats to independence and the application of any safeguards. Where the auditor of an EU PIE provides non-audit services to the parent of that PIE, it is important that there is an appropriate mechanism for those services by the audited EU PIE's audit committee. The FRC considers that the requirement on the audit committee of the EU PIE, and therefore the requirement also relevant to the audit firm is that the audit firm and audited entity need to have in place systems (in the case of the audit firm within its network) to ensure no breach of independence requirements occurs with respect to the PIE. In doing so, the audit firm and audited entity will need to monitor those services provided by the audit firm and its network firm to the PIE and where appropriate its controlled undertakings and parent undertaking and their connected parties to allow it to satisfy the requirements in paragraphs 4.34R and 4.37-4.40 of the Ethical Standard.

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2	Not accepting engagements where a former partner or RI holds a senior position	Paragraph 2.57 of the Ethical Standard prohibits an audit firm from accepting an engagement where a former partner or former RI (statutory auditor) has joined that entity as a director (either executive or non-executive), member of the audit committee (or similar body) or in a key management position (which is a term defined in the glossary to the Ethical and Auditing Standards). This prohibition applies for two years before acceptance of the engagement where a partner has joined the audited entity, and one year for another person. The requirement applies to former partners and RIs who have been covered persons in any engagement carried out by the audit firm, and who would have been involved in engagements involving the partner or the engagement quality control reviewer of the proposed engagement, were it to be accepted (and therefore in a position to exert influence over the engagement team). Note: this requirement is one of a series of wider requirements in this area, and should not be considered in isolation.
2	PIE organisations with listed debt	Organisations which have listed wholesale debt of €100 million or less on a regulated market **are** Public Interest Entities. For the purposes of the FRC's inspection work, and selecting audits for audit quality review, where listed debt is issued by a subsidiary company, the FRC's policy is to select the group company for review, which includes the PIE entity by virtue of it being included in the consolidated accounts. This is consistent with our inspection approach for large private entities with subsidiaries issuing listed debt on a regulated market and does not reflect a view that those subsidiaries are not listed PIEs.

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3	Services linked to financing, capital structure and allocation	Guidance on the application of the requirements of the audit regulation in respect of prohibited services linked to financing, capital structure and allocation is now incorporated in **[SGN 01/17]**.
3	Application of KAP requirements to non-EU partners	We have been asked how the requirements in the Ethical Standard pertaining to key audit partners apply to non-EU based partners, given that many of the requirements refer to the 'statutory auditor' which is not a concept used in a number of significant non-EU jurisdictions. The FRC Ethical Standard is principles-based, and an audit firm should ensure that they are applying the requirements of the standard in a way that complies with those principles, rather than seeking to narrowly apply the requirements of the Audit Directive only to entities carrying out statutory audit within the EU. This is consistent with our approach elsewhere in the Ethical Standard. As a result the KAP requirements apply to non-EU based partners where they are involved in the group audit of a UK PIE. A similar principle is also followed where rotation requirements for PIE auditors differ in different jurisdictions (both EU and non-EU). This was discussed by the TAG 5 December 2016 https://www.frc.org.uk/Our-Work/Publications/Audit-and-Assurance-Team/FRC-Technical-Advisory-Group-Rolling-record-of-ac.pdf, and the conclusion was drawn that requirements should not be limited by whether or not a component audit is covered by the EU definition of statutory audit:
28 April 2017 Meeting – Auditing Issues		
2	Material to support a review or investigation by the Competent Authority: (ISA (UK) 600 50D-3)	A group audit engagement file needs to contain documentation necessary to support a quality assurance review or investigation by the Competent Authority. The principles to be followed when preparing a group audit engagement file have already been discussed by the TAG at its October 2016 meeting, which is recorded in the record of rolling actions: https://www.frc.org.uk/Our-Work/Publications/Audit-and-Assurance-Team/FRC-Technical-Advisory-Group-

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		Rolling-record-of-ac.pdf. ISA (UK) 600 also sets out what an auditor should do where it is not possible to arrange access to documentation held by non-EEA component auditors. The group auditor is required to obtain sufficient appropriate audit evidence to enable an opinion on the group financial statements to be issued. Where the group auditor is unable to obtain or gain access to the component auditor's working papers for the purposes of the group audit, the auditor needs to consider what other action would be appropriate to take. This may include reporting any impediments and their impact to management and those charged with governance, considering whether the group auditor can undertake additional procedures to gather the evidence necessary to support the group audit through their own efforts, or where gaining access to documentation is problematic, carefully thinking about requesting additional material from component auditors before the auditor's report is signed. The engagement partner, in these circumstances, should carefully consider and document on the file how they have satisfied themselves as to the adequacy of the audit evidence. Where the group auditor is unable to obtain sufficient appropriate audit evidence, the group auditor considers the impact on the auditor's report. The auditor may also wish to discuss with the FRC, as competent authority, any particularly problematic cases.
2	Documenting the scope of an Engagement Quality Control Review: (ISA (UK) 220 21R-1 and 21R-2)	The Audit Regulation includes requirements regarding the documentation of the scope of an engagement quality control review (EQCR) which have been incorporated within ISA (UK) 220. We have been asked whether there is any additional guidance the FRC is able to provide over and beyond that included in paragraph 21R-1 (a) to (h), with regards to what we expect to see held on an audit file.

