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By Email only: Kate Dalby at AAT@frc.org.uk

Dear Kate,

PROPOSED REVISIONS TO ISA (UK) 250 SECTION A AND ISA (UK) 250 SECTION B

Thank you for the opportunity to comment on this consultation on the proposed revisions to ISA (UK) 250 section A and ISA (UK) 250 section B.

Price Bailey is a top 40 UK accountancy practice specialising in providing audit, accountancy, tax and business advice to enable the growth of regional, national and international businesses. We audit a number of entities within the SME sector and also listed companies.

We have 9 offices in the UK. We employ over 450 professionals and have a group turnover of over £35million.

The proposed standards represent an entirely unnecessary deviation from the international ISAs and, we believe, increases the risk of confusion and inconsistent application.

It is unclear what current deficiencies FRC are attempting to address with these proposals, and little clarity on how they will improve audit quality. Upon reading recent Audit Quality Reviews it is surprising that this matter is high on the FRC agenda.

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The messaging around the impact assessment has been inconsistent. It is unclear whether this is a codification of what FRC regard as best practice or something more substantial. It would appear to be the latter however the assessment of an additional 15 hours work appears to be entirely unsupported, let alone justified, and we suspect in many cases considerably more might be required.

We understand the starting point is for management to prepare and provide the auditors with a complete list of laws and regulations that potentially have a material impact but this is not clear from the standard. Some entities will not have this and some entities might have incomplete considerations, and there is no guidance in the standard about how much is enough. Nor is there any guidance for audited entities.

What these proposals therefore seem to amount to is indirect regulation of Companies and Company Director's via the 'back-door', with the auditor as proxy.

Some entities will no doubt require specialist legal advice further adding to the cost and impact. The auditor will have practical difficulties in determining if a full list of correspondence has been provided by management.

Finally, many of the changes around Section 2XO appear to have little to do with enhancing audit quality and should not be implemented without the legislative protection for auditors.

We have provided our detailed response to each of the questions in the attached appendix.

Yours faithfully

PRICE BAILEY LLP

APPENDIX

1. Do you believe that the proposals in ISA (UK) 250, considered collectively, will enhance and strengthen the auditor's identification of risks of material misstatement of the financial statements due to fraud or error relating to non-compliance with laws and regulations?

It is difficult for us to see how the proposed changes appropriately address the 'public interest' any better than the existing standard as it is unclear what 'public interest' issues FRC are trying to address.

The requirement for the auditor to conclude on whether non-compliance or suspected non-compliance with laws and regulations has resulted in a material misstatement of the financial statements would appear to be in pursuit of this addressing the public interest but it is difficult to see what it adds given that auditors already report on material misstatements howsoever caused.

The impact assessment suggests an extra 15 hours per audit. It is unclear what the support for this is and it will impact costs for firms and therefore preparers. This would appear difficult to justify in the public interest without clarity on what improvements are expected.

There is no clear evidence of 'root cause analysis' to understand why the issues FRC are trying to fix have occurred and how these revisions will address those causes. However, based on the information provided this is not in the public interest as it will increase costs both for firms and entities to be audited without any clarity as to how this will improve audit quality or what problems it will fix.

We also believe it likely that the changes will widen the "expectation gap" between perception of what the audit will be able to identify and what a properly performed audit actually will. If the proposals are designed to require auditors to put pressure on management to make changes then this will significantly and disproportionately increase costs to owner managed businesses as they will need to pull together and document their consideration of laws and regulations in a lot more detail than they currently do or need to, and how these are documented will vary greatly.

It has also been noted during the roundtables that these proposed amendments would not have prevented some recent high profile examples of non-compliance with laws and regulations.

2. Do the proposed requirements in paragraphs 12-2–12-3 support auditors to be able to identify those laws and regulations with which non-compliance may have a material effect on the financial statements?

We understand that the current distinction (between direct and indirect) is viewed by some as artificial and that FRC wish to move towards a more risk based approach. We believe that the current requirements do allow for a sufficiently risk based approach.

We also understand the starting point is for management to prepare and provide the auditors with a complete list of laws and regulations that potentially have a material impact but this is not clear from the standard. Some entities will not have this and some entities might have incomplete considerations, and there is no guidance in the standard about how much is enough. Some entities will no doubt require specialist legal advice further adding to the cost and impact. The auditor will have practical difficulties in determining if a full list of correspondence has been provided by management.

3. Do you believe that the proposals in ISA (UK) 250, considered collectively, will enhance and strengthen the auditor's identification of risks of material misstatement of the financial statements due to fraud or error relating to non-compliance with laws and regulations?

FRC wishes to move away from what is regarded as a procedural approach yet the proposed standard appears to do precisely the opposite. FRC have stated that the current standard was 'too procedural' (it had two prescribed risk assessment processes and two prescribed audit procedures). The proposed standard has 7 prescribed processes for risk assessment alone, making the standard somewhat more procedural (and therefore less responsive to risk) than it previously was. We believe that the current direct/indirect distinction allows for a sufficiently risk-based approach.

It is unclear what level of scalability might be expected for audits of smaller entities that aren't subject to any specific regulatory frameworks. We suggest that the revised requirements in their current form might be extremely difficult to apply in the context of audits of smaller entities, which may only have very basic documentation regarding laws and regulations and very little by way of structured internal reporting mechanisms.

The potential impact on group audits and use of component auditors is also unclear and we can only see the issues identified above being amplified for such engagements. The need for locally qualified legal advisers will further increase costs for such audited entities. Given that this amounts to an additional requirement for global companies created for the purposes of a UK audit the vague 'public interest' assertions put forward by FRC are even more difficult to justify.

