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Dear Mr. Ferris

Consultation on Revisions to Ethical and Auditing Standards 2019 – Request for comments

Grant Thornton UK LLP (Grant Thornton) welcomes the opportunity to comment on the Financial Reporting Council's (FRC) Revisions to Ethical and Auditing Standards 2019 (The Revised Standards).

In the current environment, where the UK has recently seen a number of high-profile corporate failures and the future relevance of audit is consequently being brought into question, we support the view that it is increasingly important that confidence in the assurance provided by an independent audit is restored.

Revised Ethical Standard 2019 Exposure Draft

Our review of the Revised Ethical Standard 2019 Exposure Draft (2019 Ethical Standard) has identified:

- A lack of clarity in places, which raises concerns about consistent interpretation across the industry and how systems, processes and controls should be designed and implemented in order to ensure compliance
- A lack of change to certain areas of the Ethical Standard, such as Section 2 on Personal Independence, which formed a significant part of our response to the Post Implementation Review of the 2016 Ethical and Auditing Standards, to simplify the language and/or provide more clarity
- The use of different terminology for what appears to be essentially the same underlying concept
- There should be more guidance in the Ethical Standard on its application. We consider that if the intention is to issue a shortened Ethical Standard, this is best achieved with a focused document covering the requirements and core guidance but supported by a suite of detailed guidance documents including illustrations and examples as necessary.

We note that the other reviews into the auditing and accounting industry, including Sir Donald Brydon's review into the quality and effectiveness of UK audits[1] and the expected Department for Business, Energy & Industrial Strategy (BEIS) consultation on the definition of Public Interest Entities (PIEs) in

[1] Independent Review into the Quality and Effectiveness of Audit: https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/794244/brydon-review-call-for-views.pdf

Autumn 2019, will have an impact on many of the amendments proposed in the 2019 Ethical Standard and consider it important the Exposure Draft does not pre-empt the outcomes or require amendment afterwards. The future of local government audit is also under the spotlight, with the Government sponsored Redmond Review examining the scope, quality and regulation. As many major local government audits also meet the definition of PIE or of "other entities of public interest" (OEPIs), it will be important that the implications of the Exposure Draft are also consistent for this area.

We are also concerned given, the shortened consultation period, the limited time between the expected release of the final version of the 2019 Ethical Standard and the proposed Effective Date, does not provide accounting firms with sufficient time to ensure that they comply with the revised rules from this date. We therefore request that the Effective Date is moved forward to 15 June 2020 or later so that sufficient time is available to implement the relevant changes to systems, processes and controls to ensure compliance with the 2019 Ethical Standard. It will also enable a smooth transition for clients where services may need to be transitioned to alternative providers in what is already an uncertain business environment. Further, a delay would allow for better coordination with the Brydon, Redmond and BEIS reviews and account for any additional changes that the UK exiting the EU may bring.

Revised International Standard on Auditing (UK) (ISAs (UK)) and International Standard on Quality Control (UK) (ISQC (UK)) Exposure Draft

We note that many of the proposed amendments to the ISAs (UK) pertain to areas under consideration in the Brydon and to some extent Redmond Reviews, including:

- Auditor's reports – transparency of auditor's reports, including reporting 'graduated findings'
- Fraud – considerations to extend auditors responsibility to detect fraud, including evaluating and reporting on the entity's systems to prevent and detect fraud
- Going concern and viability statements – broadening the scope of audit to provide assurance on the viability statements
- Other information – consideration of whether audit or assurance over financial and non-financial information outside the annual financial statements would enhance its reliability.

It is important that amendments proposed to the ISAs (UK) in the Exposure Draft do not pre-empt any potential recommendations resulting from this review and are carefully coordinated with such. Further, consideration should be given to the potential negative impact on quality that continued consistent changes to the ISAs (UK) may have.

However, as we noted in our response to the Post Implementation Review 2016 Ethical and Auditing Standards Changes to Implement the Audit Regulation and Directive – Call for Feedback, we believe that it is increasingly important that confidence in the assurance provided by an independent audit is restored, and are therefore fully supportive of proposals that will make progress in restoring that confidence.

Overall, we believe that the proposals in the Revised Standards are a step in that direction through the provision of increased transparency regarding the audit process to users of the financial statements. For example, through the requirement for public interest and other listed entities to include disclosures in the auditor's report relating to the significant judgements made in relation to key audit matters, and the requirement to include enhanced disclosures regarding the levels of materiality used. In order to facilitate a correct and consistent application of the requirement to disclose significant judgements regarding key audit matters, we do, however, recommend that application guidance is provided, similar to that proposed for the disclosure of significant judgements in relation to materiality. In this respect, we also refer to our response to the recent FRC consultation on ISA (UK) 570, Going Concern (ISA (UK) 570) Exposure Draft, and particularly the proposal for auditors of all entities to provide an explanation of how the auditor evaluated management's assessment of going concern (including key observations) and to conclude on going concern in the auditor's report. We note that a number of auditor's reports are already beginning to include such disclosures and as such we reiterate our recommendation for guidance, either in a revised ISA (UK) 570 or through other means, such as Staff Guidance, to facilitate robustness and consistency of such disclosures.

We are also supportive of the extension of the requirement to explain to what extent the audit was considered capable of detecting irregularities, including fraud to entities other than public interest entities. However, we are of the view that this requirement should not be extended to all entities. For example, in the case of a small owner-managed business, the owner of the business will often be closely involved with the day-to-day management of the entity and will also have a much higher level of contact with the auditors during the performance of the audit. Therefore, reporting the extent to which the audit was considered capable of detecting irregularities, including fraud, would become a documentation exercise. We have therefore recommended, in our detailed response below, that the requirement be extended only to those entities that are of significant public interest and that this category be determined by reference to the category of "other entities of public interest" (OEPIs) proposed in The Revised Standards, subject to a clear and operable definition of this term being established. If, ultimately this requirement is extended to all entities, we have recommended that consideration be given to establishing a more scalable and proportionate disclosure for entities that do not meet the definition of a public interest entity and are not otherwise of public interest.

We are also supportive of the incorporation into the ISAs of the guidance provided in the FRC's Staff Guidance Notes. In our detailed response below, we have, however, highlighted areas where we believe improvements could be made to this incorporation and have provided recommendations in this regard.

We find that the proposed amendments to ISA (UK) 720 (Revised June 2016) less clear and helpful. In particular, we have recommended in our detailed response that application material be provided to assist auditors in addressing all the areas identified as being problematic in the FRC's Thematic Review[2] on other information. Further, clarity on the interaction between the new Corporate Governance Statement section of the auditor's report and the going concern disclosure requirements would be helpful in fulfilling these requirements.

To facilitate the consistent and appropriate interpretation of the new requirements, we strongly recommend that the FRC provide interpretations, illustrations and guidance on the areas that have been identified by firms as problematic at the same time the 2019 Ethical Standard, ISAs (UK) and ISQC (UK) are issued. We have highlighted in our detailed response below, the areas where we believe such guidance will be useful in this respect.

We set out in our response attached to this letter our replies to the FRC's questions in The Revised Standards. We have also included more detailed recommendations and editorial comments in appendices at the end of our response. We would be pleased to discuss those responses with you.

Yours sincerely,

Fiona Baldwin
Head of Audit

Adrian Richards
Ethics Partner

[2] Audit Quality Thematic Review: Other Information in the Annual Report

Response to the Consultation on Revisions to Ethical and Auditing Standards 2019

The following provides our response to the FRC's request for comments on the Consultation on Revisions to Ethical and Auditing Standards 2019.

Response to the Questions raised on the Exposure Drafts of the revised Ethical Standard and ISAs (UK):

Question 1: Do you agree with the revised definition of an 'objective, reasonable and informed third party' and with the additional guidance on the application of the test?

An "objective, reasonable and informed third party" (ORITP) was not defined in the Revised Ethical Standard 2016 (2016 Ethical Standard), generating debate around who should be considered to meet these qualities. Practitioners considered an ORITP to cover a range of views, including those of other audit practitioners and stakeholders as suitable 'third parties'.

Under the proposals in the 2019 Ethical Standard, an ORITP is defined in I14 to explicitly exclude "other practitioners" and specifically refer to an "informed investor, shareholder or other public interest stakeholder"[3]. The additional guidance is useful but raises questions regarding practical application as it is more restrictive than the IESBA Code, which references that an ORITP "need not to be an accountant, but would possess the relevant knowledge and experience to understand and evaluate the appropriateness of the accountant's conclusions in an impartial manner"[4].

We are unclear whether the FRC is envisaging firms canvassing the views of individuals from outside the Firm or to convene Investor Panels. This approach could be perceived itself to give rise to self-interest, self-review and familiarity threats with respect to the investors/stakeholders included, as well as leading to divergence across the industry based on the composition of individual Panels. Further, whilst this may be an appropriate approach for major considerations on high profile entities, it may not be proportionate for most circumstances where the "Third Party Test" would need to be applied.

Our view is that it would be valuable for the FRC to have a panel of individuals considered to be "objective, reasonable and informed third parties" that could be a reference point for firms on a no-names basis, to inform decisions and test scenarios, to ensure that these key criteria can be met. This would be in line with recommendations of the Independent Review of the Financial Reporting Council by Lord Kingman (the Kingman Review) that the new regulator (Audit, Reporting and Governance Authority (ARGA)) "should develop a new capability to offer pre-clearance on interpretation of relevant standards"[5]. Furthermore, this would be in line with existing processes undertaken by HMRC with the General Anti-Abuse Rule (GAAR) Advisory Panel and the Inland Revenue Service (IRS) in the USA[6]. We consider that these offer proven templates that the FRC could utilise.

Question 2: Do you agree with our proposed measures to enhance the authority of Ethics Partners, and do you believe this will lead to more ethical outcomes in the public interest?

The 2019 Ethical Standard requires the Ethics Partner to have a direct reporting line to the firm's leadership and the independent non-executives (INEs) under paragraph 1.12 and has a the new requirement under paragraph 1.15 for differences of opinion where, in the unlikely event that the advice of the Ethics Partner is not followed for PIEs, this would be reported to the INEs and the FRC.