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		The FRC is of the view that audit firms should develop a policy to support EQC reviewers. This should include at least: • In documenting their review the EQC reviewer should set out in writing their consideration of each of those elements covered in paragraph 21R-1(a) to (h) and their conclusion, having reviewed the relevant parts of the audit file in a way that allows an external reviewer to appreciate the scope and quality of the challenge offered by the EQC reviewer; • Documentation may take many different forms. For example, it may include a file note of the discussion between the EQC reviewer and the KAP(s) as necessary, where the results of the review are discussed, including any agreed actions arising from that discussion; • If the reviewer has, in the course of their review, used alternative scenarios to those used in the audit, as a way of considering the appropriateness of the proposed approach and the judgements and conclusions drawn by the audit engagement team, they should set these out in their documentation of the review work; and • It should be clear from the audit file that the EQC reviewer has robustly appraised the quality of the work performed and the conclusions reached by the engagement team, as a minimum, in the areas required by the ISA (UK). This is unlikely to be demonstrated where the only evidence of an EQC reviewer's review is a sign off or completion of a checklist.
2	Granularity of reporting on valuation methods: (ISA (UK) 260 16R-2(i)	We have been asked to give a view on the expected level of granularity in reporting required by paragraph 16R-2(l) of ISA (UK) 260. This requirement covers matters to be reported to the audit committee or those charged with governance by way of the additional report required by the Audit Regulation. Sub-paragraph (l) covers the: "valuation methods applied to various items in the annual or consolidated financial statements including the impact of changes of such methods."

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		When communicating with those charged with governance, the nature of the audience should be borne in mind when considering how to present the work of the auditor and any findings emerging from the audit in a way that makes them accessible, rather than just complying with a process-type requirement. Therefore, when the auditor is considering the extent of the reporting required to meet these requirements, the FRC is of the view that such reporting should enhance the value of the audit, particularly taking into account that information that would be relevant to the Audit Committee in carrying out their oversight role (particularly where aspects of that role are established by the Audit Regulation).
3	The extent to which an audit is designed to detect irregularity, including fraud: (ISA (UK) 700 45R-1(c))	The TAG has previously had a preliminary discussion about how the auditor should satisfy the requirement to explain in the auditor's report the extent to which the audit is considered capable of detecting irregularities, including fraud. The rolling record of actions stresses the importance of auditors not resorting to boilerplate reporting, and ensuring that they report in a way that will be meaningful and useful to the user of the auditor's report. We have since been asked whether it is possible to set out the FRC's expectations in respect of this requirement which comes from Article 21.2 of the Directive (which refers to irregularities, including fraud or error), and from Articles 7 and 10.2 (d) of the Regulation (which refers to irregularities, including fraud). In reporting on how the audit was considered capable of detecting irregularities, including fraud, the auditor should, therefore, consider reporting on those risks of material misstatement (either by size or by nature) relating **to fraud or non-compliance with law or regulation** that the auditor identified as being of particular significance to the public interest entity, in a way that does not use boilerplate statements and which makes the auditor's report as helpful as possible to the user.

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3 May 2017 Meeting – Ethical Issues		
2	Meaning of services having a direct effect on the financial statements (ES 5.168R)	Services having a direct effect on the financial statements, and thus not eligible to apply the member state option derogation at ES 5.168R are those having a direct effect on the financial statements of a public interest entity. A service having a direct effect on the financial statements should be interpreted as one which could or does result in a change to, or supports the continuing use of an existing tax treatment, in the financial statements (including disclosures) as a result of the service being provided. This includes situations where tax advice results in a change to tax amounts or disclosures in the financial statements or supports the continued application of a tax exempt status resulting in a lower tax impact on an entity subject to audit. This should not be narrowly interpreted as only being applicable where the non-audit service has an effect on the financial statements for the period in which the service is undertaken. It applies where the provision of a non-audit service will result in any direct effect even if that effect is on future financial statements. As a result, circumstances where the derogation can be applied are likely to be limited, as most tax and valuation services covered in paragraphs 5.167R (a)(i), (a)(iv-vii) and (f) will have a direct impact on the financial statements.
2	Status of Valuation Reports required under s.593 of the Companies Act for the purposes of the non-audit services prohibition (ES 5.167R (f))	Section 593 of the Companies Act requires a valuation report to be prepared by someone who is registered as a statutory auditor where a company proposes to issue shares in return for non-cash consideration. We consider that such reports cannot be provided by the entity's auditor as they are prohibited by the Regulation on two grounds – set out at paragraphs ES 5.167R (f) and (i):

