Proposed Standard

Audit and Assurance

Financial Reporting Council

October 2023

Invitation To Comment

Proposed International Standard On Auditing (UK) 250 (Revised)

Consideration of Laws and Regulations In An Audit Of Financial Statements

Proposed International Standard On Auditing (UK) 2X0 (Revised)

Special Considerations For Public Interest Entities—Communicating And Reporting To An Appropriate Authority Outside The Entity

The Financial Reporting Council (FRC) is the UK's independent regulator responsible for promoting responsible for promoting transparency and integrity in business. The FRC sets the UK Corporate Governance and Stewardship Codes and UK standards for accounting and actuarial work; monitors and takes action to promote the quality of corporate reporting; and operates independent enforcement arrangements for accountants and actuaries. As the Competent Authority for audit in the UK the FRC sets auditing and ethical standards and monitors and enforces audit quality.

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Financial Reporting Council

October 2023

Invitation to Comment

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

(Previously ISA (UK) 250 (Revised November 2019) *Section A—Consideration of Laws and Regulations in an Audit of Financial Statements*

and

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

(Previously ISA (UK) 250 (Revised November 2019) *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*)

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Purpose of this Consultation Document

1. The Financial Reporting Council (FRC) is committed to acting as a proportionate and principles-based regulator, and balances the need to minimise the impact of regulatory requirements on business, while working to support the delivery of high-quality audit and assurance work to maintain investor and wider stakeholder confidence in audit and assurance.

2. In July 2022, the FRC published a Position Paper in response to the government's response in respect of Restoring trust in audit and corporate governance which committed to consulting on the revision of a number of auditing standards in order to enhance the useability and informativeness of the audit. These standards included:

   - ISA (UK) 250 (Revised November 2019) *Section A—Consideration of Laws and Regulations in an Audit of Financial Statements*

   - ISA (UK) 250 (Revised November 2019) *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*

3. The FRC has therefore proposed changes to these standards and is seeking the views of stakeholders in respect of these revisions.

Invitation to Comment

4. The FRC is requesting comments on this consultation by Friday 12 January 2024.

5. Comments are invited in writing on all aspects of the consultation and the proposed revised standards, particularly in relation to questions 1–12 as detailed below. Comments should be emailed to Kate Dalby at AAT@frc.org.uk

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

6. In an audit of financial statements, the auditor is required to obtain reasonable assurance that the financial statements are free from material misstatement, whether due to fraud or error. As part of an audit of financial statements, the auditor is required to consider the laws and regulations that an entity is subject to.

7. Non-compliance with laws and regulations could result in a material misstatement of the financial statements, either through those laws and regulations which affect the determination of items in the financial statements, or through failure to comply with those laws and regulations which affect the operations of an entity. Non-compliance with such laws and regulations may result in potential fines, litigation or other consequences which could have a material effect on the entity.

8. We are proposing to revise extant ISA (UK) 250A[1] which sets out the auditor's responsibility to consider laws and regulations in an audit of financial statements.

9. The IAASB revised ISA 250 in 2016 when only limited amendments were made to incorporate and align the standard to changes made to the IESBA's project regarding non-compliance with laws and regulations. In the FRC's response letter to the IAASB's consultation,[2] we argued that a more fulsome review of ISA 250 was necessary, particularly in regard to the distinction between the different categories of laws and regulations and the procedural approach the standard takes. However, the IAASB have taken no action to strengthen ISA 250 (Revised) and the IAASB's Proposed Strategy and Work Plan for 2024–2027[3] does not include any future project proposals for that standard.

10. The FRC has previously revised standards independently of the IAASB where the public interest need outweighed the benefits of harmonisation of standards: ISA (UK) 570[4] on going concern was substantively revised in 2019 and ISA (UK) 240[5] on fraud was amended in 2021. Both the equivalent international standards are now in the process of being revised by the IAASB. The FRC is therefore of the view that it is in the public interest for the FRC to revise ISA (UK) 250A.