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[3] Defined as "such parties will include those considered to be the stakeholders of a company for the purposes of meeting directors' obligations under s172 of the Companies Act 2006" in footnote 5

[4] IESBA 2018 120.5 A4

[5] The Kingman Review, page 10: https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/767387/frc-independent-review-final-report.pdf

[6] Where private letter rulings bind both the IRS and the requesting taxpayer (in the event the matter is further disputed or litigated), but only those parties; the IRS has the option of redacting the personal content of a private ruling and issuing it as a revenue ruling, which then becomes binding on all taxpayers and the IRS.

We consider that the authority of the Ethics Partner has been appropriately reinforced by the changes proposed in the 2019 Ethical Standard to reflect how an ORITP would expect transparency on ethics and independence matters to operate within an accounting firm.

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

The FRC stated in the Positional Paper (issued in March 2019) and the Consultation document that one of their objectives was to make the 2019 Ethical Standard easier to understand and apply. We welcomed the FRC's intent, however, in our view, whilst the 2019 Ethical Standard goes some way to improve matters, it remains difficult to interpret and apply in places. There are some overlapping and/or confusing requirements and in places the application is left open to the reader to interpret.

Our response to the Post Implementation Review of the 2016 Ethical and Auditing Standards suggested measures to alleviate difficulties in interpretation of the 2016 Ethical Standard including:

- Defining concepts in the guidance more clearly – including examples and diagrams
- Using 'plain English' wherever possible and ensuring consistent terms are used throughout
- Developing the Ethical Standard to act as a single source, noting that there are numerous references to legislation throughout that are not summarised and included
- Making published guidance that supports the Ethical Standard clearly structured, with links to and from the Ethical Standard to allow ease of navigation.

We consider these points are still valid.

The 2019 Ethical Standard has been slimmed down by removing explanatory paragraphs which, whilst some were repetitive, others provided useful reference material, for example 2016 Ethical Standard paragraph 4.18 in respect of differential fees. We had hoped that more of the material in the Staff Guidance Notes would have been included in the 2019 Ethical Standard to ensure clarity. We consider that if the 2019 Ethical Standard is meant to be a focused document covering the requirements and core guidance, then it must be supported by a referenced suite of detailed guidance documents including illustrations and examples.

We consider that the requirements are similar for all Public Interest Assurance Engagements (PIAEs) entities, but some requirements are only applicable to certain types of PIAE work; there is no summary of which requirements are restricted to certain PIAEs only. We would encourage this to be reviewed and included as part of the final version of the 2019 Ethical Standard.

Alongside this, we note that there remains an inconsistency between terms used, for example, "controlled undertaking" in the 2019 Ethical Standard (and not defined in the Glossary) versus "subsidiary undertaking" in the Auditing Standards, and would welcome additional definitions and consistency of terms to aid understanding and ensure consistent application.

IESBA Code of Ethics comparison

The Positional Paper confirmed that it was the intention of the FRC to continue their longstanding approach that the Ethical Standard should remain "at least as stringent" as IESBA. However, the definition of "listed entity" in the 2019 Glossary continues to omit listed debt which is "in substance not freely transferable or cannot be traded freely" from the requirements for listed entities. This is contrary to IESBA which continues to include any entity "whose shares, stock or debt are quoted or listed on a recognised stock exchange, or are marketed under the regulations of a recognised stock exchange or other equivalent body" as entities for which the public interest entity prohibitions for non-audit services apply. We understand that IESBA has considered the suggestion that there should be some flexibility but has decided that it would not be appropriate. It considers listed entities are "the result of an overt decision by management to become listed in order to seek sources of capital"[7]. Therefore, there

[7] Joint IAASB and IESBA meeting agenda item J4-1 - Sept 2019 (paragraph 12, page 5): https://www.ethicsboard.org/meetings/september-16-19-2019-new-york-usa

continues to be a conflict between IESBA and the FRC in respect of the definition of "listed entity" which will lead to continued conflict where firms have committed to follow IESBA as a minimum standard.

Whilst there is an International Federation of Accountants (IFAC) public interest override option[8] to allow domestic regulatory requirements to be applied, we do not believe this is permitted under the Forum of Firms and may prejudice how firms operate transnationally.

Public Sector Engagements

We are aware that National Audit Office (NAO) guidance for local government audits Auditor Guidance Notes 01 (AGN01) was modified in December 2016 after the introduction of the 2016 Ethical Standard to ensure consistency in respect of prohibited non-audit services. It would be helpful if there continued to be consistency between the 2019 Ethical Standard and AGN01 (see question 4 below) and therefore we ask that the FRC liaise with the NAO in this respect.

Investment Circular Reporting Engagements

The proposed approach for Investment Circular Reporting Engagements (ICREs) in the 2019 Ethical Standard is to remove the specific application notes and replace them with changes to the auditor independence requirements to reflect all PIAEs. This, on the face of it, makes the 2019 Ethical Standard less cluttered when reading, however, when applying the 2019 Ethical Standard to ICREs several significant questions of practical application arise. These include:

- The 'whitelist' in paragraph 5.40 of the 2019 Ethical Standard can be interpreted as prohibiting a PIE/OEPI's audit firm from providing a reporting accountant's customary private due diligence/attest reports and letters (e.g. long form reports, working capital reports, financial position and prospects procedures reports, and investment circular related comfort letters) as these are not services directly required by UK law or regulation. As drafted, we note that this also seems to prohibit a PIE's auditor providing a reporting accountant's public reports in connection with a target entity in a reverse acquisition or a Class 1 acquisition as this would seemingly not meet the 'whitelist' test of requiring an "understanding of the entity obtained by the auditor for the audit of the financial statements is relevant to the service".

  This appears contrary to the FRC's intent as paragraph 5.39 specifically refers to the permissibility (subject to conditions) of customary private reporting performed by a reporting accountant, and states that such services when provided to PIEs are still subject to the 70% fee cap. Such prohibitions will require a substantial change in the UK's capital markets custom and practice and will likely be disruptive in particular to market participants for little apparent benefit.

- The application of the 2019 Ethical Standard to ICREs in section I8 is unclear and appears contradictory. Specifically, this section states that the provisions and requirements of the 2019 Ethical Standard apply only to "the specific transaction, subject matter, and subject matter information" of the ICRE (paragraph I8(c)), to persons with actual knowledge of the ICRE (paragraph I8(a)), and "where required by this Ethical Standard" (paragraph I8(b)). This application to ICREs of section I8(b) appears in conflict with a narrower and more focused application to ICREs as suggested by sections I8(a) and I8(c) and could be interpreted as applying all of the 2019 Ethical Standard restrictions to ICREs without making allowance for the significant differences between an audit engagement and an ICRE.

- The independence in respect of ICREs in paragraph I8-4 does not, but did in the 2016 Ethical Standard, include a statement that ongoing relationships are unlikely to be a problem when assessing independence by reference to the instructing parties and entities directly involved with the engagement. We are unclear why this guidance has been removed and whether the intention is to prohibit such relationships. We would suggest that paragraph 1.67 of the 2016 Ethical Standard is reinstated unless it was the FRC's intent to prohibit such relationships.

- The contingent fee prohibition in paragraph 4.5 - 4.10 could be interpreted as applying to all additional services to ICRE clients even where the service delivered under a contingent fee arrangement is clearly outside the relevant period, not relevant to the specific transaction or subject matter of the ICRE, and indeed where the contingent event may have occurred or elapsed prior to the proposed ICRE appointment. Such an approach would not take account of

[8] IESBA 2018 100.3 A2

the material differences between an audit engagement and an ICRE (particularly where the scope of the ICRE does not cover an accountant's report on historical financial information under SIR 2000) and could significantly narrow the pool of firms from which a company could appoint a reporting accountant.

- Communication with Those Charged With Governance (TCWG) specifically includes a reference to ICREs in paragraph 1.57, yet in paragraph 5.29 the reference is to "other persons as appropriate". This is inconsistent wording and may lead to confusion and debate.
- It is not clear whether paragraph 4.18 in respect of the ratio of fees from non-audit/additional services to fees for the engagement relates to audit alone, as it follows other paragraphs relating to audits, or should also be applied to ICRE engagements.

Appendix B sets out in more detail our comments in respect to ICREs; our preference would be to reinstate a separate Standard to address independence in ICRE engagements. However, if this is not possible, then there is a need for further guidance as to how to interpret and/or apply the 2019 Ethical Standard to ICRE either within the Ethical Standard itself or in a detailed Staff Guidance Note.

Areas open to interpretation

There are several other areas that are substantially open to interpretation in a multi-disciplinary firm. In particular:

- How audit "costs" should be determined (see below)
- How widely the extended prohibitions of certain non-audit services are intended to be considered (see below)
- Non-audit service whitelist (see question 4)
- The new category of audit clients (see question 5)
- The interpretation of whether a fee is on a differential basis and what will be an acceptable arrangement where the fee is negotiated after the completion of the engagement (see below and Appendix A).

Engagement costs for audit and other public interest assurance engagements

Our reading of the 2019 Ethical Standard is that the cost of the audit provision is to provide evidence that a high-quality audit can be performed even if the audit is not being performed at a profit. In this respect the definition of cost becomes important.

Paragraph 4.2 states that the engagement partner is required to disclose to TCWG when the full cost of providing that engagement would not be routinely covered by the fee. The footnote defines the "full cost of providing the engagement" as including "fixed and variable cost excluding any partnership profit element", with no further guidance on how this is expected to be calculated. Costing of work in a service industry is a subjective and judgemental area and therefore this requirement of the 2019 Ethical Standard may lead to many interpretations and unlikely to provide a consistent reference point for the industry. We are concerned that, without further guidance, this calculation could vary from firm to firm and lead to misleading data.

