



Private and confidential

Financial Reporting Council
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For the attention of: Kate Dalby
Project Director

By email to: AAT@frc.org.uk

12 January 2024

Dear Ms Dalby

Invitation to Comment - Proposed International Standard on Auditing (UK) 250 (Revised) and 2Xo (Revised)

PricewaterhouseCoopers LLP (“We”) welcome the opportunity to comment on the proposed revisions to the International Standard on Auditing (UK) 250 (Revised) and 2Xo (Revised) (“the revised standards” or “revised 250” or “revised 2Xo”). We support the FRC’s commitment to more principles-based standards and are therefore pleased to contribute to these efforts. To that end, our detailed responses to the questions in the Invitation to Comment are included in Appendix 1 and suggested minor corrections are included in Appendix 2, with an overview of the key points included below.

We are committed to the continuous improvement of audit quality, including, as it relates to our audit responsibilities regarding non-compliance with laws and regulations. However, we are concerned the changes being proposed could have a number of unintended consequences and therefore we are not supportive of the changes currently proposed. Given the significant additional burden we believe the proposed changes to ISA (UK) 250A, in particular, is likely to place on audited entities, it is critical that the FRC understands their perspective when considering the impact of these proposals.

We are unclear as to the impetus for these changes, as we are not aware of any systemic findings in relation to either ISA (UK) 250A or B as a result of external inspections. In our view, the currently proposed revised standards would also place responsibilities on auditors with no commensurate changes on the responsibilities of management and boards in relation to identifying non-compliance with laws and regulations. It is the responsibility of management, with the oversight of those charged with governance, to conduct an assessment of laws and regulations. The proposed revised standards as they are, would suggest that the auditor be expected to have the expertise to research all possible laws and regulations affecting multiple different businesses. This will not only present a challenge for larger audit firms, but could also create barriers to entry for smaller audit firms into the PIE audit

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market, which is contrary to the FRC's competition objective. We believe the current proposal underestimates the work effort and associated cost with any implementation.

These sentiments are driven by a combination of the proposed changes, most significantly:

Revised 250

- **The elimination of the distinction between direct and indirect laws and regulations, and the proposed requirement in revised 250 to "identify the laws and regulations with which non-compliance may have a material effect" (5-1)** - Based on discussions with the FRC to date and management's underlying responsibility for the compliance with laws and regulations, we understand that the intention of the proposed revised standard is that the auditor can base their risk assessment on management's identification of laws and regulations applicable to the entity. However, in our experience, many entities (particularly smaller entities and those with extensive overseas operations) may not have a comprehensive assessment of all the laws and regulations that may have a material impact on their financial statements, and it will not be feasible for the auditor to compile such an assessment without incurring significant additional time and cost (well in excess of the 15 hours suggested in the impact assessment).
- **The proposal that the auditor would have to determine if there is a risk of non-compliance with identified laws and regulations at the "provision" level for each law or regulation** - In our view, this goes further than International Standard on Auditing (UK) 315 Revised - Identifying and Assessing the Risks of Material Misstatement ("ISA (UK) 315") in that it requires auditors to consider and document the impact of laws and regulations at a much more granular level, which would not only require a significant increase in the work and expertise (and therefore cost to companies), but also risks for investors, companies and audit firms alike due to the inevitable inconsistencies of approach in a area of particular complexity.
- **The proposed level of audit work required** - The elimination of the distinction between the auditor's responsibilities with respect to direct and indirect laws and regulations means that, where there is considered to be a risk of material misstatement at the provision level, the auditor would have to perform the same level of audit work for direct and indirect laws and regulations that may have a material impact on the financial statements if not complied with. This would be true even if no identified or suspected instances of non-compliance have been identified as part of the risk assessment process. This could significantly increase the time and cost of an audit to both audit firms and businesses (again, well beyond what is suggested in the impact assessment), and further increase the need to engage with legal specialists.
- **The requirement to seek positive assurance of an entity's compliance** - Due to the removal of paragraph 18 from the extant ISA (UK) 250A, it is our interpretation that the revised standards would require auditors to seek positive assurance of an entity's compliance. If this understanding is correct, then we would request the FRC to provide clarifications as to how auditors would then obtain the evidence required, without needing to design and perform procedures which are not typically financial statement audit in nature, as well as requesting more information from management, regulators or legal advisors.