Also ISA 580 will need to be updated to require management to confirm they have provided a full list of relevant laws and regulations.

The above being said, we believe that the enhanced linkages to ISA 315 are to be welcomed.

4. Have appropriate enhancements been made to the application material?

Paragraph A10-2 is helpful in providing some examples of sector specific laws and regulations non-compliance with which may have a material impact on the financial statements, as well as UK specific laws and regulations in relation to the same. Equally the acknowledgement and examples in paragraph A8-1 of the inherent limitations in identifying non-compliance with laws and regulations is helpful.

That said paragraphs A10-1 to A10-6 show indications of an attempt to articulate that which was established much more clearly in the extant direct/indirect distinction, especially once the

extant paragraph A12 is also taken into consideration, itself providing guidance on laws and regulations generally recognised to have a material effect on the financial statements.

Furthermore, despite acknowledgement within the invitation for comment that knowledge of applicable laws and regulations cannot be open ended, A10-1 can and is being interpreted as such.

Footnote 8a within A2-3 references Section 499 of the Companies Act 2006 covering the auditor's general right to information. This should also reference Section 501 covering the offences related to a failure to provide auditors with information.

5. Do you support the deletion of the Appendix on “Money laundering, terrorist financing and proceeds of crime legislation in the United Kingdom”?

No, as this is useful guidance.

6. Do you agree with the proposed effective date for audits of financial statements for periods commencing on or after 15 December 2024?

It is difficult to conclude on this question since we believe fundamental elements of the project lack merit. In any case we don't think this gives auditors enough time to update methodology.

ISA (UK) 2X0—Special Considerations for Audits of Public Interest Entities—Communicating and Reporting to an Appropriate Authority Outside the Entity

7. Do you agree that the proposals in ISA (UK) 2X0 appropriately address the public interest?

With the omission of audit reform from the 2023 King's speech it raises concerns about when the audit reform will be implemented, an important part in the proposed legislation are the protections for auditors for reporting which are essential to ensure auditors are not in breach of confidentiality requirements in applying 2X0. Without those protections in place, the proposals should not be implemented. We do not believe that either standard should be finalised before these protections are implemented.

8. Do you agree with the proposed scope of ISA (UK) 2X0 being limited to public interest entities, or do you believe that the requirements of ISA 2X0 should also apply to: a) Listed entities b) Charities c) Other entities in regulated industries d) All entities. When responding consider that for many audits, as reportable matters are not likely to be identified, only the requirements in paragraphs 11 – 13 will apply and that all auditors are subject to anti-money laundering legislation.

A pre-requisite of eligibility to be a registered auditor in the UK is membership of one of 4 qualifying bodies, all of which derive their Code of Ethics from IESBA and therefore the members of which are already subject to a public interest reporting considerations, regardless of whether the entity is listed or not.

Furthermore auditors are already subject to a myriad of different reporting regimes specifically aligned to the sector in which the audited entity operates (e.g. FCA, Charities, Pensions), as well as more generally applicable requirements to report suspicions of crimes with proceeds. These requirements are long established by the regulators of those particular sectors and well understood by those auditing such entities. No doubt is the aforementioned regulators had cause for concern if there aren't any reporting requirements not covered by existing regulatory frameworks that don't come under FRCs jurisdiction then it would appear that FRC are trying to regulate a 'catch-all' requirement on behalf of every sector that doesn't already have a discreet framework. We need to understand what types of reports FRC are looking for that are not currently being received.

9. Do you support the definition of Reportable Matters?

The definition of reportable matter includes those required by law, regulation or ethics (which auditors will be doing anyway as noted above), those where we deem it appropriate and those that we believe are in the public interest.

It is not clear what is meant by situations where we deem it "appropriate". Surely this would already be covered by the requirements of law, regulation, ethics, or where we deem it to be in the public interest. Furthermore a subjective determination that it is "appropriate" to report something outside of regulatory/ethical requirements or the presence of a public interest is not something that the existing Code of Ethics (nor the FRCs current articulation of confidentiality) permits¹. As mentioned above, FRC need to provide specific examples of the types of report they are expecting that are not currently being received.

As set out above 'public interest' remains undefined and we understand that it is frequently the case that a legal opinion is required to determine. Furthermore the legal implications for an auditor reporting matters where there is not a legal or regulatory requirement to do so are manifold (see comment earlier about the protection needed for auditors). Were an auditor to draw their own conclusions on public interest without seeking legal advice it might be all too easy to conclude that simply because the public later became interested that a contemporary judgement should have concluded that the matter was in the public interest.

There is no guidance that auditors (or regulators) can follow in making the judgements above, which will lead to inconsistent application across the sector.

10. Do you believe that the proposals in ISA (UK) 2X0, considered collectively, will enhance and strengthen the auditor's identification of matters that should be reported to an appropriate authority outside the entity?

The FRC also has no expectation as to whether there will be an increase in reports under the new standard, or whether this would cause an issue for audit firms. So it seems somewhat speculative which is an undesirable starting point when introducing new regulation, it also

¹ https://media.frc.org.uk/documents/Revised_Ethical_Standard_2019.pdf

seems apparent that there is therefore no clear mischief that they are seeking to address. We would advise FRC to seek responses specifically from the legal sector if they have not already.

11. Have appropriate enhancements been made to the application material?

Much of the application guidance, whilst useful, simply reinforces some of the issues we have identified above. For example, the section on “Breaches of Statutory or Regulatory Requirements” is somewhat redundant in the face of the myriad statutory or regulatory requirements themselves.

12. Do you agree with the proposed effective date for audits of financial statements for Financial Reporting Council periods commencing on or after 15 December 2024?

It is difficult to conclude on this question since we believe fundamental elements of the project lack merit.