We understand the reasons for calculating and reporting the costs of audit to TCWG as a means of demonstrating the viability of individual audits and hence that the relative fees and costs of the audit are sufficient to support a fully independent and quality audit. The government is currently examining the impact of multi-disciplinary firms' structures on audit independence as part of its formal consultation on the recommendations made within the Competition and Markets Authority's (CMA) market study into the statutory audit market and at present its proposals are only applying to the 'Big Four' firms. Therefore, given the inherent difficulties in identifying a consistent and accurate approach for estimating the full costs of an audit, it appears more sensible to defer consideration of this proposal until after the Government's response to the CMA's recommendations is published.

It is also unclear whether paragraph 4.2 should be applied to ICREs and, if it is applicable to ICREs, how "does not routinely cover the full cost of providing that engagement" should be applied to what is a non-recurring service. In particular, the actual recovery for an ICRE may, due to events/issues unforeseen at the outset, may be significantly lower than the budgeted recovery. This should be clarified in the final draft.

Extended prohibitions for non-audit services:

The 2016 Ethical Standard included a number of services where it was unclear which services were included in the prohibitions without Staff Guidance Notes to clarify. These are still included in the 2019 Ethical Standard as prohibited and we note that the new prohibitions brought in are described at a high level and therefore also leave a risk of varying interpretations without specific guidance regarding what is included, specifically relating to:

Internal Audit services

The Brydon Review[9] considers at the role of audit within the wider context of the assurance that companies are expected to provide to their shareholders regarding management of the business and its key risks. Views have been sought on whether external auditors should make greater use of the work of internal auditors, and whether there should be a role for the external audit in assessing directors' disclosures in areas beyond the financial statements. Proposals arising from this review are therefore likely to have a significant bearing on the scope of both internal and external audit. We consider that the result of this review should be awaited before proposed significant changes to the Ethical Standard are confirmed and implemented. However, we support the continued prohibition of internal audit services when engaged as external auditors.

The Internal Audit prohibition proposed under paragraph 5.44 states that the firm "shall not provide internal audit services", but we are unclear whether it also includes other services which may typically be undertaken by the internal auditor or one off internal audit type services which may be advisory in nature such as forensic services. For example, whether internal audit should be regarded as limited to services that relate to internal controls over financial reporting or financial accounting systems. We are unclear which category attest reporting engagements, such as Special Attestation Reporting (SAR) (which includes SOC1, SOC2, ISAE3402, AAF0106), fall into for the application of the 2019 Ethical Standard – i.e. whether they are to be viewed as internal audit or whether they are specifically allowed in the 'whitelist' (see question 4 below).

We would regard it as beneficial if the FRC could provide similar guidance on the services intended to be covered by this prohibition under paragraph 5.44 in a similar way to those for audit related services in paragraphs 5.35 to 5.36.[10]

For internal audit services, the relevant period is extended under Appendix B of the 2019 Ethical Standard to include a 'clean year' for PIEs and OEPIs between acting as internal auditor and the firm being permitted to accept appointment as external auditor. This makes the need for clarification of what is included as internal audit particularly important. Further, there should be guidance for transition to this longer period regarding whether this means that where an internal audit service has been provided by a firm during the 2019 year-end, that firm then cannot be external auditor for the 2020 year-end.

Recruitment and Remuneration services

The 2019 Ethical Standard under paragraph 5.87 - 5.88 further restricts the provision of recruitment services and advice on the "quantum of the remuneration package or the measurement criteria on which the quantum is calculated" to all audit and PIAE clients and, in the case of the advice about remuneration, it widens the application to include all employees.

It is unclear which services may be drawn into this prohibition, raising questions as to whether it includes advice on Employee Related Security (ERS) schemes or the structuring of management incentive assignments that does not directly impact the quantum of the remuneration. Further, there are services that are related to recruitment and remuneration, such as the annual returns, which are customary to be provided by the auditor or tax advisor. Further clarity is required in this area.

Information Technology services

In the Information Technology section (paragraph 5.47 - 5.51) there is reference to defining the design, provision and implementation of information technology (including financial information technology) systems by firms for an audit client. We make two observations in relation to this section:

[9] Chapter 3 (Audit and wider assurance)

[10] We would consider the Institute of Internal Auditors (IIA) definition of internal audit to be a natural point of reference for this.

1. Allowing non-relevant parts of an entity to have systems implemented by the external auditor presents a risk given that in a future period they could come into the scope of the audit. There may not have been a sufficient period since the implementation to mitigate such risk.

2. "Off the shelf accounting package" is a term used as a rationale for allowing such systems to be implemented by the external audit firm. We would argue that this term is out of date and does not reflect the reality of implementing current systems. There are many systems which are cloud or server based, and the difference between what is configured (a subtle change in the look and feel of the product) to what is customised (bespoke change for that product to achieve functional benefit) is hard to define even for "off the shelf" systems. We believe that the design, provision and implementation of information technology in any context should be prohibited for the external auditor firm concerned.

Contingent and differential fees

The 2019 Ethical Standard Exposure Draft proposes that contingent fees become prohibited under paragraph 4.10, which will end the ongoing debate on contingent fees under the 2016 Ethical Standard.

However, further guidance is required on the circumstances where a fee on a differential hourly fee rate may be utilised in the provision of non-audit services to audit clients in order to give all practitioners clarity and consistency in how the standard is applied in the market. Specific guidance on what is an acceptable range of differential fee and whether there are any circumstances where a differential fee would be considered a contingent fee, would provide greater clarity around the use of differential fees.

Alongside this, paragraph 4.7 states that an "arrangement under which the fee payable will be negotiated after the completion of the engagement", is open to significant interpretation and could be utilised in respect of 'gentleman's agreements' on the fee payable; we consider that this could be akin to a delight fee (considered as contingent in the interpretation of the 2016 Ethical Standard), and will give rise to a significant self-interest threat and lack of transparency regarding the expected fee to be earned for any engagement.

We would also welcome clarification on whether a firm may be appointed to undertake an audit or PIAE to an entity following payment of a contingent fee in respect of a non-audit or additional service that has completed, if such a fee was paid during the period of the audit. If not, guidance is required on whether a firm may be appointed to undertake such a service in subsequent audit periods.

Please see Appendix A below for more information.

Secondments

We consider that the extension of the restrictions on loan staff/secondment arrangements for audit clients and public interest assurance engagements simplifies the requirements and in our view is proportionate to the threats where the arrangement affects financial reporting, accounting or other financial areas of the business or other subject matter information of a public interest assurance engagement.

However, we consider that this prohibition is not proportionate where the loan staff arrangement affects other areas of the business that do not directly interface with financial reporting, accounting or other financial area of the business or other subject matter information of a public interest assurance engagement.

Further, the services which may have been sought through a loan staff arrangement may still be permitted services under a letter of engagement for the service and therefore this dilutes the effect of the prohibition.

Personal independence

The FRC advised in the Position Paper that the 2019 Ethical Standard should be easier to understand and apply. However, there have been limited changes to Section 2 on Personal Independence. This section, which is a difficult read, leads to both different interpretations and lack of clarity of the intention of the requirements. We were hopeful that the FRC would simplify and clarify this section of the Ethical Standard.

Gifts and Hospitality

Further clarification is required regarding what constitutes an entity which is "likely to subsequently become" an audit client, or at what point they become a prospective client and therefore from when paragraph 4.43 will need to be applied.

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

Whitelist

We believe that there should be absolute transparency and clarity on the restrictions on the provision of non-audit services (as set out in our response to the Post Implementation Review of the 2016 Ethical and Auditing Standards) and that, as an overriding principle, such permitted services should be kept to a minimum.

The 2019 Ethical Standard seeks to address the confidence issue over the audit of entities in the public domain. However, it has addressed the issue of the provision of non-audit services to such entities prior to any changes being made in law as a result of the Brydon and BEIS reviews and actions. Changes to permitted or prohibited services should be designed to dovetail into outcomes from these other reviews so that the independence landscape is clear.

We consider that the inclusion of a 'whitelist' of non-audit services set out in paragraphs 5.40 and 5.41 for provision to PIEs and OEPIs is appropriate as it permits audit-related services and most other services expected or required to be provided by the auditor. However, many of the services included in the 'whitelist' are specific and leave no room for other similar services to be included especially where regulation, laws or accepted practice in other jurisdictions allow an auditor to perform wider non-audit services or application of a principles driven approach. This is a significant departure in stance from one that services were permitted unless on the prohibited list, to an approach where all non-audit services are prohibited unless on the permitted list. For example, it is unclear whether independent business reviews and other loan performance engagements are included within covenant compliance engagements.

We note that the 'whitelist' does not include certain services, such as:

- due diligence services, including vendor due diligence
- a reporting accountant's customary private due diligence/attest reports and letters (e.g. long form reports, working capital reports, financial position and prospects procedures reports, and investment circular related comfort letters)
- iXBRL tagging services
- non-audit services required or expected to be carried out by the auditor in other jurisdictions
- data analytics and benchmarking services using historic data.

All of these services have historically not been considered as included in the 'blacklist' as set out in paragraph 5.167R of the 2016 Ethical Standard (and therefore not covered by Appendix B of the 2019 Ethical Standard), and we consider that these services would be expected in many cases to be provided by the auditor.

We are also unclear whether other agreed upon procedures engagements under ISRS 4400 and wider assurance work undertaken under ISAE 3000 and ISRE 2400 are included. We would consider that the 'whitelist' should be principles-based and specifically reference the Auditing Standards under which audit-related services may be provided (subject to the prohibitions in the 'blacklist').

A ban on these services, and similar wider assurance services, for PIEs and OEPIs, which we consider are generally complementary to the provision of a high-quality audit could adversely impact the effectiveness of the audit service, and bring inefficiencies and disruption to audit clients or other market participants, for no obvious significant benefit to the integrity of the audit. These should be included on the whitelist either specifically or as a service type.

Due diligence

Recital 8 of the EU Audit Regulation states that "services linked to the financing, capital structure and allocation, and investment strategy of the audited entity should be prohibited except the provision of

services such as due diligence services, issuing comfort letters in connection with prospectuses issued by the audited entity and other assurance services". Due diligence is not referenced within the 'whitelist' and therefore appear to be not permitted to PIE and OEPI audit clients, which is over and above the EU restrictions. We are unclear as to why the FRC has thought this is necessary and consider this should be clarified within the 2019 Ethical Standard.