Revised 2Xo

- **The emphasis in revised 2x0 on reporting “in the public interest”** - This is a proposed requirement even if there are “no law, regulation or relevant ethical requirements” for such reporting. This is especially concerning, given the ambiguity with respect to the type of reporting the FRC is seeking to increase, and in the absence of any anticipated legislative changes which would increase protection for auditors.

In our detailed responses to the questions in Appendix 1, we have expanded on these concerns and, where considered possible, we have suggested alternative approaches.

We understand through different forums of discussion with the FRC that examples would be helpful to better communicate our concerns and our interpretation of the difference in the extent of work required between the current and revised standards. Examples in this regard include the compliance with GDPR or other territory specific data protection rules where the impact of any non-compliance can easily be material and for which no, or limited, corroborative audit evidence of compliance would be available. Furthermore, industries such as digital services, financial services, construction and manufacturing all have large bodies of legislation indirect to the preparation of the financial statements which can have material consequences for non-compliance and for which corroborative evidence may not be available. Failure to obtain persuasive, corroborative audit evidence may lead to a limitation of the auditor’s scope and consequently a significant increase in the prevalence of qualified audit reports.

Other Considerations

In addition to the concerns outlined above, we wanted to share our thoughts on a number of other matters we believe are pertinent to the discussions surrounding the proposed revised standards.

PCAOB proposal around NOCLAR

It is important to consider how the FRC’s proposals for revised 250 compare to the PCAOB’s recent consultation on auditors’ responsibilities for identifying non-compliance with laws and regulations (NOCLAR) and the significant concerns raised by many corporates and the profession in the US about what was being proposed. In our view, the changes being proposed by the FRC would go further than the PCAOB’s proposals, as revised 250 is applicable to *all* entities, not just the largest organisations.

Impact assessment and effective date

Given our view that the proposals will actually result in significant additional time and effort for many engagements, we do not believe that the additional 15 hours estimated in the FRC’s impact assessment is realistic. The actual amount of time and work effort required would clearly depend on the individual entity’s facts and circumstances, however we believe in many cases this would be significantly more than 15 hours. In some of the largest and most complex global audits, we anticipate this could run to hundreds of hours. Additionally, this could also create a significant burden for management.

Fundamentally, due to the wider concerns raised within our response and in wider forums, we recommend that the FRC engage further with stakeholders to address those concerns before the final standards are issued, even if that means deferring the release.



We hope our comments are helpful and if you have any questions or would like to discuss any of the points raised in this letter in more detail, please contact Matthew Hulme (tel: +44 (0) 7850 908 339) or me.

Yours sincerely,

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Appendix 1:

Response to consultation questions

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

1. Do you agree that the proposals in ISA (UK) 250 appropriately address the public interest?

We do not believe there is a consistent definition of what is considered to be “in the public interest”, so more guidance from the FRC on its view of the public interest would be helpful. Notwithstanding this request, in our view, the public interest is best addressed when all parties in the corporate “ecosystem” have appropriate responsibilities. Our reading of the proposed revisions indicate a substantial increase in the auditor’s responsibility for identifying all laws and regulations which may have a material effect on the financial statements, without a sufficiently explicit corresponding enhancement to the responsibilities of management and those charged with governance. This is compounded by the fact the Government recently withdrew the draft legislation that would have required large companies to make a “Material Fraud Statement” - something that would have enhanced management's responsibility in this area. This sentiment is echoed in Sir Donald Brydon’s 2019 report on ‘Improving Audit Quality and Effectiveness’¹, which acknowledged that “*auditors cannot act alone in the public interest; they need directors to do so too*”. The FRC should consider what can be done, absent the requirement for the Material Fraud Statement, to increase the responsibilities and accountability of companies in this area, as well as auditors.

As we have commented before, we are supportive of a diverse audit market, but are concerned that the proposed changes, and the increased cost, expertise and risk they could entail, could not only increase the cost to entities of obtaining audits from any audit firm, but could also create barriers to entry for smaller firms, which would appear to be contrary to the public interest.

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?