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[1] International Standard on Auditing (UK) (ISA (UK)) 250 (Revised November 2019) *Section A—Consideration of Laws and Regulations in an Audit of Financial Statements*

[2] https://www.frc.org.uk/getattachment/458e530c-af1b-4b85-af68-3b9f10bcc910/FRC-Response-to-IAASB%e2%80%99s-Exposure-Draft-on-ISA-250-Responding-to-Non-Compliance-or-Suspected-Non-Compliance-with-Laws-and-Regulations.pdf

[3] https://www.iaasb.org/_flysystem/azure-private/publications/files/IAASB-Consultation-Strategy-2024-2027.pdf

[4] ISA (UK) 570 (Revised September 2019) *Going Concern*

[5] ISA (UK) 240 (Revised May 2021) *The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements*

Explanation of proposed key changes

Removal of distinction between different categories of laws and regulations

11. ISA (UK) 250A currently distinguishes the auditor's responsibilities and work effort in relation to the entity's compliance with laws and regulations into two categories conditional upon whether those laws and regulations effect the determination of material amounts and disclosures in the financial statements.

12. If the provisions of those laws and regulations have an effect on the determination of material amounts and disclosures, for example, most directly they may require specific disclosures to be made in the financial statements ("direct laws and regulations"), then the auditor is required to obtain sufficient appropriate audit evidence regarding compliance with those provisions.

13. ISA (UK) 250A describes the second category as other laws and regulations that do not have a direct effect on the determination of amounts and disclosures in the financial statements ("other laws and regulations"). ISA (UK) 250A explains further that compliance with those other laws and regulations may be fundamental to the operating aspects of the business, the entity's ability to continue its business, or to avoid material penalties. Accordingly, the ISA (UK) recognises that other laws and regulations may have a material effect on the financial statements but does not specifically describe them as such. However, the auditor is not required to obtain sufficient appropriate audit evidence on the entity's compliance with other laws and regulations, but only required to perform limited specified audit procedures to help identify such instances.

14. We are concerned that this distinction between different categories of laws and regulations is preventing auditors from identifying risks of material misstatements in the financial statements. We are therefore proposing to remove the distinction in work effort between direct laws and regulations and other laws and regulations and require auditors to identify those laws and regulations with which non-compliance may have a material effect on the financial statements.

15. We recognise that the auditor's responsibilities cannot be open-ended to the effect of identifying and determining compliance with all laws and regulations pertaining to the entity. However, in order to assist the auditor to identify those laws and regulations with which non-compliance may have a material effect on the financial statements, we have introduced a more robust risk assessment process. This will give auditors an effective mechanism to identify those laws and regulations that have, or may potentially have, a material effect on the financial statements.

Implementing a More Risk-Based Approach

16. ISA (UK) 250A is an overly procedural standard that is out of line with the ISAs (UK) outcome-based approach with a risk focused assessment ("risk-based approach"). Procedural requirements can increase audit quality when they form part of, or supplement, an already established risk-based approach (for example, when they require auditors to examine a matter more thoroughly). However, in practice, absent a risk-based approach, the risk that the auditor does not identify material misstatement(s) of the financial statements due to non-compliance with laws and regulation (detection risk) is increased. This is because a procedural approach instantly narrows the focus of the audit, whereas a risk-based approach allows the auditor to exercise professional judgment and choose which audit procedures will be most effective in the circumstances.

17. We have therefore introduced a new overarching requirement in proposed paragraph 12-1 for the auditor to design and perform risk assessment procedures to obtain audit evidence that provides an appropriate basis for the identification of laws and regulations with which non-compliance may have a material effect on the financial statements.

18. In order to help auditors to meet this requirement, we have established a number of additional risk assessment requirements in proposed paragraphs 12-2 and 12-3 such as:

    - Understanding those laws and regulations that relate to the applicable financial reporting framework or arise from regulatory factors.
    - Understanding management's process regarding compliance with laws and regulations and how those charged with governance oversee this.
    - Determining whether there are any deficiencies in internal control relevant to non-compliance with laws and regulations.
    - Making inquiries of management, those charged with governance and other individuals to obtain their views on which laws and regulations could have a material effect on the financial statements.
    - Inspecting a range of documents for indications of non-compliance with laws and regulations.

19. Similarly, we have also introduced explicit requirements in proposed paragraphs 14-1 and 15-1 for the auditor to identify, assess and respond to the risks of material misstatement due to fraud or error relating to non-compliance with laws and regulations.

20. The auditor also has a stand back requirement in proposed paragraph 16-1 to assess whether they have obtained sufficient appropriate audit evidence regarding whether there is a material misstatement of the financial statements relating to non-compliance with laws and regulations.

Adequacy of disclosures

21. Proposed paragraph 22-1 introduces a requirement for the auditor to conclude whether non-compliance or suspected non-compliance with laws and regulations has resulted in a material misstatement of the financial statements.

