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Our ref DLC/01/24

12 January 2024

**For the attention of Kate Dalby**

### **Invitation to comment - Proposed International Standard on Auditing (UK) 250**

We welcome the opportunity to comment on the proposed amendments to International Standard on Auditing (UK) 250 (Revised) – Section A *Consideration of laws and regulations in an audit of financial statements* and 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*.

We provide responses to the consultation questions in more detail below, but would like to put these responses in a wider context.

On 22 November 2023 the Secretary of State for Business and Trade, Rt Hon Kemi Badenoch MP, issued the Financial Reporting Council (FRC) with a new remit letter updating the Government's priorities for the FRC's work. The new remit letter sets out the FRC's core responsibility to enhance public trust and confidence in the quality of audit, corporate reporting and governance whilst supporting the UK's economic growth and international competitiveness. It speaks of the proportionality of any new requirements being essential and that it is also important to look at where rules and guidance are no longer proportionate and can be removed or streamlined. In response, the FRC's new CEO Richard Moriarty welcomed the Government's updated remit for the FRC, noting that their initial priority will be to conclude their review of the UK Corporate Governance Code followed by a fundamental review of the UK Stewardship Code. Further, the FRC has recently watered down its consultation on the UK Corporate Governance Code, in part due to the withdrawal of the Government's Statutory Instrument which addressed certain requirements of businesses.

Against this backdrop we would question the extent to which this consultation aligns with this new remit. Firstly, with regard to whether these proposals are proportionate and which quality issue they seek to address. Secondly the proposals appear to widen the remit of the auditor with respect to areas of audited entities' corporate governance that are not well defined. The auditor is being asked to enhance procedures around the audit of laws and regulations without the support of enhancements to corporate governance procedures in this area. This is particularly problematic for the audit of smaller and/or private entities in which governance structures may not be well developed because there is no imperative for them to be so. We do not believe it is the role of ISAs

to encourage changes in how businesses organise themselves, as ISAs are not an efficient vehicle for effecting such change.

We are also concerned about the timing of this consultation. The audit reform initiative and proposals put forward in the White Paper on 'Restoring Trust in Audit and Corporate Governance' published in March 2021, proposed a new definition of a public interest entity (PIE) which, as currently drafted, widens the PIE net to include large private entities. We don't yet know if and when this new definition is to be finalised and take effect. Consequently, auditors and businesses do not currently have a fixed idea of what a PIE is. Given the current lack of clarity it does not seem the right time to be consulting on the impact of a standard which relies heavily on this definition. It is also relevant that the IAASB have determined no changes are required to the international standard ISA 250 at present - it is not included in the IAASB's 2024 to 2027 work plan.

To be clear, we support improvements to ISAs which enhance audit quality. But we are not convinced we are at the right point in the chronology of audit reform (including the timing of the new PIE definition) and corporate governance reform to be making the proposed amendments to ISA (UK) 250.

### **ISA 250 – Considerations 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?

The proposed revisions to these standards have been contemplated for some time by the Financial Reporting Council (FRC). This is evidenced by the consultation response to the IAASB amendments to the international standard in 2016, the 2014 audit quality thematic review and the commitment to amend this standard within the FRC's 2022 Position Paper in response to the Government's response to restoring trust in audit. However, it would be helpful to understand where the need has arisen in terms of addressing wider public interest concerns. The IAASB is currently not proposing any amendments to this standard and has therefore presumably not considered there to be any public interest needs in this area. We are unsure as to the improvements the FRC is expecting to be achieved through these proposed amendments.

We are also concerned about the increasing divergence between UK auditing standards issued by the FRC and International Auditing Standards issued by the IAASB. There are already significant differences in several key standards. Whilst we acknowledge the need for some differences to address UK legislation and other jurisdiction specific requirements, this amendment would represent a significant departure over and above that of a UK-specific "top up". In respect of group assignments with overseas entities this imposes additional burdens on auditors to ensure fully compliant procedures by component auditors. Therefore, our view is that there needs to be a significant benefit to audit quality as a result of the revisions in order to outweigh the risks of group audits not meeting the UK-specific requirements. We are not clear that the proposed revisions would deliver those benefits.