Proposed paragraph 12-2

Laws and regulations relevant to “operating aspects of the business”

Proposed paragraph 12-2(a) states the risk assessment procedures extend to laws and regulations relevant to the “operating aspects of the business”. Whilst this is not a new concept, we do draw attention once more to the removal of the distinction in the auditor’s responsibilities with respect to laws and regulations which have a direct or an indirect effect on the financial statements. Specifically, in the extant standard, it was acknowledged that there is a greater degree of inherent limitation on the auditor's ability to detect material misstatements as “*there are many laws and regulations, relating principally to the operating aspects of an entity, that typically do not affect the financial statements and are not captured by the entity's information systems relevant to financial reporting*”. This

¹ https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/852960/brydon-review-final-report.pdf



acknowledgement now sits in proposed paragraph A8-1 and we recommend adding a cross-reference to this application material.

Requirements at the “provision” level

Proposed paragraph 12-2(b) articulates the need for the auditor to understand “provisions in laws and regulations”. Although provisions are referenced throughout the extant standard, it was not explicitly included within the extant paragraph 13 on auditor’s understanding, thus appearing to have elevated former guidance into a requirement. This will be especially challenging for indirect laws and regulations and will require significant additional time as some laws and regulations may contain a significant number of provisions and the identification of risk may require increased legal expertise. Further application material or clarification to elaborate on this requirement would be helpful.

Responsibility for compilation and completeness of an assessment of laws and regulations

Through discussions with the FRC and in our reading of proposed paragraph 12-2(c) to (e), we understand that the intention is for management and those charged with governance to be responsible for the compilation and completeness of an assessment of laws and regulations, to facilitate the auditor’s risk assessment. However, it is unclear what procedures should be performed by management and those charged with governance to ensure their assessment is complete. Furthermore, even if all required procedures are performed, there is always a risk that a law or regulation may be missed and we believe additional clarity/strengthening is needed regarding the inherent limitation on the auditor's ability to detect material misstatements if auditors are to obtain an assessment of laws and regulations from management and this is incomplete. To this point, we would also encourage the FRC to provide additional clarity regarding how these proposed paragraphs interact with International Standard on Auditing (UK) 580 - Written Representations (“ISA (UK) 580”) as the existing wording on written representations within proposed paragraph 17 and Appendix 2 of ISA (UK) 580 would need to be enhanced.

We acknowledge some entities may already have a sufficiently robust assessment of all laws and regulations but this is unlikely to conclude on the potential impact on the financial statements - for example, the magnitude of potential fines for non-compliance. However, for those that do not, we believe that it is critical to provide entities sufficient time and guidance to ensure there is a solid foundation upon which the auditors will perform their risk assessment procedures.

Proposed paragraph 12-3

With respect to the requirement for auditors to inspect “correspondences with relevant licensing or regulatory authorities” in proposed paragraph 12-3(b), we note that this no longer contains the wording “if any”, which implies that all entities will be expected to have some form of correspondence. Furthermore, as stated above, given the elimination of the distinction with respect to laws and regulations which have a direct or an indirect effect on the financial statements, the expected population of correspondences which would need to be inspected by the auditors is expected to increase significantly. We believe that as a minimum an acknowledgement that correspondence may not exist should be retained within the standard.

We also believe that application material setting forth examples of “records or documents” referenced in proposed paragraph 12-3(b)(iv) would also be helpful in understanding the types of evidence the auditor may look to obtain.



Additional Points

We would also request the FRC to consider the following with respect to these proposed paragraphs:

Global considerations including the impact of International Standard on Auditing (UK) 600 Revised - Special considerations—Audits of group financial statements (Including the work of component auditors) (“ISA (UK) 600”)

For larger entities with global operations, our understanding of the revised standard through discussions with the FRC is that management and those charged with governance need to provide a comprehensive assessment of all laws and regulations and all correspondences with all licensing or regulatory authorities and all legal firms for all territories in which they operate. We are concerned that there is no acknowledgement of the inherent limitation associated with these requirements, as it would be impractical for auditors to establish the completeness of such assessments and correspondences and therefore recommend further clarity be embedded within the standard as to how this would be applied with reference to ISA (UK) 600. There would also be confidentiality considerations for certain jurisdictions which may cause delay or impact the completeness of the correspondences.

Risk of material misstatement

We understand that the FRC is seeking to align the revised standards to the recently revised ISA (UK) 315 and would encourage the inclusion or reference to paragraph A186 of ISA (UK) 315, which notes that “*the identification of risks of material misstatement...is based on the auditor’s preliminary consideration of misstatements that have a reasonable possibility of both occurring, and being material if they were to occur*”. This would not only introduce the concept of reasonable possibility as defined in paragraph A15a of International Standard on Auditing (UK) 200 - Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with International Standards on Auditing (UK) (“ISA (UK) 200”) but would also clearly articulate that the risk assessment is performed based on preliminary consideration, thus allowing auditors to narrow down the number of indirect laws and regulations upon which to perform further research and procedures for the purpose of the risk assessment.