Linking ISA (UK) 250 (Revised) to other ISAs (UK)

22. Whilst ISA (UK) 250A specifically deals with the auditor's responsibilities in the audit of financial statements relating to laws and regulations, an ISA (UK) is never applied in isolation, but instead forms part of the wider suite of auditing standards. The FRC believes that enhancing the links from ISA (UK) 250A to important principles in other ISAs (UK), will better demonstrate how the other ISAs (UK), in particular, ISA (UK) 315 which was itself significantly revised in July 2020, are applied in respect of the auditors responsibilities in the audit of financial statements related to laws and regulations and provide an improved basis for the identification of those laws and regulations with which non-compliance may have a material effect on the financial statements.

Effective date

23. We are proposing an effective date for audits of financial statements for periods beginning on or after 15 December 2024. Earlier adoption would be permitted.

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

24. ISA (UK) 250 (Revised November 2019) *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* is an auditing standard unique to the UK and not based on a corresponding international one issued by the IAASB.

25. It was originally introduced back in 2009 in order to assist auditors to comply with the statutory right and duty to report to regulators in the financial sector (primarily the now defunct Financial Services Authority) arising from the Financial Services and Markets Act 2000 and regulations made under that Act. It was updated in 2016 to incorporate the requirement for auditors of public interest entities (PIEs) to report to an appropriate authority if certain information came to their attention.

26. Much of the content is outdated and so we are proposing to introduce a new more principles-based standard covering reporting and communicating to an appropriate authority outside the entity to replace ISA (UK) 250B.

Explanation of proposed key changes

Renumbering and renaming ISA (UK) 250B

27. Whilst ISA (UK) 250B has historically been linked to ISA (UK) 250A the scope of the potential reporting to an appropriate authority outside the entity is, in fact, potentially much wider. For example, other matters that are required to be reported to an appropriate authority outside the entity might come to light through the auditor's work on going concern in accordance with ISA (UK) 570, fraud in ISA (UK) 240, integrity of management and the fit and proper status of those charged with governance in ISA (UK) 210 and modified auditor's opinion in ISA (UK) 705.

28. It therefore makes sense to renumber and rename the standard to make it clear that reporting and communicating to an appropriate authority outside the entity can arise at any point throughout the audit and in relation to a wide range of matters.

Definition of Reportable Matter

29. We have deleted many of the old definitions included in the current standard and introduced a new definition for "reportable matters". This is information about which the auditor becomes aware during the audit that the auditor is either required to report to an appropriate authority or that the auditor determines should be reported to an appropriate authority outside the entity.

30. A requirement – often known as a statutory duty to report – arises where an appropriate authority outside the entity specifies matters that should be reported. Many regulators refer to these as "matters of material significance", but this is not always the case. Application material has been added to support the definition in this respect.

31. Alternatively, the auditor may determine that reporting a matter is an appropriate action in accordance with relevant ethical requirements or because the auditor has a right to do so (often referred to as a statutory right to report).

32. However, we are also proposing to include in the definition of reportable matters, information that is of such significance that it is in the public interest to report ever where law, regulation or relevant ethical requirements do not require it.

Reporting in the Public Interest

33. Sir John Kingman recommended that a duty of alert for auditors to report viability or other serious concerns should be introduced.[6]

34. We are therefore proposing to include an additional reporting requirement for auditors in proposed paragraph 18 that where a reportable matter exists but there are no law, regulation or relevant ethical requirements identified, the auditor is still required to consider whether the reportable matter is one that should be reported in the public interest to an appropriate authority outside the entity.

35. This requirement existed to some extent in the application material in ISA (UK) 250A which included application material on reporting in the public interest.[7] This application material has been moved from ISA (UK) 250A to ISA (UK) 2X0 to support the requirement in paragraph 18.

36. The government has indicated in its Response to the White Paper "Restoring Trust in Audit and Corporate Governance" that it intends to introduce appropriate protections for auditors making reports to regulators for all statutory audit work.[8]

Structure of ISA (UK) 2X0

37. The standard is effectively split into two in terms of work effort:

    - Requirements 11–13 apply to all audits of public interest entities

    - Requirements 14 – 21 apply only if the auditor becomes aware of information that may relate to a reportable matter.

38. We have replaced some of the existing requirements which were specific in nature and overly focused on the financial sector with more principles-based requirements that could be applied to any entity, irrespective of whether it is in a regulated industry.