To assist audit committees and audit firms understanding, further clarification of paragraph 5.9 is required. In respect of vendor due diligence, a potential purchaser which is a PIE audit client of the audit firm may be a beneficiary of the work which has been instructed by the non-audit client at a point when the ultimate purchaser is not known. This benefit does not constitute a delivery of services. Moreover, the ultimate purchaser will often commission further due diligence work to 'top up' that already performed. In many situations, it is most efficient and economical for this to be delivered by the original due diligence provider rather than bring in an alternative firm. The footnote to paragraph 5.9 (footnote 43) is still in situ, however without clarification of the status of due diligence within the whitelist it is not clear whether top up to vendor due diligence services within this context is permitted.

Public Sector implications

We consider that consistency between the 2019 Ethical Standard and AGN01 should be retained so that the 'whitelists' (in and out of the fee cap) and the 'blacklist' remain consistent to make it easier to apply, especially as public sector assurance clients may well fall under both AGN01 and as a PIE or an OEPI (see question 3 above and Appendix C). The auditor of public service engagements are often appointed to undertake work mandated by government departments such as Housing Benefits claims, Teachers Pensions claims, Quality Accounts work and Mental Health Investment Standard. Whilst this work can be undertaken by other accounting firms, Government guidance recognises that the auditor tends to be best placed to deliver the work, as they have a good working knowledge of relevant systems and controls. Whilst this work is mandated by Government departments, it is not required by legislation and would therefore not currently be permissible under the proposed 'whitelist' in paragraph 5.40.

Auditors can also offer assurance services around contracts to support identification of savings or recoveries which address the financial pressures faced by the sector. In addition, there are other non-advisory services and information platforms, or data analytics and tools, that audit firms currently make available across Government which the proposed drafting could inadvertently prevent or limit access to. This would result in the loss of information and associated benefits to sectors of government.

We therefore propose that services mandated by Government departments, contract assurance services and information platforms/tools are added to the list of permissible services to enable the auditor to continue to provide these.

See Appendix C for more details.

Extra-territoriality

The worldwide application of the 2019 Ethical Standard under paragraph 2.4 gives us a primary concern in respect of educating, monitoring and enforcing the FRC Ethical Standard for group audit engagements in jurisdictions where IESBA has historically been applied. We consider that this requires additional review of the implications prior to its introduction.

Summary

Alongside our comments above, the provision of any non-audit service to an audit client is reliant on the principles-based approach that underpins the Ethical Standard. This allows for all circumstances that threaten independence, avoiding the inefficiencies of the wholesale prohibitions. We consider that, whilst the 'whitelist' may be set at an appropriate level with prohibitions in place to limit non-audit services to entities of particularly high public interest, this is rules based and does not embrace the principles-based approach.

Question 5: Do you agree with the additional prohibitions we are proposing to introduce – in learning from the experience of enforcement cases like BHS, if the more stringent PIE provisions are to have a wider application to non-PIE entities, which entities should be subject to those requirements?

We agree that there should be an extension of the restriction on non-audit services which can be provided (see question 4 above) and support the creation of OEPIs as a new type of entity within the Ethical Standard.

However, whilst this clarifies the treatment of entities which are regarded as of public interest, the requirements for the firm to establish policies and procedures that set out the circumstances in which the additional requirements or prohibitions as stated in paragraph 1.49 of the 2016 Ethical Standard remains in paragraph 1.43 of the 2019 Ethical Standard. Therefore, OEPIs create an additional layer of complexity to apply to public interest assurance engagements when considering whether non-audit or additional services can be performed.

In our view, the definition of OEPIs being limited in the 2019 Ethical Standard Glossary to "entities included within the scope of the FRC's Audit Quality Review, which are not public interest entities" is not a suitable or stable benchmark to use, as the AQR population has been established for a different process and purpose, and the FRC is able to change the population without due process.

We therefore consider that OEPIs should be formally defined in the Glossary in a similar level of detail given for PIEs in order to ensure that:

- Audit firms are aware of the entities which fall into the OEPI population and at which point the restrictions come into force
- Organisations are aware of when they will become and OEPI and the impact that will have on their requisitioning of non-audit service from their auditors and requirement to utilise alternative providers.

We do not disagree with these entities becoming OEPIs, as this is consistent with Grant Thornton's approach when considering entities to which additional independence requirements are applied under paragraph 1.49 of the 2016 Ethical Standard (and will remain so under the requirements of paragraph 1.43 of the 2019 Ethical Standard), but request that the OEPI category is formally clarified in the 2019 Ethical Standard to ensure correct identification and compliance. However, we note that such a definition would have to be carefully defined to capture companies with clear public interest implications (such as systemically important privately-held global businesses), without impinging upon the freedom that is deliberately afforded to support ambitious privately-owned companies.

We note that the creation of OEPIs comes alongside the continued requirement in paragraph 1.43 of the 2019 Ethical Standard for the firm to establish policies and procedures that set out the circumstances in which the additional requirements or prohibitions apply to PIEs and listed entities are extended. So, whilst the non-audit/additional services are specifically dealt with for this new class of entity, paragraph 1.43 would be relied on for other areas of the 2019 Ethical Standard in respect of these entities, such as Long Association with Engagements. This may cause confusion if not clarified.

Given the significant differences proposed between the independence requirements for PIE and potential OEPI audits and other audits, it is important for firms and organisations to be clear into which category audited entities would fall and to ensure that entities are not being switched from one category to another (with resultant changes in the independence requirements) unless there is a fundamental shift in the nature of the business.

Specifically, the OEPI population of "quoted companies incorporated in the UK with a market capitalisation of more than €200M" per the AQR Inspection Scope[11] is clearly defined. However, private entities with turnover greater than £500m are also currently included within the AQR population. It is not clear at what point this reference point should be taken, especially where entities may be close to this threshold. It would be helpful if the transition requirements as an entity migrates into this population are clear in a similar way to acquisitions and disposals as set out in paragraph 1.27 for mergers and acquisitions. We are concerned that inadvertent breaches of the Ethical Standard could occur due to

[11] AQR Inspection Scope (as of September 2019): https://www.frc.org.uk/getattachment/afa6e9e9-fa6b-4f15-90dd-a244da42792d/AQR-Scope-of-Retained-Inspection_.pdf

audit clients entering this population during an audit period, after non-audit services not included in the 'whitelist' as set out in paragraph 5.40 - 5.41 of the 2019 Ethical Standard, had already been provided.

We consider that the FRC should provide more detail on the requirements expected to be applied and the types of entities included, rather than leaving this to firms to set their own policy under paragraph 1.43, particularly in an area where the requirements are being enhanced. In particular, the FRC should consider extending the firm rotation requirements to OEPIs, or otherwise require greater consideration of the familiarity threat in relation to the long association with an audit firm, and reflect on the partner and senior staff rotation requirements to OEPIs. It appears incongruous to extend the non-audit service restrictions and not other restrictions, which an ORITP could regard as having a significant impact on an auditor's independence.

We also note that Brydon and Redmond are considering the definition of the 'user' of an audit and that BEIS is seeking to consult on the definition of PIE in Autumn 2019; introducing significant changes before the results of this consultation appears premature and could give rise to misunderstandings if further changes are made.

Question 6: Do you agree with the removal of the reliefs for SMEs in Section 5 of the Standard, and the retention of reliefs for 'small' entities (in Section 6 of the Standard)?

Yes.

As set out in our response to the Post Implementation Review of the 2016 Ethical and Auditing Standards, we do not consider that the reliefs from certain FRC ethical requirements for non-PIE audits for the audit of small- and medium-sized entities should be maintained as it provides another layer of complexity for the auditor to consider and stakeholders will not necessarily understand the impact that the different provisions may have on independence. Further, IESBA has no such provisions and therefore this relief is contrary to section 5d(iii) of the Constitution of the Forum of Firms[12], which requires members to comply with IESBA as a minimum.

Question 7: Do you agree with the proposed removal of the derogation in the 2016 Ethical standard which allowed for the provision of certain non-audit services where these have no direct or inconsequential effect on the financial statements?

Yes.

Our response to the Post Implementation Review of the 2016 Ethical and Auditing Standards, set out that we have found that interpreting which services are prohibited to be provided to PIEs under paragraph 5.167R of the 2016 Ethical Standard is more problematic than we would have expected as the definitions of the non-audit services that are included (which have been taken directly from the EU Regulation) were not fully clarified. We would therefore support that this derogation is not maintained in the 2019 Ethical Standard or, if it is, further clarity and guidance to support understanding its application is needed.

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

We agree with the proposed changes made to the Audit Regulation and Directive references within the ISAs (UK). We have highlighted areas where clarification of changes may be helpful and have included this in Appendix D below.

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

We agree with the inclusion of FRC staff guidance within the application material and overall agree that this has improved the clarity of the requirements. However, we are of the view that additional guidance from Staff Guidance Note (SGN) 02/2018 – Group Guidance, could be incorporated into ISA (UK) 600, Special Considerations – Audits of Group Financial Statements (Including the Work of Component Auditors) (ISA (UK) 600), particularly in respect of the determination of a material subsidiary and the

[12] Forum of Firms Constitution (as of September 2019): https://www.ifac.org/system/files/uploads/TAC-FoF/Forum-of-Firms-Constitution.pdf

implications thereof. We would recommend that the FRC also considers incorporating a simplified version of the flowchart included in SGN 02/2018 in this respect.

Question 10: Do you agree with the changes we have made to ISAs (UK) 700, 250 A and 250 B, including the extension of the requirement for auditors to report on the extent to which their audits are capable of detecting irregularities, including fraud.