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?

The proposed requirements in paragraphs 12-2-12-3 are useful however they make assumptions regarding the nature of the entity and their corporate governance regime. Some application guidance would be helpful regarding procedures to perform when the entity's corporate

governance regime does not specifically cover an internal risk assessment process or other oversight of laws and regulations.

It has been noted that a by-product of this consultation might be the improvement of systems and controls in this area within entities, but the improvement of corporate governance is not an objective of auditing standards. This is better achieved with legislation targeted at businesses. Attempting to 'legislate' for better corporate governance via ISAs places the auditor in a difficult position. It is not the role of auditors to mandate that companies perform risk assessment and introduce controls - auditors have no power to do this and rightly so, as this is a management role. Where controls are not present or are weak the auditor, in accordance with the proposed objectives, would still need to identify those laws and regulations with which non-compliance may have a material effect on the financial statements and therefore this moves what is a management responsibility from the audited entity to the auditor. This is not appropriate and contradicts a fundamental plank of the auditor's independence – that they do not adopt a management role. Revisions need to be scalable and proportionate to all sizes of audited entity.

The extant version of ISA (UK) 250 already requires the auditor to perform procedures to help identify instances of non-compliance with other laws and regulations which may have a material effect on the financial statements (para 15) which are essentially inquiry and inspecting correspondence, so it is not clear why a revision is needed in this area.

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 the extant version of ISA (UK) 250 A is well-understood and proportionate to the risks being addressed. The auditor is already required to perform risk assessment procedures to obtain an understanding of the entity and its environment, the applicable financial reporting framework and the entity's system of internal control and consider whether there are any indications of non-compliance with laws and regulations. Again, we are not sure what benefits the proposed amendments bring.

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

The application material focuses on larger entities. Examples of this include the suggestion that inquiries may be made of the internal audit function or a regulatory compliance function and the references to a formal whistleblower program. The vast majority of audited entities are not required to follow a corporate governance code and many do not have a regulatory compliance function. We would appreciate more guidance for smaller entities and entities that are not subject to a regulatory regime.

We support the removal of the reporting in the public interest section and it's moving to the proposed Auditing Standard 2X0 where this material sits better. The application guidance relating to obtaining an understanding of the nature of the act and the circumstances in which it has occurred is helpful.

5. Do you support the deletion of the Appendix on "Monday laundering terrorist financing and proceeds of crime legislation in the United Kingdom"?

Yes, we support the deletion of the Appendix on "Money laundering terrorist financing and proceeds of crime legislation in the United Kingdom".

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

We note that this is a relatively short time period for adoption. It would be preferable to give extra time for other standards to settle such as ISA (UK) 600; the changes required would unlikely be as significant as those arising from other recent amendments such as ISA (UK) 315 and therefore it would not require as long a lead-time for adoption.

Generally, we feel that whilst the consultation document recognises that the auditor's responsibilities cannot be open-ended to the effect of identifying and determining compliance with all laws and regulations pertaining to an entity, we are concerned that in the absence of formal controls and procedures within an entity regarding laws and regulations the effect would be that the auditor's responsibilities would become open-ended. We note removal of the following wording regarding the responsibility of the auditor "however, the auditor is not responsible for preventing non-compliance and cannot be expected to detect non-compliance with all laws and regulations". The removal of this wording may be construed as therefore expecting auditors to be responsible for preventing non-compliance and to be able to detect non-compliance with all laws and regulations.

### **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?

The elements of this standard regarding reporting under law, regulation or ethical requirements are seeking to support regulatory reporting rather than specifically the public interest although regulatory requirements are developed with the public interest in mind. To the extent that proposals improve reporting to regulators then they should necessarily address the public interest. We note that the reporting in the public interest guidance was previously in the Application Guidance to ISA 250 A and therefore there has always been an obligation to report certain matters in the public interest. This sits better within Proposed Standard 2X0 although we would welcome guidance on the types of matters that this is intended to cover in order for this to be meaningful and for this to specifically support and encourage compliance.