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		• The issuing of a valuation report is a prohibited service for PIE audits as it meets the definition of a valuation service in Article 5 of the Regulation. Although the derogation is applicable to these services, it only applies where there would be no direct effect on the financial statements; • Such valuation services would also be subject to the absolute prohibition on the auditor providing services linked to the financing, capital structure and allocation of an entity (ES 5.167R (i). We are also of the view that it might be difficult for an objective, reasonable and informed third party to draw a conclusion that an engagement to produce a valuation report would **not** be covered by a prohibition on valuation services. We do not consider that the wording in Recital 8 of the Regulation provides a basis to not apply the prohibitions in respect of these services as they are not linked to the financial statements of the audited entity and are not linked to prospectuses issued by the audited entity[5].
2	Services prohibited by the 'human resources services' prohibition (ES 5.168R (c))	We have been asked to provide guidance on those services which are prohibited by the 'human resources services' prohibition at 5.167R (k). In common with the approach taken at other TAG meetings this is intended to clarify the black list of prohibited services, rather than setting out permitted services.

[5] This is not a change of substance. It is consistent with the guidance in Bulletin 2008/9 – *Miscellaneous Reports by Auditors required by the UK Companies Act* 2006, and also with the revisions made to the "APB Ethical Standards", issued by the FRC, in 2010 which was subject to a public consultation in 2009. At the point the Ethical Standards were amended to state that the auditor is able to provide valuation report services where they are **required** to do so rather than the earlier version of the standards which permitted the provision of valuation reports where the auditor was **eligible** to do so.

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		The prohibition driven by the Regulation covers three main areas: • An audit firm is prohibited from providing human resource services which involve executive search, or candidate searches to identify candidates for a management post or posts which could exert significant influence over the preparation of accounting records or financial statements that are the subject of statutory audit. The prohibition extends to the audit firm carrying out reference checks for any such positions; • An audit firm is prohibited from providing human resources advice or support in connection with the structure of the organisational design of an audited entity – we take this to mean that the firm cannot advise or provide support on the structure of all or any parts of the business from a human resources perspective; and • An audit firm cannot provide human resources advice or services where the purpose of this service is to lead or contribute towards personnel-related cost control. This could be likely to lead to decisions about costs which the auditor might be expected to examine as part of their statutory audit of the financial statements. These prohibitions should be applied to the audit firm and its network and apply to the audited entity, its parent undertaking and its controlled undertakings in the Union in accordance with the requirements in paragraph 5.167R of the Ethical Standard. Audit firms should also remember the further prohibition in ES 5.116 that audit firms shall not provide advice on the remuneration package or the measurement criteria on which remuneration is calculated for a director or person in a key management position for any audited entity.

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3	The application of the Objective, Reasonable and Informed Third Party Test	We were asked by the Company Reporting and Audit Group (CRAG) and a number of other stakeholders to provide additional guidance on the application of the Objective, reasonable and Informed Third Party (ORITP) Test. We consider that the following issues need to be considered by audit firms, and should be clearly documented in any audit files where such a consideration is necessary. The issues set out below do not constitute an exhaustive list: • The assessment of what an ORITP might think **should not** be a narrow legalistic assessment – it should be an overarching, principles based assessment of risks that the ORITP might consider would have an impact on the audit firm's independence; • In carrying out such an assessment, the audit firm should consider not only issues arising on an engagement or issue specific basis, **but also wider publicly available information that an *informed* person would be aware of and would bring to bear on their assessment**. This might include, for example, where the ORITP is aware of a series of ethical issues which taken together might cause the ORITP to have concerns about an audit firm. The more questions they have about this the more they could question the integrity of that firm. Audit firms should take account of this when making their own considerations, and be careful to document their consideration of how they have applied this test, and the conclusions drawn. This principle is well established in the way in which audit firms are required to consider gifts, favours and hospitality provided as if on a cumulative basis; • Audit firms should consider who might be proxies for the ORITP – investors may be a good proxy, **but should not be the only stakeholder that the firm considers**, and a diversity of views is important. Who might be considered an