ISA (UK) 700 – Forming an Opinion and Reporting on Financial Statements (ISA (UK) 700)

We support the intent of the changes proposed in ISA (UK) 700 to extend reporting requirements concerning the extent to which audits are capable of detecting irregularities, including fraud. However, extending this requirement to all entities would in our opinion increase the expectations gap between the objectives of the auditor in conducting the audit of financial statements and the assurance users believe is provided by the performance of an audit with respect to compliance with law and regulation, including fraud. Furthermore, we do not agree with extending this requirement to all entities. We are of the view that this requirement is unlikely to add any value for smaller entities, such as small owner-managed businesses. As noted above, the value of such disclosures would likely be minimal given the nature of these businesses, especially in relation to the cost their provision. As such, we are of the view that the requirement to disclose the extent to which the audit was capable of detecting irregularities, including fraud, should only be extended to those entities that have an element of 'public interest.' In this respect consideration could be given to extending to the new proposed category OEPIs in these Exposure Drafts, subject to a clear and operable definition of this term being established (see question 5 above).

If the FRC was to proceed with extending this requirement to all entities, we would recommend that consideration be given as to how the requirement can be made proportionate and scalable for those entities that are not of significant public interest, for example, a small owner-managed business, as highlighted above. Whilst we appreciate the matters for the auditor to consider in making these disclosures are included in application material, experience suggests that this guidance will become a de-facto requirement that will result in auditors being required to explain why the examples listed are not included as disclosures in the auditor's report. The need to 'comply or explain' could lead to unnecessary documentation and also result in boilerplate disclosures that will add little or no value to the user of the auditor's report.

The potential implications of such extended disclosures on auditor liability should also be considered. The introduction of 'safe harbour' provisions in this respect may address such concerns.

ISA (UK) 250 Section A - Consideration of Laws and Regulations in an Audit of Financial Statements (ISA (UK) 250 Section A)

We support the proposed requirement in ISA (UK) 250 Section A, which requires auditors to consider whether there are any indications of non-compliance with laws and regulations as part of their risk assessment procedures. We are of the view that this provides an important reminder to engagement teams to include consideration of laws and regulations when planning an audit engagement. This is supported by proposed application material in paragraph A11-1 (the first instance of A11-1), which indicates that an 'auditor may obtain that understanding through a combination of inquiries and other risk assessment procedures (i.e., corroborating inquires through observation or inspection of documents).' We would recommend that this paragraph is deleted as it does not provide any additional guidance to auditors as to how or why this requirement is performed. We do, however, support the inclusion of paragraph A11-1 (formerly paragraph A11-18), which provides examples of matters that may be an indication of non-compliance with laws and regulation. We are of the view that this provides useful guidance to engagement teams when fulfilling the requirements of paragraph 13-1. We would also recommend that the examples of matters that may indicate non-compliance with laws and regulations be extended to include specific examples for the audits of public sector entities and of group financial statements.

We note that capital maintenance has been highlighted as an area of the audit where improvements are necessary, however, there appear to be no specific proposed amendments in this regard. We would recommend, as a minimum, that specific examples with respect to dividends and other distributions be included in paragraph A11-1 (formerly paragraph A11-18) as indications of non-compliance with laws and regulations to support guidance already included in paragraph A12.

ISA (UK) 250 Section B - The Auditor's Statutory Right and Duty to Report to Regulators of Public Interest Entities and Regulators of Other Entities in the Financial Sector (ISA (UK) 250 Section B)

We support the proposal to include guidance in paragraph A35a and A35c concerning the auditor's duty to report to the regulator in the circumstances described in paragraph 14. We believe this is responsive to previous requests for guidance in this area.

We note that when the European Union Audit Regulation and Directive were incorporated into the ISAs (UK), the term 'material threat or doubt' was introduced. This term is not defined within the ISAs, or otherwise explained. We do not find the proposed guidance in paragraph A35e. helpful in explaining what should be considered a material threat or doubt, or in understanding how this interacts with the auditor's responsibilities in relation to going concern or the viability statement. For example, would a material threat or doubt be considered to be a matter that casts significant doubt on an entity's ability to continue as a going concern and as such be reported in the 'Material Uncertainty related to Going Concern' section of the auditor's report? We would recommend that a definition or description of material threat or doubt be included in ISA (UK) 250 Section B along with application material that clarifies its interaction with ISA (UK) 570[13] and with the auditor's responsibilities in relation to the viability statement where applicable. Further, specific examples of matters that would meet the definition of a material threat would be helpful and would enable auditors to better identify matters that need to be reported to the relevant regulators.

We have also included more detailed recommendations and editorial comments in Appendix D below.

Question 11: Do you agree with the proposed additional auditor reporting requirements, including the description of significant judgements in respect of Key Audit Matters and increased disclosure around materiality?

We support the proposed additional auditor reporting requirements, including the description of significant judgement in respect of Key Audit Matters (KAM) and increased disclosure around materiality. We also appreciate the clarification provided in paragraph A51-1 as to when it is appropriate to report key observations. We do note, however, that engagement teams typically experience difficulty in reporting key observations without implying a separate conclusion on the matters included as KAM. As such, we would recommend that guidance be provided on what is considered appropriate to include in a key observation, for example, in an update to the FRC's Compendium of illustrative auditor's reports[14].

We note that paragraph A59-1 states that UK legislation precludes the auditor from determining that there is a situation where there are no KAM to disclose in an auditor's report. The footnote referenced therein cites The Statutory Auditors and Third Country Auditors (Amendment) (EU Exit) Regulations 2019 (SI 2019/177).' It is unclear how this reference infers that an auditor's report for a PIE must always have at least one key audit matter. We would welcome further clarification in this respect. Further, in relation to PIEs, we question whether the intention was for this preclusion to also apply to the audit of group financial statements where a separate auditor's report is prepared for the parent company. In many instances, the parent company is merely a holding company and, as such, the financial statements would only likely comprise an investment in the subsidiary undertaking, or in the case of the financial statements of a public sector body, holding residual accounts; and reserves. In such circumstances, we question whether there is truly a matter that would meet the definition of a KAM.

In addition, confirmation would be helpful regarding whether entities other than PIEs (for example , AIM listed entities or special purpose vehicles with listed debt), may apply paragraph 16 and as such determine that there are no KAM to communicate and include a statement to that effect in the auditor's report.

We note that guidance has been provided in paragraph A59-2 regarding significant judgements the auditor made in determining materiality, however, guidance as to the nature of the disclosures required in the auditor's report in relation to significant judgements made by the engagement team in respect of the KAM has not similarly been provided. Absent further guidance in this area, the requirement is likely to be inconsistently interpreted and applied. We would therefore recommend that further guidance is provided in relation to the application of significant judgements in respect of KAM. To that end, we note

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[13] ISA (UK) 570, ***Going Concern***

[14] Bulletin: Compendium of illustrative auditor's reports on United Kingdom private sector financial statements for periods commencing on or after 17 June 2016

that the current Exposure Draft on the Proposed ISA 220, Quality Management for an Audit of Financial Statements (ISA 220), paragraph A79, includes examples of potential significant judgements that an engagement team may make in relation to an audit engagement. To facilitate the appropriate application of this requirement and to promote consistency, consideration could be given to whether any of these examples are what the FRC intended to be disclosed in the auditor's report and, if so, including the examples in the proposed ISA 220 as application material or an appendix in the proposed revisions to ISA (UK) 701. We would also recommend that examples or illustrations of the disclosures to be included in the auditor's report in this respect are issued to provide further clarity of what is expected in order to fulfil this requirement. These examples and illustrations could also be provided by way of an update to the FRC's Compendium of illustrative auditor's reports.

In our response to the Brydon review into the UK auditing standards we also supported further transparency through the introduction of reporting 'graduated findings' with respect to the audit conclusions reached. Whilst we note that the outcome of the review should not be pre-empted, the ISAs (UK) do not prevent such disclosures in the auditor's report and we would recommend that consideration be given to providing guidance on reporting graduated findings for those firms that wish to voluntarily make such disclosures in the auditor's report.

We have also included more detailed recommendations and editorial comments in Appendix D below.

Question 12: Do you agree with the revisions we have made to ISA (UK) 720, including the enhanced material setting out expectations of the auditor's work effort in respect of other information?

Whilst the proposed revisions to ISA (UK) 720 are helpful in relation to setting out the expectations of the auditor's work effort in respect of other information, we are of the view that the enhanced application material in paragraph A53-12 does not fully address the issues identified in the FRC's Thematic Review[15] on other information. As such, we would recommend that this application material be expanded to assist auditors in fully addressing the issues noted in the thematic review. We would also recommend the provision of examples, particularly in relation to how auditors are able to demonstrate professional scepticism when determining if inconsistencies in other information exist.

Further, we are of the view that the proposed changes to ISA (UK) 720 in relation to the Corporate Governance need further clarification. The proposals require a separate section entitled 'Corporate Governance Statement' for entities that report on how they have applied the UK Corporate Governance Code. However, the proposed requirements lack clarity on how the new Corporate Governance Statement section interacts with the requirements in extant ISA (UK) 570 or the proposals in the recent Exposure Draft: Proposed ISA (UK) 570 (Revised) – Going Concern. We would recommend that additional application material be incorporated into ISA (UK) 720 to explain this interaction, for both commercial and public sector entities, and that illustrations or examples be incorporated in an update to the FRC's Compendium of illustrative auditor's reports.

We have also included more detailed recommendations and editorial comments in Appendix D below.

Question 13: We are proposing changes to the standards to be effective for the audit of periods commencing on or after 15 December 2019. Do you agree this is appropriate, or would you propose another effective date, and if so, why?

The proposed Effective Date for the revised Auditing Standards could be achievable and give firms time to implement the changes, including updating audit methodology and delivery of training, provided that the revised standards are issued on a timely basis following the conclusion of these Exposure Drafts.

However, the proposed Effective Date for the 2019 Ethical Standard of 15 December 2019 will not give sufficient time make the changes to systems, processes and controls and update policies alongside ensuring that effective training is developed and delivered to professionals across firms. For example, PIEs and OEPI which have December year-ends will have to implement the "whitelist" with effect from 1 January 2020. Further, as the 2019 Ethical Standard is to be extended to apply to audits throughout an international group (where previously IESBA could be applied outside of the EU), firms will require time

[15] Audit Quality Thematic Review: Other Information in the Annual Report

to educate network firms which, with the limited lead time available, may be extremely difficult to achieve.