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.

The scoping of the proposed standard is difficult to understand. The scoping paragraph references public interest entities (PIE) and establishes the responsibility of the auditor of a PIE to report to an appropriate authority outside the entity. However, it also establishes responsibilities under which reporting to an appropriate authority outside the entity may be appropriate in the circumstances. It further requires that even when there is no established requirement or responsibility under law, regulation or relevant ethical requirements, the auditor is required to consider whether the information is of such significance or severity that it ought to be reported in the public interest.

This suggests that the scoping is not limited to public interest entities. It appears to apply to information identified during the audits of all entities. This is further enhanced by the definition of a reportable matter which appears to require all auditors to report matters in the public interest irrespective of whether they are a PIE or not.

For many entities a framework already exists to allow matters to be reported for example, the Joint Charity Commission Guidance for auditors and independent examiners sets out clearly what matters of material significance are and the auditor's duties in this respect. Many auditors would use this guidance and therefore it is not necessary for ISA 2X0 to apply to these entities. However, where a framework is not as well developed this standard could be useful if applied and therefore it might be useful to extend the guidance in paragraph 17 to all regulated entities.

9. Do you support the definition of Reportable Matters?

We acknowledge that there is already a requirement for auditors to report identified or suspected non-compliance with laws and regulations which do not give rise to a responsibility under law, regulation or relevant ethical requirements to report where it ought to be reported in the public interest (ISA 250 A33-1). The proposed definition of reportable matters within ISA 2X0 being "of such significance that it is in the public interest to report even where law, regulation or relevant ethical requirements do not require it" extends beyond non-compliance with laws and regulations. We would welcome further guidance as to what types of matters this relates to and the extent to which this expands the auditor's responsibilities generally to matters beyond their audit. Given the serious consequences for an auditor where their work may be determined to have breached the requirement of an ISA, it is crucial to understand what might be in the FRC's thoughts as to what constitutes 'the public interest'. We would also like to understand what the regulator would do with such reports and whether their powers enable them to address concerns raised in them.

Whilst noting the existing requirements in ISA 250 B, para 14 ii we do have concerns over the requirement for auditors of PIEs to report to the regulator where there is a material threat or doubt concerning the continuous functioning of the entity. There is currently no requirement for large private entities (which may become PIEs under a revised definition) to prepare a viability statement. The responsibilities of the auditor under ISA 570 regarding the viability statement are to identify whether there is a material inconsistency between the auditor's knowledge obtained in the audit, including that obtained in the evaluation of management's assessment. In the absence of a viability statement the requirement to report to a regulator concerns regarding continuous functioning would present difficulties for the auditor – as might occur in the audit of a large private entity. With resilience statement proposals not being taken forwards it is not clear where this would leave a private PIE and we would suggest that the interaction of ISA 2X0, ISA 570 and the PIE definition proposals be further considered.

10. Do you believe that the proposed effective date for audits of financial statements for periods commencing on or after 15 December 2024?

It is difficult to comment on the proposed effective date of 15 December 2024 as the finalisation of the standard is dependent upon the outcome of the PIE definition consultation over which there is currently no visibility. We would question whether now is the right time to introduce a revised ISA which depends on a revised PIE definition of uncertain timing.

We note the following drafting errors:

IAS 250

- In paragraph A29-1 there is still a reference to the appendix (money laundering, terrorist financing and proceeds of crime legislation) which we assume needs to be removed if the appendix is deleted.

ISA 2X0

- In paragraph 17a the reference to the Application Guidance (A35-1-A35-3) relates to the extant standard and has not been updated.
- References in 17a i, ii and iii to A35 d, e and f are also incorrect and relate to A35-4,5 and 6 in the extant standard.
- Paragraph A53 refers to paragraph A33-3 (which is in the extant ISA 250 A)

If you have any queries, or would like to discuss our comments in more detail, please do not hesitate to contact [Donna.Caira@saffery.com](mailto:Donna.Caira@saffery.com)



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