Scalability

Although proposed paragraph A10-5 on scalability is in line with paragraph A16 of ISA (UK) 315, further enhancements can be made by explicitly referencing the application of the auditor's professional judgement in determining the nature and extent of risk assessment procedures to be performed. Furthermore, this proposed application material can be referenced with proposed paragraphs 12-3 and 16-1, instead of just being referenced within proposed paragraph 12-1.



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?

We believe that while the revised 250 has become more principles-based, amendments and further clarifications are required to ensure the requirements within the revised standard will be interpreted as intended. We have described these areas in our cover letter and in our response to other questions, but we want to highlight the following matters in particular:

- a) Reinstating the distinction between laws and regulations which have a direct or an indirect effect on the financial statements or providing greater clarity regarding the extent of work required over indirect laws and regulations. In addition, including an enhancement to the acknowledgement of the inherent limitation of the auditor’s ability to assess completeness and impact of indirect laws and regulations;
- b) Reintroducing paragraph 18 from the extant standard or elucidating the extent of work required in the absence of identified or suspected non-compliance; and
- c) Explaining how the revised 250 interacts with:
 - i) ISA (UK) 600: in terms of the extent that group auditors are expected to be involved with understanding and performing risk assessment for laws and regulations which are highly specific to a particular geographical region, especially when component auditors would not be required to perform such procedures to the same degree of detail under their own local statutory audit legislation; and
 - ii) ISA (UK) 580: whilst we note that written representations by themselves do not constitute sufficient appropriate audit evidence, we do believe that enhancements to the wording within paragraph 17 of the revised 250 and the Illustrative Representation Letter in Appendix 2 of the existing ISA (UK) 580 would better reflect the expectations the FRC has of management and those charged with governance to provide a complete and accurate assessment of all laws and regulations, correspondences, etc. Likewise, we believe there is a further opportunity to highlight the importance of Section 501 of the Companies Act 2006.

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

We have identified points throughout our response where we believe the application material could be enhanced or needs to be changed. In Appendix 2, we have also suggested some more minor enhancements or changes.

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

We do not support the deletion as we believe that the Appendix on “Money laundering, terrorist financing and proceeds of crime legislation in the United Kingdom” contains key guidance for engagement teams, which is not fully captured by proposed application material as that is not to the same depth.



If this Appendix were to be deleted, we urge the FRC to make the guidance available as a separate, external document which could then be referenced within the proposed paragraphs or application material.

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

Fundamentally, due to the wider concerns raised within our response and in wider forums, we recommend that the FRC engage further with stakeholders to address those concerns before the final standards are issued, even if that means deferring the release.

ISA (UK) 2Xo - 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) 2Xo appropriately address the public interest?

As we note in our response to Q1, we do not believe there is a consistent definition of what is considered to be “in the public interest”, so more guidance from the FRC on its view of the public interest would be helpful.

Based on discussions with the FRC to date, we understand that consideration has been given to the findings of Sir Donald Brydon’s 2019 report in drafting the revised standards. However, we note that, although Sir Donald Brydon’s 2019 report² recommended that auditors should report to the regulator(s) in the following situation: “*if they consider the Board does not pay sufficient attention to their anxieties, they should have an obligation to report to ARGAs, or an alternative regulator depending on the circumstances....if they have encountered any information in the course of their audit which leads to an anxiety about the resilience of the business*”, this recommendation was solely in relation to the proposed Resilience Statement but is being considered here in the wider NOCLAR context in the proposed revisions.

Furthermore, whilst revised 2Xo contains application material moved from the extant ISA (UK) 250A regarding the legal aspects when making a report in the public interest, there have been minimal to no enhancements and it still does not contain sufficient clarity with respect to how the standard or other legislations may protect auditors from being charged for breaching confidentiality. In fact, in its May 2022 response to the Brydon and other related reviews, the Government promised protections for auditors around this “duty to report”. It is our understanding that there are no current plans from the Government to put these protections in place. We therefore urge the FRC to reconsider its proposals in this area in light of the Government’s position.