We therefore request that the Effective Date for 2019 Ethical Standard is rolled forward to 15 June 2020 or later, so that that accounting firms have sufficient time to implement the relevant changes to systems, processes and controls to ensure compliance with the 2019 Ethical Standard. It will also enable smooth transition for clients where services may need to be transitioned to alternative providers in what is already an uncertain business environment. This delay would allow for better coordination with the Brydon and BEIS reviews and to take account of any additional changes that the UK exiting the EU may bring. In addition, we also recommend that the FRC provide interpretations, illustrations and guidance on the areas that have been identified by firms as problematic at the same time the ISAs (UK) and ISQC (UK) are issued. This will help to prevent different interpretations of the new proposed requirements.

Comments on wider issues identified in the Exposure Draft of the revised Ethical Standard

Appendix A - Contingent fees

Further to our response in question 3 above in relation to the prohibition on the provision of non-audit services to an audit or public interest assurance engagement client under a contingent fee arrangement in paragraph 4.10 of the 2019 Ethical Standard, we would like to expand on our considerations in relation to this subjective area.

When is a fee a contingent fee?

We note that the prohibition on contingent fees has been brought in as part of the attempt to simplify the 2019 Ethical Standard and make it clearer, following a number of discussions on this topic at the FRC Technical Advisory Group. In relation to group audits, it will challenge firms to put in processes, policies and controls to restrict or monitor the actions of other network firms, especially when the component may be in a jurisdiction that is less developed or has less stringent ethical standards.

However, we note that there remain significant areas for interpretation, as the 2019 Glossary defines a contingent fee as follows:

> "Any arrangement made under which a fee is calculated on a predetermined basis relating to the outcome or result of a transaction, or other event, or the result of the work performed...
>
> Differential hourly fee rates, or arrangements under which the fee payable will be negotiated after the completion of the engagement or increased to cover additional work identified as necessary during the engagement, do not constitute contingent fee arrangements."

This therefore raises the following questions:

1. Is a service where the fee is calculated on a differential fee basis, but contingent on a "trigger" event considered to be on a contingent fee basis and therefore prohibited or to be on a differential fee basis and therefore permissible?

Our consideration is that where the fee is based on a range of hourly rates agreed with the client in the engagement letter and where the firm is not making a decision on the outcome of the event which would trigger the receipt of either the higher or lower rate, this should not be regarded as a contingent fee subject to the prohibition. We note the potential for our output to influence these decisions but consider that informed management is able to make its own decisions.

2. Under what situations would an "arrangement under which the fee payable will be negotiated after the completion of the engagement" exist?

We see this requirement as being open to significant interpretation and could be utilised in respect of 'gentleman's agreements' on the fee payable. We consider that this would be akin to a contingent fee, as well as giving rise to a significant self-interest threat in relation to contingent fees being able to be set without the clarity and protection of an engagement letter as well as enabling the prohibition to be bypassed.

We would welcome clarification and guidance from the FRC in relation to how differential fees and arrangements agreed after the completion of the engagement are intended to operate.

Differential fee basis

Additionally, we note that there is not guidance on the level of differential fee uplift or discount which would be considered acceptable alongside the prohibition on contingent fees. We would therefore seek clarity on the levels of the uplift or discount which would be regarded as acceptable.

We would request greater clarity on the range which would be deemed to remain within the intent of the prohibition in paragraph 4.10 and would welcome illustrative examples to aid understanding and ensure compliance with the intent and the letter of the requirements.

Appointment as auditor following payment of contingent fees in respect of non-audit services

A firm may be asked to act as auditor to an entity that has previously paid a contingent fee in relation to a non-audit service, for example in the case of an audit client acquiring a non-audit client where a

contingent fee has previously been paid. In the event that the non-audit service has been completed in advance of such an appointment and the contingent fee has been crystallised and paid in full, it is not clear how the firm's integrity, objectivity or independence would be compromised, subject to consideration of the self-interest threat arising from non-audit fees in general. Guidance should be provided on whether a firm may accept an appointment as auditor in the audit period in which the payment is made or whether an appointment may only be accepted in the subsequent audit period.

Transition requirements

We would expect the prohibition on the provision of non-audit services to audit clients on a contingent fee basis (subject to the clarifications above) to apply for new engagements from Effective Date of the 2019 Ethical Standard. However, we would request that additional guidance be provided in relation to transition arrangements for non-audit services engagements that were permitted under the 2016 Ethical Standard that may no longer be permitted under the proposals. We are concerned that without a suitable transition period, engaged clients could be placed in the very difficult position of having to find alternative advisers at what might be a very critical juncture of a non-audit engagement. In particular, we note the extraterritorial application of the 2019 Ethical Standard and the implications in exiting such arrangements (see question 13 above).

We therefore request that transitional requirements are put in place to enable the completion of services on a contingent fee basis where the engagement has been entered into in advance of the Effective Date of the 2019 Ethical Standard, permitting these to be completed on this basis over the next twelve months to avoid disruption.

Comments on wider issues identified in the Exposure Draft of the revised Ethical Standard

Appendix B - Investment Circular Reporting Engagements

We consider that this is best dealt with as a separate Standard rather than incorporated within the Ethical Standard. However, we have included our comments below on how this can be managed, or the information we require from the FRC in order to manage this.

There are substantial changes to the requirements for Investment Circular Reporting Engagements, with the 'boxed' sections being removed from the 2019 Ethical Standard and the same restrictions applying other than otherwise specified by section I8. The limited areas included in I8 however means that the level of impact is substantial.

A group representing the major firms working with the ICAEW has provided further drafting and comment in respect of independence matters for ICREs included in the consultation document direct to the FRC.

Section I8

In section I8, we note the addition of item (c) stating the requirements of the 2019 Ethical Standard apply only to "the specific transaction, subject matter and subject matter information" of the engagement. Whilst this is useful wording as it articulates what we consider to be the paramount ethical consideration for ICRE, there is potential for I8(b) (which states the requirements apply to "the firm") and I8(c) to be in conflict with each other. For instance, where the 2019 Ethical Standard stipulates a requirement in respect of an audit engagement, for ICRE should such a requirement always be interpreted through I8(c), or is I8(c) simply an additional requirement? If item I8(c) is an additional criterion then arguably it would have limited utility and is superfluous in that form.

Examples of particular relevance are:

- Paragraph 4.10 prohibits the provision of services to an audit or PIAE client on a contingent fee. Is this intended to be interpreted as applying to all such services to non-audit clients where a reporting accountant role might be undertaken, or rather should it only be applied where the service delivered under a contingent fee arrangement is relevant to the specific transaction or subject matter of the ICRE engagement? We would appreciate clarification on this.
- Paragraph 5.13 requires the consideration of threats and safeguards of services to ICRE clients as well as other audit of public interest assurance engagements. It is unclear if these should be applied through I8(c) and we would welcome guidance on this.
- The provision of other non-audit services to an ICRE client (such as internal audit services under paragraph 5.44 and accounting services under paragraph 5.122) where it is not clear how the provision of such services would compromise the objectivity of an ICRE where the scope was limited to services such as provision of a working capital report/comfort letter or, for a Class 1 acquisition, a long form report on the target. Therefore, is this prohibition overridden by I8(c) considerations? We would appreciate clarification on this.

For ICREs, the period for consideration of independence and other ethical issues "covers the period during which the engagement is undertaken and any additional period before that but subsequent to the balance sheet date of the most recent audited financial statements of the entity relevant to the engagement".

Whilst we acknowledge that this does not constitute a change from the 2016 Ethical Standard, we would welcome the FRC taking this opportunity to explain the rationale for including the pre-commencement of the engagement period for reporting accountant services where the firm may not have given, and may not be giving within its reporting accountant suite of services, a 'true and fair' opinion on any period(s).

We also note that I8-4 requires that in assessing its independence the reporting accountant shall consider relationships with other parties which are connected with the investment circular, including other entities directly involved in the transaction and their wider group. The FRC should clarify which services provided to parts of a wider group that are not directly involved in the transaction might constitute a threat to the independence of a reporting accountant. Additionally, clarify "entities directly

involved in the transaction" as it appears that it is wider than simply the entities which are party to the transaction, and could be interpreted to include, for example, the advisers working on the transaction.

PIE and OEPI non-audit service 'whitelist'

Under the 'whitelist' of non-audit services which can be provided to PIE and OEPI audit clients (see question 3 above), we note that the FRC has narrowed the range of reporting accountant services that may be undertaken by the audit firm. The FRC has not provided its rationale for this approach, and we would ask the FRC to confirm that this was indeed its intent. For reasons set out below, we think that the approach adopted in the 2019 Ethical Standard will be detrimental to the efficient operation of the UK's capital markets.

The 'whitelist' restricts the provision of reporting accountant services to PIE audit clients to "services required by UK law or regulation". Given that paragraph 5.40 specifically references services provided as "reporting accountant", our interpretation is that there only be a requirement for the report/service under UK law or regulation, and that the 2019 Ethical Standard does not require that the UK law or regulation mandate that the report/service be provided by the entity's auditor; however we would welcome confirmation of this point.

However, the 'whitelist' therefore prohibits the audit firm from providing reporting accountant services relating to:

> (i) the provision of SAS72 comfort letters, as these are required under US law/regulation rather than UK law/regulation
>
> (ii) the provision of ICMA comfort letters, as these are governed by market practice as codified by the International Capital Markets Association rather than UK law/regulation.

In both instances the provision of these services by the audit firm would otherwise appear to satisfy the requirements in paragraph 5.40 that the understanding of the entity obtained by the auditor for the audit of the financial statements is relevant to the service, and where the nature of the service would not compromise independence. Indeed, SAS72 comfort letters are required to be provided by the auditor.

We also note that the meaning of "required by UK law or regulation" is, in the absence of further guidance from the FRC, open to differing interpretations. We recommend that the FRC clarify whether this covers only reports which are specifically cited by UK law/regulation (for example public reports required to be published within an investment circular to make it compliant with UK law/regulation), or whether it also covers reports/letters required under market custom or practice to assist other market participants to meet their legal and regulatory obligations (for example working capital reports, financial position and prospects procedures reports, and long form reports provided to directors and sponsors/nominated advisers).