39. We have also ensured that the requirements relate solely to the scope i.e. reporting and communicating to an appropriate authority outside the entity. In the current standard, the auditor is required to obtain an understanding of such matters as the entity's regulated activities, the regulatory requirements and the control environment. Whilst these are matters that need to be understood by the auditor, they are already covered by the requirements in proposed ISA (UK) 250 (Revised XXX) and in ISA (UK) 315 (Revised July 2020) and do not relate directly to the auditor's responsibility to

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[6] Recommendation 45 of Independent Review of the Financial Reporting Council published December 2018

[7] Paragraphs A33-1–A33-8 of ISA (UK) 250 (Revised November 2019) Section A.

[8] Paragraph 11.4.23 of Restoring trust in audit and corporate governance: Government response to the consultation on strengthening the UK's audit, corporate reporting and corporate governance systems published May 2022

communicate with or report to an appropriate authority outside the entity. Accordingly, such requirements have been deleted from ISA (UK) 2X0.

Scope of ISA (UK) 2X0

40. Currently, the proposed scope of ISA (UK) 2X0 is public interest entities. We are aware that the public interest entity definition is in the process of being amended, but it is our intention that ISA (UK) 2X0 will apply to all entities caught by that future definition.

41. However, we are aware that there are more entities subject to statutory regulation than just PIEs. For example, auditors of certain charities and pension funds also have a duty to report to the appropriate regulator if they identify matters of material significance to the regulator.

42. Further, all auditors have responsibilities to report to the appropriate authorities if they know or suspect, or have reasonable grounds to know or suspect, money laundering.

43. We believe that the requirements in proposed ISA (UK) 2X0 are proportionate and scalable to all entities. In many cases, auditors will already be undertaking similar work in the planning and performance of an audit. For example, in respect of proposed requirement 11 to obtain an understanding of whether law, regulation or relevant ethical requirements required the auditor to report to an appropriate authority outside the entity, auditors are already required to understand their responsibilities and requirements under the Anti-Money Laundering Legislation.

44. We also believe that the principle-based requirements established in requirements 14–23 would assist all auditors in the event that they identified a reportable matter.

45. We have therefore included a consultation question about whether the scope of ISA (UK) 2X0 should be extended to other regulated entities or to all entities.

Effective date

46. We are proposing an effective date for audits of financial statements of public interest entities for periods beginning on or after 15 December 2024. Earlier adoption would be permitted.

Request for Comments

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?

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?

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?

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

5. Do you 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?

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?

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.

9. Do you support the definition of Reportable Matters?

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?

11. Have appropriate enhancements been made to the 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?

Responses should be sent to **AAT@frc.org.uk** and marked for the attention of **Kate Dalby**.
Responses should be received by **Friday 12 January 2024**.

Impact Assessment

The FRC is a principles-based regulator and is committed to issuing proportionate Standards and Guidance that support the provision of high-quality, independent audit. As a matter of policy, the FRC's auditing standards are based on the corresponding international standards issued by the IAASB. Where necessary the international standards are augmented with additional requirements to address specific UK legal and regulatory requirements; and additional guidance that is appropriate in the UK national legislative, cultural and business context.

In developing the proposed revisions to ISA (UK) 250 and ISA (UK) 2X0, we have sought to maintain our support for the underlying international standards while introducing supplemental requirements and guidance to address concerns currently identified in the UK.

We recognise that some additional costs will be incurred by practitioners, including those relating to enhanced planning and performance, staff training, and familiarisation with the standards. The standard has been designed to be scalable. We believe that benefits in the public interest of clarifying the auditor's responsibilities in relation to the consideration of laws and regulations and reporting to an appropriate authority outside the entity in an audit of financial statements, although not quantifiable, will outweigh the costs of changes that may be necessary to audit firms' methodologies.

The quantifiable cost as a result of these proposals is estimated to be:

Revised requirement	Assumptions	Cost Impacts	Estimated Cost (Hours)	Recurring (Y/N)
Familiarisation and Training (impact is mitigated to some extent as forms part of update process undertaken annually)	Updating guidance by technical managers/partners (90%/10%)	Audit firm	45 per firm	N
	Familiarisation of changes by practitioner	Audit firm	2 per practitioner	N
Increased Work Effort in identifying laws and regulations with which non-compliance may have a material effect on the financial statements	Additional risk assessment procedures and related activities, identifying, assessing and responding to risks of material misstatement due to NOCLAR	Audit firm	15 per audit	Y
Increased Work Effort in communicating and reporting to an appropriate authority outside the entity (PIEs only)	Identification of laws/regulations/ethical requirements. Most requirements already exist so no additional work effort.	PIE audit firms	1 per audit	Y

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