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		ORITP may change over time to reflect the context in which the assessment is being made; • When considering ethical issues and how they might be considered by an ORITP, the audit firm should consider their assessment in qualitative and well as quantitative terms. The context in which a decision is taken will impact upon the assessment made and the actions a firm takes as a result. An issue subject to repeated stakeholder criticism may, for instance, have a more serious impact each successive time it arises; and • Audit firms should carefully consider any ORITP assessment – the conclusions a firm draws should be from a principles based perspective, rather than disaggregating the assessment into a series of detailed requirements. The FRC will consider making further guidance available once it has completed the ongoing AQR Firmwide Review of how audit firms have addressed the ORITP Test in practice.
July 2017 Matters By Correspondence – Auditing Matters		
2	Determining key audit matters (ISA (UK) 701 paragraph 10)	Key audit matters is defined in Paragraph A8-1 of ISA (UK) 701. This means that: those risks that would previously have been reported under ISA (UK and Ireland) 700 (Revised September 2014); and any risks identified as "the most significant assessed risks of material misstatement, including assessed risks of material misstatement due to fraud" as required by the Audit Regulation, are always a subset of those matters that were of most significance in the audit of the financial statements, and are key audit matters. However, these matters relate to risks of material misstatement, whereas the definition of key audit matters in paragraph 8 of ISA (UK) 701 is "those matters

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		that, in the auditor's professional judgment, were of most significance in the audit of the financial statements of the current period". It is possible, therefore, that other matters, other than risks of material misstatement, may be identified by the auditor as being key audit matters. In practice, the FRC is not anticipating a significant change in the numbers or types of matters that are reported as key audit matters.
2	Providing additional information when reporting on a material uncertainty relating to going concern in the auditor's report (ISA (UK) 570 paragraph 22)	The IAASB recognised in revising ISA 570, that material uncertainties relating to going concern were so important in the context of the auditor's report that they should be included in a separate section (and no longer included as an emphasis of matter). This is further explained in ISA (UK) 701 paragraph 15, which sets out the interaction between key audit matters and other elements required to be included in the auditor's report. ISA 701 requirements do not apply to the disclosure of a material uncertainty relating to Going Concern in the auditor's report – rather the requirements of ISA 570 apply. This is made clear in paragraph 15 of ISA 701 which states: "A matter giving rise to a modified opinion in accordance with ISA (UK) 705 (Revised June 2016), or a material uncertainty related to events or conditions that may cast significant doubt on the entity's ability to continue as a going concern in accordance with ISA (UK) 570 (Revised June 2016), are by their nature key audit matters. However, in such circumstances, these matters shall not be described in the Key Audit Matters section of the auditor's report and the requirements in paragraphs 13–14 do not apply. Rather, the auditor shall: (a) Report on these matter(s) in accordance with the applicable ISA(s) (UK); and (b) Include a reference to the Basis for Qualified (Adverse) Opinion or the Material Uncertainty Related to Going Concern section(s) in the Key Audit Matters section."

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		However, as explained in paragraph A30 of ISA 570, the auditor may provide additional information that supplements the required statements set out in paragraph 22 of ISA 570, which may include how the matter was addressed in the audit.
2	Work effort required as a result of revisions to ISA (UK) 720	The FRC has been asked to clarify whether the revisions in ISA (UK) 720 (Revised June 2016) should lead to a substantially increased work effort required in order to meet the requirements of the revised standard. In doing so we note that the previous version of ISA (UK) 720 went beyond the base requirements in the IAASB's ISA 720. As a result, a UK auditor is already required to consider whether there is a material inconsistency between the other information and the auditor's knowledge obtained in the audit and is also already required to report on certain of the other information in the auditor's report. The new requirements to report on statutory other information –directors' report, strategic report, separate corporate governance statement derived from the Accounting Directive as amended by the Audit Directive, state that the opinions and statements that the auditor are required to provide are given based on the work undertaken in the course of the audit. It is the FRC's view, that in order to be able to give an opinion on whether the statutory other information has been prepared in accordance with applicable legal requirements, the auditor must first obtain an understanding of those requirements (paragraph 12-1 refers). The auditor is, therefore, expected to undertake additional work where necessary to obtain this understanding. In practice, this is not likely to generate significant levels of additional work as most auditors are likely to already have an understanding of the applicable legal requirements in

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		respect of statutory other information. The auditor is expected to their use professional judgment to perform such procedures as required by paragraph 14-2 of the ISA (UK).
10 July 2017 Meeting – Ethical Matters		
2	Tax services having a direct effect on the financial statements	A table has now been appended to **SGN 05/16** to provide guidance for practitioners.
2	Contingent Fees	A table of examples has now been appended at **Appendix 3** to this rolling record of actions.
2	Application of the non-audit services fee cap to regulatory reporting work	We have been asked to clarify how paragraphs 4.34R and 4.35R of the Ethical Standard apply in respect of regulatory reporting work which is required by statute. Paragraph 4.35R of the Ethical Standard means that where non-audit services which are not prohibited, are required to be provided under national or EU law or regulation, the cost of those services do not count towards the 70 per cent non-audit services fee cap. Audit firms are, nevertheless reminded that they must still seek prior approval from the audit committee to provide such a service, and both the auditor and the audit committee will need to consider the service or services to be provided to ensure that they would not compromise the independence of the audit (to be considered from the perspective of the ORITP). Where the provision of such a service would compromise independence, the auditor should not provide that service. This also applies where these engagements are required to be carried out using statutory regulatory powers that a regulator has been granted through legislation.