In our opinion it would be counter-intuitive if customary private due diligence work performed by a reporting accountant in connection with an investment circular (such as a long form report or working capital report), and therefore in accordance with the FRC's Standards for Investment Reporting, is 'blacklisted' for PIE and OEPI audit clients when such work is regarded by the 2019 Ethical Standard as being a public interest assurance engagement, and so subject to the provisions of the 2019 Ethical Standard (as modified by section I8).

We also note that a prohibition on customary private reporting in relation to PIE and OEPI audit clients under paragraph 5.40 appears inconsistent with paragraph 5.39, which specifically envisages (subject to conditions) an auditor being permitted to provide customary reporting, inter alia, "in the case of premium listed issuers [who are by definition a PIE], to support confirmations provided by the sponsor to the FCA".

The 'whitelist' only permits reporting accountant work where it is "probable that an objective, reasonable and informed third party would conclude that the understanding of the entity obtained by the auditor for the audit of the financial statements is relevant to the service". Where the "understanding of the entity obtained by the auditor for the audit of the financial statements is relevant to the service" test will be clear for some services, for example an accountant's report on the audit client's historical financial information under SIR 2000, it will be less clear for other services, such as a report on a quantified financial benefits statement issued by the audit client or – assuming it passes the "required by UK

law/regulation" test discussed above – a working capital report on a working capital statement being issued by the audit client.

As this is a new third-party test, further guidance from the FRC will be required to ensure consistent interpretation and application across the market.

Furthermore, the "understanding of the entity obtained by the auditor for the audit of the financial statements is relevant to the service" test will not be met where the reporting is on a target entity for the purposes of a reverse acquisition of a Class 1 acquisition being undertaken by the audit client. Were the acquisition to conclude that the audit firm will subsequently audit the target as part of its next future audit of the consolidated enlarged group of the audit client; however the apparent prohibition on the audit firm from reporting on the target means that the audit firm would no longer be able to benefit from audit efficiencies gained from providing reporting accountant services on the target, and so would not be in position to pass these efficiencies on to the audit client through the audit fee.

Other comments

We note that paragraph 1.47 requires that in order to use the work of another firm, the lead firm must satisfy itself that such other firm is independent of each entity relevant to the engagement. We would welcome clarification that, in the context of reporting accountant assignments, this only covers situations where the reporting accountant has subcontracted work to another firm, and that it should not be read as covering the situation where a reporting accountant engaged to provide a SIR 2000 report on historical financial information makes use of the pre-existing audit work papers of another firm which is normal market practice and permitted under the SIRs.

We also have queries in relation to:

- Paragraph 2.36 prohibits loan staff/secondments – we request that the FRC confirms whether a firm which has provided temporary staff to an entity during the relevant period for an ICRE is then precluded from providing any form of reporting accountant services (including private due diligence type reports and comfort letters), or should this be interpreted through I8(c) (see above)?
- Paragraph 5.25(b) requires that an engagement quality reviewer review the work and conclusions of the engagement team in accordance with the requirements set out in paragraph 35-44 of ISQC (UK) 1, and paragraph 20-21 of ISA (UK) 220. As these are audit specific standards, we request that the FRC provides guidance on how it expects them to be applied to ICRE services.

We also note that there are a number of paragraphs from the 2016 Ethical Standard which have been removed and not replaced, but which gave useful support and clarity, and for which there is no obvious replacement/equivalent section:

- Paragraph 4.18 of the 2016 Ethical Standard made clear that the prohibition on contingent fees for additional services was not intended to prohibit a firm from charging a lower fee where the services relates to a transaction or engagement that was either aborted or prematurely terminated and where the rationale for the lower fee is to take account of either the reduced risk and responsibility involved or the fact that less work was undertaken than originally anticipated. Is the intent to prohibit lower fees in such situations – which would appear to be inequitable for ICRE clients?
- Paragraph 1.40 of the 2016 Ethical Standard recognises and acknowledges the significant practical difficulties of identifying all relationships for entities relevant to reporting accountant engagements who are not also audit clients, and so the requirement for reporting accountants was modified to undertake "those enquiries that are practical in the time available into the relationships and other services that the firm has with the non-audit entity relevant to the engagement and, having regard to its obligations to maintain confidentiality, addresses any identified threats". As reporting accountant assignments will continue to be (i) market sensitive and subject to strict confidentiality, and (ii) frequently time sensitive, we recommend that I8 in the 2019 Ethical Standard be modified to reflect the content of this paragraph.
- Paragraph 1.43 of the 2016 Ethical Standard specifically recognises that whilst a reporting accountant may have extensive relationships with financial institutions acting as sponsor etc,

such relationships will not generally give rise to a significant threat to the reporting accountant's integrity or objectivity. We request confirmation whether this removal was intentional.

- Paragraph 1.67 of the 2016 Ethical Standard states that for ICREs the independence declarations should be made to TCWG. There is no equivalent ICRE specific wording in the 2019 Ethical Standard, so either the rules for PIE/listed entities should apply to ICREs, or the rules for non-PIE/listed entities should apply to ICREs. Please clarify and, if necessary, advise on the required approach where no audit committee exists at point the reporting accountant is appointed (which is often the case for IPO engagements).

We request that the FRC clarifies the reason for the removal of these paragraphs without equivalent replacements

Transition requirements

In relation to ICRE, we note that under paragraph 1.70, firms may complete engagements commenced prior to the Effective Date in accordance with the existing ethical standards before implementing any necessary changes in the subsequent engagement period. We request that the FRC clarifies that there are no requirements to put in any changes for "subsequent engagement periods" for a reporting accountant engagement as there will not be a subsequent engagement period.

Comments on wider issues identified in the Exposure Draft of the revised Ethical Standard

Appendix C - Public Sector implications

The 2019 Ethical Standard Exposure Draft as it relates to public sector audits has particular implications:

Paragraph 5.35-5.36

Audit related services include "reporting required by law or regulation to be provided by an auditor" with only those that are required by national legislation being exempt from the 70% fee cap. For public sector audits, local auditors are often required to carry out mandated work, e.g. on quality reports or the Mental Health Investment Standard (MHIS), but this work is not currently required by legislation (though is expected by the Government to be undertaken by the auditor). Consequently, even though there is an expectation that the local audit team complete this work, it will form part of the 70% fee cap. This work is, by its nature, independent assurance work needed by Government and therefore we consider that the FRC should clarify that such work will not count against the cap. In addition, it would be helpful if the FRC would clarify whether the first bullet only relates to reporting which must be carried out by the entity's appointed auditor or if it covers any auditor eligible for appointment.

Paragraph 5.36

Under the NAO Code of Practice there is an expectation that audit teams will co-operate with requests from other audit firms for the benefit of the wider public purse. This can include the requirement to carry out specified work at their audited body which does not fall within ISA (UK) 600, for example, work on the controls in place at a local government pension fund on request of an admitted body auditor. This type of work is an audit related service but does not currently fall under any of the existing options in paragraph 5.36 (or those in paragraph 5.39) – we request that this paragraph is expanded to include work such as this.

Paragraph 5.40

The non-audit services included in 'whitelist' should be expanded to cover all the work that public sector auditors are typically required to carry out for their audit clients. These include Quality Accounts and MHIS compliance work in the NHS and other Government returns and pensions assurance work in local government, which auditors are expected to undertake, otherwise, if the audited body is a PIE, there will be a conflict with public sector requirements as set out in AGN01.

There are other services we provide to local government bodies which are not included on the 'whitelist' which we do not consider impact on audit independence. For example, we currently have local authority audited bodies who subscribe to information platforms such as Place Analytics and CFO Insights. These are online platforms to consolidate data sources which the bodies use regularly providing structure and insight around a range of open source databases with content available to users for a subscription payment for access to the data. We would request that such services are included in the whitelist for local audited bodies.

Paragraph 5.46

This refers to additional work that could impact on an auditor's opinion on the financial statements and states that this is eligible and can be carried out, but it does not refer to any additional work that might be required to fulfil any additional responsibilities of the auditor, e.g. work on the Value for Money Conclusion or the application of the formal audit challenge powers under the Code of Audit Practices. Again, the wording in the 2019 Ethical Standard Exposure Draft does not encompass the different services which auditors are required to provide to the public sector. The broader scope of a local audit should be fully addressed by the Standards in our opinion.

Application of the fee cap

When the audit firm, or a member of its network, provides to a public interest entity that it audits, its parent undertaking or its controlled undertakings, non-audit services other than those referred to in Regulation 80 of The Statutory Auditors and Third Country Auditors (Amendment) (EU Exit) Regulations 2019 (SI 2019/177):

a) the total fees for such services provided to the audited entity and its controlled undertakings shall be limited to no more than 70% of the average of the fees paid in the last three consecutive financial years for the audit(s) of the audited entity and of its controlled undertakings and of the consolidated financial statements of that group of undertakings; and

b) the total fees for such services provided by the audit firm shall be limited to no more than 70% of the average of the fees paid to the audit firm in the last three consecutive financial years for then audit(s) of the audited entity and, where applicable, of its parent undertaking, of its controlled undertakings and of the consolidated financial statements of that group of undertakings.

It would be helpful if the FRC liaised with the NAO to ensure there is greater clarity on how this should be applied in the public sector where, for example, there are devolved institutions, Local Enterprise Partnerships (LEPs), and for various health organisations across the NHS. Guidance on how the determination of whether they are controlled undertakings by an audit client would be helpful.