Although there have been amendments made to the revised 2Xo to emphasise the need for auditors to consider if a report shall be made in the public interest, the requirement for such a consideration and the associated application material are already embedded in the extant ISA (UK) 250A. As such, our reading is that auditors would already be making such reports, though it is unclear how the existing requirement has addressed the public interest to date. Conversely, we are not aware of any matters which should have been communicated in the

² https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/852960/brydon-review-final-report.pdf



public interest and have not been, and so we are uncertain how the revised 2Xo would better address the public interest.

8. Do you agree with the proposed scope of ISA (UK) 2Xo being limited to public interest entities, or do you believe that the requirements of ISA 2Xo 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.

If the intended goal of the proposed revisions is to enhance reporting requirements in the public interest, then it is sensible for the revised 2Xo to be limited to public interest entities. We note that there is already existing legislation that governs reporting by certain categories of entities listed above (e.g., financial services firms regulated by the FCA and the PRA, charities by the Charity Commission).

9. Do you support the definition of Reportable Matters?

Consistent with our response to Q2 above, we believe that further clarifications are required to ensure the definition of Reportable Matters will be correctly interpreted, especially with respect to proposed paragraph 10(b)(ii) and 10(b)(iii). The proposed wording for both of these paragraphs currently implies a degree of professional judgement, especially proposed paragraph 10(b)(iii), which pertains to information which has been determined to be “of such significance that it is in the public interest to report” even when the auditor is not required to do so by law, regulations or ethical standards. The definition of “significance” is a matter of judgement and we fear that, barring further clarification or examples, not only would this create uncertainties and inconsistencies in the market, it also increases auditors’ exposure to regulatory and litigation risks where different interpretations are preferred by others.

We are also concerned that this ambiguity in the language may result in more challenges from regulators regarding what matters have or have not been reported in the public interest and/or whether it is an appropriate action in the circumstances. We note that proposed paragraph A59, which highlights the potential for auditors to be questioned on the appropriateness of the decision made on the basis of what the auditor “ought to have known” or concluded or done, and proposed paragraph A60, which explains that auditors may need to seek legal advice, are both taken from the extant ISA (UK) 250A. However, taken alongside the amendment to the definition of Reportable Matters and the emphasis of reporting in the public interest, additional clarity is required with respect to the intention of these paragraphs as without it, the ambiguity is likely to result in the need for auditors to obtain potentially extensive additional legal advice on a more regular basis with the consequent increase in costs to companies.



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?

To the point raised in our response to question 7, the requirement to consider reporting in the public interest is already embedded in the extant ISA (UK) 250A, and consistent with our response to question 9, we believe that further clarifications are required to ensure the requirements within revised standard will be interpreted as intended so as to actually enhance the identification of matters that should be reported and to whom.

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

We have identified points elsewhere in our response regarding other enhancements, for which updates would be beneficial within the proposed application material.

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

Consistent with our response above, we urge the FRC to engage further and defer the proposed effective date.

Notwithstanding our concerns with the revised standards themselves, we feel that the proposed effective date in and of itself does not allow sufficient time for audit firms to adapt their existing methodology to any new requirements and provide more fulsome training to their practice.



Appendix 2:

Minor points

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

- i) 12-3(b) refers to “Para. A13–A14-1” and should be “Paras. A13-1–A14-1”
- ii) 13-1 refers to “Paras. A11-4–A11-5” and should be “Paras. A12-1–A12-2”
- iii) 14-1(a) refers to “Para. A11-6” and should be “Para. A15-1”
- iv) 14-1(b) refers to “Para. A11-7” and should be “Para. A15-2”
- v) 22-1(b) states that auditors shall take into account “whether the financial statements adequately reflect or, where appropriate, disclose the non-compliance or suspected non-compliance with laws and regulations”. It seems odd to suggest that management would make disclosure about “suspected” non-compliance. If there is a suspected instance, management would likely investigate and conclude if there is actual non-compliance prior to disclosure rather than make disclosures about a potential non-compliance.
- vi) 29-2(b) refers to “any indications of non-compliance with laws and regulations” but immediately following, paragraph 30 refers to documentation of both identified or suspected non-compliance. It seems repetitive to include both.
- vii) A29-2 and A29-3 both refer to “Section B of this ISA (UK)” and should be updated

ISA (UK) 2Xo - Special Considerations For Audits Of Public Interest Entities – Communicating And Reporting To An Appropriate Authority Outside The Entity

- i) A8 refers to “Ref: Para. 10” and 10 should have a corresponding reference to A8