Agenda Item	Issue	Action
2	In-year appointments – the impact of prohibited non-audit services	We have been asked how an audit firm should respond where it is asked to tender for the provision of audit services to a PIE entity, where the first financial year of the engagement has already started, and that firm has already provided prohibited non-audit services in that period. Can such an audit firm accept the appointment? Our view is that where the entity is an EU PIE, Article 6 of the Regulation applies directly (preparation for the statutory audit and assessment of threats to independence), and if an audit firm that had provided prohibited non-audit services in the financial period did tender and was successful that firm would be in breach of Article 6.1(a), because the firm would also breach Article 5.1(a) which does not allow an auditor to provide prohibited non-audit services in the period between the beginning of the period audited and the issuing of the audit report. Where the prohibited service involves the design and implementation of internal control or risk management procedures related to the preparation and/or control of financial information, or the design and implementation of financial information technology systems then the prohibition **also applies in respect of the preceding financial period**. No safeguards are applicable in this respect as the audit firm would be in breach of the Regulation which has direct effect in law. *Legal Requirements regarding the appointment of auditors is set out in section 485 – 491A of the Companies Act 2006*

5 October 2017 Meeting – Ethical Matters		
2	Members' Voluntary Liquidations – Application of Prohibited Services Requirements.	The issue has been raised as to whether services in respect of executing members' voluntary liquidations in a public interest entity are prohibited by the Audit Regulation, as set out in paragraph 5.167R(i) of the FRC Ethical Standard. A Members' Voluntary Liquidation (MVL) is where the shareholders of a solvent company adopt a voluntary winding up resolution and appoint a liquidator to realise the assets of the business in order to distribute the proceeds to company members. A company is considered legally solvent when it is able to meet its financial obligations, and the value of its assets is equal to or exceeds the total sum of all its debts and liabilities. Prior to entering into an MVL, all or at least a majority of directors of a company must make a sworn Declaration of Solvency, which states that they have thoroughly reviewed the company's balance sheet and finances and have concluded that it is solvent and able to repay all existing and prospective debts, together with interest at the official rate within a period of no more than 12 months from the commencement of the winding up. To assess this matter depends on understanding the powers granted to the liquidator. For an MVL, the liquidator has a wide range of powers to enable realisation of the company's assets, agreement of creditors' claims and distributions to creditors and members. The liquidator is able to operate bank accounts in the name of the company and to invest funds. Reasons for an MVL may include: tax planning considerations within groups of companies or as part of group; and company reorganisations or reconstructions. They may, therefore, have the following characteristics in that they relate to: • the audited entity's decisions in respect of the division of financial resources and other sources of capital to different processes, people and projects;

		• decisions in respect of generating wealth for shareholders/stakeholders by optimising the allocation of capital within the business; and • management's decisions as to how best to maximise returns from the business. In circumstances where there is no impact on the financing, capital structure and allocation or the investment strategy of the audited public interest entity, the entity is dormant, all balances other than inter-company balances have been settled and there is no cash[6] to be distributed, the provision of a MVL is unlikely to be subject to the prohibitions in the Audit Regulation. This is consistent with SEC rules applicable to US listed entities.
2	KAP Materiality	The Audit Regulation requires an audit firm to designate a key audit partner (KAP) or partners for the audit of a public interest entity. Those partners are statutory auditors who are: primarily responsible for carrying out the statutory audit on behalf of the audit firm; primarily responsible (in a group audit) for carrying out the statutory audit of the group and of any material subsidiaries in that group; or the statutory auditor who signs the audit report. The TAG has previously discussed rotation arrangements for those who carry out the KAP role, but there has been no discussion as yet about what is meant by the need for an audit firm to designate a KAP for the audit of material subsidiaries in a group engagement. The concept of materiality is applied by the auditor both in planning and performing the audit, and in evaluating the effect of identified misstatements on the audit and of uncorrected misstatements, if any, on the financial statements. In general, misstatements, including omissions, are considered to be material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of

[6] This requirement is consistent with applicable SEC Rules.

		the financial statements. Judgments about materiality are made in the light of surrounding circumstances, both quantitative and qualitative, and are affected by the auditor's perception of the financial information needs of users of the financial statements, and by the size or nature of a misstatement, or a combination of both. We noted that audit firms had addressed this requirement in a range of different ways, and using a range of different levels of 'materiality'. The FRC's expectation is that when considering which subsidiaries are material in the context of a group engagement, the firm should use the definition of materiality included above from paragraph 6 of ISA (UK) 200, *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with International Standards on Auditing (UK)*. **The FRC is raising this with the CEAOB to seek views from other EU Member States, including what happens when a subsidiary changes over time from being material in the context of a group, to not being material.**
2	Contingent Fees – Consolidated Guidance	The Ethical Standard prohibits the use of contingent fees for non-audit or additional services provided to an audit client (4.6R), where the contingent fee is material to the audit firm, or any part of that firm which is used to calculate the profit share of the partner or partners involved (4.14). Contingent fees are also prohibited where the fee that will ultimately be paid for the engagement depends on an outcome related to an amount that will be included in the financial statements of an audited entity, on which the auditor will have to exercise judgment. Where that amount is material in the current financial year, or subsequent financial years, contingent fees may not be used. This is because where contingent fees are paid to an audit firm in respect of non-audit services, a conflict is created where that fee arrangement incentivises the firm in a transaction that will produce an asset or liability in the financial statements to be audited or impacts on an existing asset or liability in the financial statements, which may be subject to a judgement by the auditor as part of the audit.