Other comments in respect of the Revised International Standard on Auditing (UK) and International Standard on Quality Control (UK) Exposure Draft

Appendix D – Revised International Standard on Auditing (UK) (ISAs (UK)) and International Standard on Quality Control (UK) (ISQC (UK))

ISQC (UK) 1 – Quality Control for Firms that Perform Audits and Reviews of Financial Statements and Other Assurance and Related Services Engagements and ISA (UK) 220 – Quality Control for an Audit of Financial Statements (ISQC (UK) 1)

The definition of 'Public interest entity' included in ISQC (UK) 1 and ISA (UK) 220 states 'A credit institution within the meaning given by Article (4)(1)(1) of Regulations (EU) No. 575/2013 of the European Parliament and of the Council, which is a CRR firm within the meaning of Article (4)(1)(2A) of that Regulation'. The paragraph makes reference to CRR however this has not been defined in the ISA or glossary. We would recommend that the acronym be footnoted within the ISA (UK) for clarity.

We also note that part (iii) of the definition includes insurance entities that would meet a definition of PIE. However, we note that the addition of "as that Article had effect immediately before the exit day, were the United Kingdom a Member State" could be better articulated in this aspect of the definition to make it easier to understand.

ISQC (UK) 1 – Quality Control for Firms that Perform Audits and Reviews of Financial Statements and Other Assurance and Related Services Engagements

ISQC (UK) 1 footnote 3b includes a reference to paragraph A2-1 of ISA (UK) 220 (Revised June 2016). We note that this paragraph does not exist in ISA (UK) 220 (Revised June 2016).

ISA (UK) 220 – Quality Control for an Audit of Financial Statements (ISA (UK) 220)

Paragraph 7(f)-1 also includes a reference to paragraph A2-1. This reference similarly should be amended.

Paragraph 21-2 requires the engagement quality control (EQC) reviewer to discuss the results of the EQC review with the key audit partners (KAP). Paragraph 21-3 requires the EQC reviewer for PIEs consider the same matters as 21-2 for components and discuss results with each KAP. There is a lack of clarity as to whether this is requiring the EQC reviewer to perform the review on all components but only discuss the results of the review of certain components, i.e., those to which a KAP is appointed. We do not believe that this is the intention of this requirement and are therefore of the view that a separate requirement in relation to PIEs is not required. This requirement could be combined with the requirement in paragraph 21-2, thus resulting in one requirement applicable to all entities.

Paragraph A32-1 states "in such circumstance, the engagement quality control reviewer documents the rationale for this decision". As written, this creates a requirement within the application material. If the intention was to create a requirement, we would recommend that this is included in the requirement section of the ISA and not the application material.

Paragraph A32-2 provides guidance on documentation of the EQC review as follows:

> "For example, it may include a file note of the discussion between the engagement quality control reviewer and the key audit partner, as necessary"

Since this application guidance is in relation to the EQC reviewer's discussions with the KAP, the meaning of the qualifier is unclear.

Paragraph A32-3 uses the phrase, "it is important." If the matter is important, drafting conventions would suggest that a requirement in relation to the 'important' matter would be more appropriate.

Paragraph A32-4 includes an example to "perform a scenario analysis". We are unclear what a scenario analysis would be in this context and would recommend either clarification of the term or an alternative example be provided.

ISA (UK) 250 Section A – Consideration of Laws and Regulations in an Audit of Financial Statements (ISA (UK) Section A)

We noted that the ISA includes two paragraph A11-1 and this would need to be corrected.

We recommend the following edits to paragraph A11-2:

> "The auditor considers both quantitative and qualitative factors when considering both categories of laws and regulations as described in paragraph 6~~. Even~~, including in circumstances when the direct effect on the determination of amounts and disclosures in the financial statements is not quantitatively material. For example, acts of non-compliance may not generate material fines or penalties, but may have a direct effect on disclosures because, due to the nature of the entity, disclosures of acts of non-compliance are important to users of the financial statements."

The addition to paragraph A12 is, in essence, a requirement for 'auditors to take into account potential fines, litigation or other consequences for the entity when evaluating the possible effect on the financial statement'. As such, we would recommend that it is moved to the requirement section of the ISA (UK).

Paragraph A16-1 is included under the sub-heading of 'Written Representations (paragraph 17)' however the guidance in this paragraph does not appear to be providing guidance to obtaining written representations from management or where appropriate, those charged with governance. The guidance also references management…informing the auditor of … non-compliance [through] some other means. We question whether 'other means' can be linked to the guidance provided in paragraph A17.

ISA (UK) 260 – Communication with Those Charged with Governance (ISA (UK) 260)

Paragraph 16-1(e) requires auditors to "communicate to the audit committee the information that the auditor believes will be relevant to… the robustness of the board's assessment of the entity's emerging and principle risks including the related disclosures in the annual report confirming that they have carried out such an assessment and describing the principle risks, what procedures are in place to identify emerging risks and explaining how **these** are being managed or mitigated." It is not clear which risks are being referred to in the requirement, for example is it just the emerging risks or both the principle risks and the emerging risks. We would recommend clarification in this respect.

Paragraph A28-6 includes an example of when a matter may not need to be reported in the additional report to those charged with governance. This example refers to reporting on a 'valuation method.' We would recommend that a more simplistic example be included to illustrate this point as valuation methods are more often associated with matters that give rise to a higher risk of material misstatement.

ISA (UK) 600 – Special Considerations – Audits of Group Financial Statements (Including the Work of Component Auditors) (ISA (UK) 600)

Paragraph 9(b) includes the following proposed amendment to the definition of component auditor:

> "A component auditor may also be a Key Audit Partner."

This amendment to the definition lacks precision and implies that any component auditor may be a KAP. We recommend that it is amended to state, "A component engagement leader [partner] may also be a key audit partner."

Paragraph 9(h) includes the following proposed amendment to the definition of group engagement partner:

> "A group engagement partner may also be the key audit partner."

As drafted, this implies that there would only be one key audit partner, and this may not be the group engagement partner. We are not aware of any circumstances where group engagement partner would not be a KAP as this partner would have responsibility for the group engagement and would sign the group auditor's report. We would recommend the follow amendment to the proposed addition to the definition of group engagement partner:

> "A group engagement partner is a key audit partner."

Paragraph A61-1 indicates that the requirements in paragraph 42-1 goes beyond the requirement in paragraph 42(b). Further elaboration of this statement would be helpful.

The first sentence of paragraph A61-2 merely repeats information included in ISA (UK) 220. We would recommend that this sentence is deleted and the focus of the guidance be on the matters that the firm's policies and procedures address in the context of a group engagement.

Paragraph A61-4 includes the following:

> "The group engagement partner documents on the file how they have satisfied themselves as to the adequacy of the audit evidence."

This essentially creates a requirement, and as such, should be included in the requirement section of the ISA and not in the application material.

ISA (UK) 620 – Using the Work of an Auditor's Expert (ISA (UK) 620)

Paragraph A20-1 makes reference to paragraph 9-1, whilst the immediately preceding subheading refers to paragraph 9R-1. This should be amended for consistency.

ISA (UK) 700 – Forming an Opinion and Reporting on Financial Statements (ISA (UK) 700)

There is an inconsistency between the requirement in paragraph 29-1 and the guidance supporting this requirement A39-3. Paragraph A39-3 states that "the auditor may explain the extent to which aspects of the auditor's work addressed the detection of irregularities…" As currently drafted, this implies that such disclosures are optional, which is in contradiction of the requirement. A suggested alternative lead into the examples provided is as follows:

> "Aspects of the auditor's work that may address the detection of irregularities include:"

Paragraph 45(e) proposes to change "controlled undertaking" to "subsidiary undertaking," to align with UK legislation, however the 2019 Ethical Standard continues to refer to controlled undertaking. We note there is no definition of controlled undertaking in the 2019 Ethical Standard. As such, clarification as to whether the difference is merely terminology or if not, an explanation of the differences between a subsidiary undertaking and a controlled undertaking; or, alternatively, including a definition of both a controlled undertaking and a subsidiary undertaking would be helpful.

Paragraph 45(e) also makes reference to the annual report. To assist in applying this requirement to certain public sector bodies that meet the definition of a PIE it would be helpful to amend to 'annual report or equivalent' and to include application material that provides examples of the public sector equivalents.

Paragraph A39- 1 states that 'Irregularity is not defined in UK legislation, but it is deemed to correspond to the definition in ISA (UK) 250 (Revised June 2016)'. Whilst we appreciate that this language has been copied directly from SGN 02/2017[16], for clarity we would recommend that this paragraph is amended as follows:

> "For the purposes of this ISA (UK), irregularity corresponds to the definition of non-compliance in ISA (UK) 250 (Revised June 2016)."

Paragraph A39-3, the second sub-bullet, we suggest changing "which" to "the."

ISA (UK) 701 – Communicating Key Audit Matters in the Independent Auditor's Report (ISA (UK) 701)

Paragraph 16-1(c)(ii) refers to paragraph A59-3, which does not exist.

Paragraph A59-2 has been amended as follows:

> "An explanation of the significant judgments made by the auditor in determining materiality may include a description of how the auditor applied the concept of materiality, in planning and performing the audit~~, is~~ tailored to the particular circumstances and complexity of the audit…"

As illustrated, we suggest that "is" is deleted.

Further the third bullet of paragraph A59-2 includes "(as described in paragraph 10 of ISA (UK) 320 (Revised June 2016))." This is then repeated in the footnote to this bullet. We suggest that one instance of this reference is deleted.

[16] Staff Guidance Note 02/2017 (Revised November 2018), Explaining to what extent the audit was considered capable of detecting irregularities, including fraud

ISA (UK) 720 – The Auditor's Responsibilities Relating to Other Information (ISA (UK) 720)

Paragraph 22-1(b) and paragraph 22-4 make reference to application material in paragraph A53-7 and A53-9 respectively, however these paragraphs do not exist.

Paragraph A10-3 clarifies that information included in statutory other information by way of cross reference would also be considered statutory other information. We note that public sector bodies often include hyperlinks to other documents within the annual report. Further clarification, specific to the public sector, as to which of these documents would then be regarded as statutory other information would be useful.

Paragraph A36-5 essentially reiterates the requirement to perform procedures on the statutory other information and does not provide auditors with any additional guidance. We suggest that this paragraph is deleted.

Paragraph A53-13 includes a typographical error, "proposer" and we propose this is changed to "proper". However, we would suggest that "appropriate" is used instead of "proper".