		Accordingly a prohibition on contingent fee arrangements exists (4.14b), if: • There is an event that ultimately triggers a contingent fee being paid; and • There are or will be material balances in the financial statements that result from, or are impacted by, that event; and • Those balances will be subject to a judgment by the auditor as part of current or subsequent audits. The prohibition on contingent fees is not new, however, it has been redrafted to help practitioners to clearly understand their responsibilities, rather than interpreting the requirement in a way that is unhelpfully narrow and does not effectively safeguard independence. When considering their independence, the auditor should not only consider the materiality of the transaction or impact on the financial statements in the current financial year subject to audit, but should also consider the likely impact on future years (for example – a material impairment to an acquisition might only be revealed over time) when considering whether a contingent fee for non-audit or related services is permissible. Auditors should also consider when tendering for appointment, whether contingent fee services they have provided prior to tendering for appointment impact on their independence to be able to accept appointment. (Also see **Appendix 3**, attached to this document for further information and some illustrative examples.)
12 February 2018 – Ethical Matters – Investment Circular Work *Due to an oversight this material was only added to the rolling record in August 2018.*		
2	Applicability of the ES to Investment Circular Work	The FRC Ethical Standard applies in respect of audit engagements and other public interest assurance engagements. Work carried out in accordance with the Standards for Investment Reporting (SIRs) is required to follow the FRC Ethical Standard. In the Ethical Standard, all requirements apply unless indicated otherwise. Specific considerations in respect of Investment Circular Reporting Engagements

		are shown in boxed text. Reporting accountants should also take particular account of paragraph I8 in the introduction to the Ethical Standard which states that: the supporting ethical provisions and requirements of the Ethical Standard apply to persons with *actual knowledge* of the engagement, when considering who is a covered person for an investment circular reporting engagement. For this type of engagement, persons with *actual knowledge* refers to those who have knowledge of the subject matter of the particular transaction that is a subject of the engagement. This information may well be price sensitive, and as a result access is restricted to those carrying out the reporting engagement, rather than being provided to a wider group of practitioners.
2	Is an agreed upon procedures (AUP) engagement an other public interest assurance engagement?	Where an agreed upon procedures engagement reports results on a purely factual basis, with no opinion or conclusion expressed, it is not an assurance engagement, and therefore, not within the scope of the Ethical Standard. However, the ethical codes of the Professional Bodies will, of course, apply in those circumstances. It is worth noting the importance of these engagements being clearly and precisely scoped in letters of engagement, so as to avoid any confusion as to the type of engagement that is being carried out. This does not preclude audit firms being able to apply, on a voluntary basis, the requirements of the FRC Ethical Standard to AUP engagements.
2	Where a reporting accountant (A) relies on/ uses the work of another unrelated firm (B) which does not have a direct relationship with the entity which issues the investment circular, is there a requirement for that firm to follow the requirements of the Ethical Standard, other than as	The TAG has already considered the applicability of the Ethical Standard in a situation where an auditor is required to assess the independence of an external expert. In this situation the same approach should be followed. The section of the TAG rolling record is attached for information. *Where the auditor has used the work of an external expert, the Audit Regulation requires the auditor of a PIE to obtain confirmation from that expert regarding their independence. The FRC recognises that the expert may be from a different professional body with different ethical requirements to those applicable to auditors. Although the external expert is not part of the engagement team as defined by the ISAs (UK), as someone whose services are placed at the disposal*

	required to through its contract to perform work for (A)?	*of the audit firm / team, they will be subject to the 'covered person' definition within the Ethical Standard.*
2	What services and relationships are to be required to be reported to those charged with governance by paragraph 1.67(i) of the Ethical Standard?	The engagement partner for an investment reporting circular engagement reports to those charged with governance of each issuing entity (and if different, the entity whose financial information is the focus of the report) relevant to the engagement and other persons or entities that the firm is instructed to advise: • All relationships that might reasonably impact on the integrity, objectivity and independence of the reporting accountant/ firm, having considered: ○ Relationships with each entity relevant to the engagement; ○ The directors and senior management of those entities; and ○ Any affiliates of the entity relevant to the engagement. In determining those services and relationships that need to be reported, the engagement partner will be required to exercise careful judgment, and to take account of what an objective, reasonable and informed third party would consider would affect the independence of the reporting accountant. The Ethical Standard requires the reporting of services that the engagement partner considers are significant when considering the independence of the practitioner in the context of each entity that is a party to the engagement and their significant affiliates.

Appendix 1

Rotation periods for key audit partners

Maximum period of rotation Applicable to	Engagement Partner (EP)[7]	Key Audit Partner (KAP)	Key Partner Involved in the Engagement (KPIE)	Engagement Quality Control Reviewer (EQCR)	Other partners and staff in senior positions
Public Interest Entity (PIE)	5[8] on/ 5 off	5[8] on/ 5 off	7 on/ 2 off[9]	7 on/ 5 off	Apply threats and safeguards approach, for staff who have been involved in the engagement for more than 7 years.
Other Listed	5[5] on/ 5 off	N/A	7 on/ 2 off	7 on/ 5 off	
Non-PIE/Listed	Apply threats and safeguards approach, specific steps to be taken at 10 years.	N/A	Apply threats and safeguards approach, specific steps to be taken at 10 years.	Apply threats and safeguards approach, specific steps to be taken at 10 years.	Apply threats and safeguards approach.

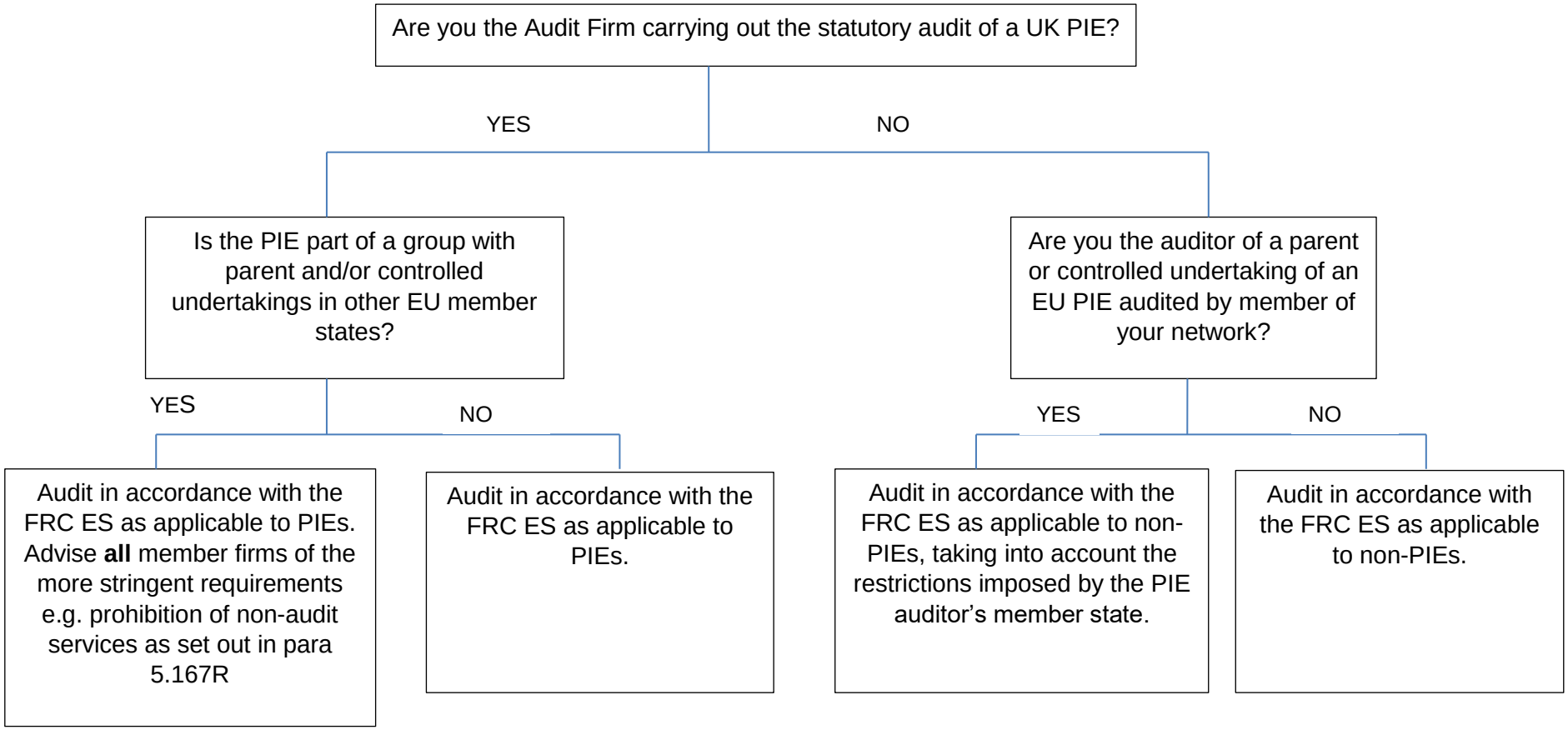
[7] An engagement partner is a key audit partner.

[8] With the agreement of the audit committee, this can be extended where there is good reason (e.g. to maintain audit quality) to no more than 7 years – this also applies to Key Audit Partners.

[9] Except where an individual has held a combination of roles, in which case it is 7 years on and then 5 off.

Appendix 2

Requirements applicable to audits of UK subsidiaries of a PIE



Appendix 3

Contingent Fees – Illustrative examples

The Ethical Standard retains the prohibition on contingent fees that was in the earlier version of the Standard in respect of non-audit services or additional services provided to an entity relevant to the engagement. The conditions that apply to such engagements are set out in paragraph 4.14 of the Ethical Standard. We have been asked to provide further guidance, not on the materiality of a proposed contingent fee, but on the requirement at 4.14(b) which prohibits a contingent fee arrangement[10] where it is dependent on an outcome or result what relevant to a future or contemporary judgment relating to a material matter in the financial statements. This additional guidance is included in the examples set out in the table below, which are intended to provide additional clarity – **for the purposes of these examples, the entities are not PIEs**. In addition to the requirements in Section 4 of the Ethical Standard, prohibitions on the provision of tax services on a contingent fee basis are set out in paragraphs 5.85-5.91 of the Standard.

The intention of this guidance is not to provide a series of rules, but to set out the requirements and principles that a firm should consider when deciding on whether or not a contingent fee arrangement is permissible when providing a non-audit service. The information in the table below is not exhaustive.

Example	**Factors to consider (not exhaustive – indicative examples only)**
1. One or more shareholders who are not audit clients of an audit firm, are selling their shares in company A, which is an audit client of the firm. The firm is engaged by the shareholders and/ or the company to provide CF advice. The fee is contingent on completion of the disposal, and varies dependent upon the enterprise value of the deal. The fee is fully payable by the shareholders in cash at completion.	• Service counts as if a NAS provided to A; • Dealing, promoting or underwriting shares is prohibited; • Timing of the transaction – will it have been completed by the year end, or will it straddle year-ends? If completed and paid for, with no outstanding conditions, unlikely to be caught by (b), if not then carefully consider risk; • Where sale transactions take place consider whether the risk under 4.14(b) is likely to be lower in terms of impact on current or future financial statement audits;

[10] Additional fees referred to as 'value added' or 'delight fees' should be considered as contingent fees for the purposes of this guidance.

	• Consider from perspective of ORITP test; • Consider materiality quantitatively and qualitatively.
2. Client A is selling subsidiary B (which is also an audit client). The firm is engaged to provide CF advice to A. The fee is contingent on completion of the disposal and varies dependent upon the enterprise value of the deal. The fee is fully payable by A in cash at completion.	• Consider as for example 1.
3. Client A is selling subsidiary B (which is also an audit client of the firm, and will remain an audit client of the firm). The firm is engaged to provide CF advice to A. As part of the negotiations, A agrees that the consideration will include a deferred amount, either a sum certain payable at a later date, or an amount payable in the future which varies dependent on the profitability of subsidiary B for a fixed future period after the disposal (i.e. an earn-out). The fee is contingent on completion of the disposal and varies dependent upon the enterprise value of the deal. The amount of the fee is calculated by reference to the sum payable on completion by the purchaser and an estimate of the additional consideration under the earn-out provisions. The fee amount is not adjusted subsequently.	• Consider as for example 1 – and; • Note that earn out option is likely to mean the auditor should consider whether there is a greater risk that the fee is dependent on matters related to contemporary or future audit judgments in certain circumstances, and therefore prohibited if material.
4. The firm is engaged by audit client A to either raise debt or equity funding for a new project or to replace an existing funding package. The fee is contingent on the signing of the facility agreement (or the subscription for new shares). The amount of the fee might be either fixed fee or calculated by reference to a % of the funds raised.	• Dealing, promoting or underwriting shares is prohibited; • Consider materiality quantitatively and qualitatively. • If completed before the year end, with no outstanding conditions, complex structures or embedded derivatives, unlikely to be subject to contemporary or future audit judgments; • Consider from ORITP test perspective – e.g. increased risk may exist where going concern is uncertain and finance is likely to be a key factor.
5. Audit client A is acquiring target B, which may or may not be an audit client. The firm is engaged to provide CF advice to A. The fee is contingent solely on completion of the acquisition. The amount of the fee is a fixed sum. There is no deferred payment element of the contingent fee.	• An acquisition is likely to be subject to the prohibition in 4.14(b), as amounts relating to the transaction will subsequently appear in the financial statements of A, are may be subject to future audit judgments e.g. for impairments; • Consider materiality quantitatively and qualitatively; • Consider from ORITP perspective.