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

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

Dear Kate

Chartered Accountants Ireland welcomes the opportunity to respond to the above proposed standards.

We are supportive of the aims of proposed ISA (UK) 250 in assisting the auditor to identify those laws and regulations with which non-compliance may have a material effect on the financial statements however we believe there are fundamental flaws in the current form in which the standard is drafted as we believe that it is unclear as to the extent of audit procedures that will be required to be performed in order to meet the objective of the revised standard in relation to those laws and regulations that are currently considered “indirect”. We believe that the proposed changes could be interpreted as requiring auditors to perform “compliance” audits in relation to laws and regulations where a breach could result in a material financial impact on the entity.

In relation to ISA (UK) 2X0, we are not supportive of the proposed changes without the required statutory protection for auditors and clearer identification of the appropriate recipient of any reports.

These flaws, which are detailed further below along with other considerations, are of such significance that we believe that substantial revisions and re-exposure will be required.

We attach our response to the questions posed. If you have any questions on any of the comments in this response, please do not hesitate to contact me at anne.sykes@charteredaccountants.ie.

Yours sincerely



Anne Sykes

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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 that the reasons for the proposed changes in ISA (UK) 250 are clear. We are not aware of any specific UK regulatory issues or FRC inspection findings that indicate a need to revise ISA (UK) 250 in the way currently proposed. There is no context provided in the Consultation Paper as to the public interest rationale behind the proposals.

We acknowledge that the Kingman and Brydon reviews uncovered defects in reporting, however these reviews did not identify any matters that align to the current proposals in ISA (UK) 250.

The expanded scope of audit procedures to consider “all” laws and regulations to which an entity is subject which may have a material impact on the financial statements raises many concerns and problems as noted below. Without an understanding of the relevant public interest rationale, it is difficult to contextualise the proposals.

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?

As noted in the FRC proposals, the ability of the auditor to perform what is required here is based on an in-depth understanding of the business and controls through a robust risk assessment process under ISA (UK) 315 (Revised).

This robust risk assessment is expected to be an effective mechanism to identify those law and regulations that have, or may potentially have, a material effect on the financial statements. However, the ability of the auditor to perform a robust risk assessment process in this area, will be heavily dependent on the adequacy of the processes and controls that the directors of the entity have implemented to monitor compliance with laws and regulations.

We do not believe that the proposed requirements would support auditors to be able to identify those laws and regulations with which non-compliance may have a material effect on the financial statements as not all entities will have a sufficiently mature risk assessment process and system of internal control in relation to the identification of non-compliance with all relevant laws and regulations across their operations without any point of reference such as a UK internal controls framework or standards to apply. We acknowledge there were proposals in this regard in the proposed UK Corporate Governance Code (“the Code”) requirements, however these have since been delayed. Furthermore, the Code applies only to UK PIEs and companies who apply the Code voluntarily. Therefore, consideration should be made in relation to developing an appropriate framework for entities who do not apply the Code.

Where an entity does not have a sufficiently mature risk assessment process and system of internal control in place in relation to the monitoring of compliance with relevant laws and regulations, it is not clear what the expectations on the auditor are in order to comply with the requirements of Proposed ISA (UK) 250.

Without a framework for entities in relation to relevant laws and regulations in the UK and the potential shifting of responsibilities to the auditor as a result of these proposals, we have a concern that the proposed requirements will be perceived as extending the auditors’ responsibility beyond the audit of historical financial statements and will have the impact of further widening the ever-present expectation gap.

In line with ISA (UK) 315, in identifying risks of material misstatement an auditor should consider both the likelihood of a misstatement occurring and the magnitude of the potential misstatement. In order to assess the likelihood of a misstatement in relation to those laws previously defined as “indirect”, the proposed changes could be interpreted as requiring auditors to perform procedures consistent with the objective of a compliance audit or forensic investigation, particularly where an entity does not have a sufficiently mature risk assessment process in place. Further, we consider that in order to perform adequate risk assessment procedures to meet the objectives of the revised standard, the auditor would need to expand their understanding of the systems and processes in place well beyond the financial systems of the entity to include many other operating processes and systems.

Furthermore, the proposed changes will require auditors to have legal acumen and expertise beyond their core competencies and will result in a need to engage multiple

specialists to assist in assessing both the likelihood and magnitude of potential misstatements in relation to non-compliance with relevant laws and regulations.

We also have concerns that even if it was feasible to perform risk assessment procedures, in the event that adequate processes and controls are not in place, we do not believe it would be possible for the auditor to develop an appropriate response to the increased level of risk and that this would result in an increase in the level of qualified opinions even in situations where no breaches of laws or regulations have occurred.

We do not believe that the proposed procedures are easily scalable, other than for very small entities with minimal or no laws and regulations impacting the financial statements that arise from operational aspects of business. We believe that for a large multinational company subject to a vast array of laws and regulations, including numerous foreign jurisdictions, there could be significant challenges in identifying and retaining specialists in all such fields and jurisdictions to achieve the objectives of the standard. Further, the proposed changes will present significant difficulties in instructing component auditors.

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 do not believe that the proposals will enhance and strengthen the auditor’s identification of risks of material misstatement for the reasons set out in our response to question 2.

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

Application material in an auditing standard needs to be supportive of the requirements. We do not believe that the proposed requirements are appropriate therefore we are unable to comment on the application material at this point.

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

We agree that it is not necessary to include the contents of the appendix and an appropriate cross reference is sufficient.

Reference to the ISA (UK) 2X0 in the application paragraph A33-1 is not useful as the proposed standards ISA (UK) 2X0 is only applicable for audits of Public Interest Entities, rather than all audits.

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

We believe that the proposed timeframe is unrealistic. In our view, the proposals as currently written will present significant implementation difficulties as set out in our responses above and therefore, we cannot comment on the proposed effective date at this point.

**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?

We are supportive of the aims of the proposed revisions, but we believe there are significant practical impediments.

It is unclear how this standard will operate in the absence of protection for auditors making disclosures or reports in good faith as opposed to in line with legal or ethical requirements. We believe that as it is currently worded this standard will result in many new liability implications for auditors.

If the audited entity is not a regulated entity, there is no supervisory body to report to which poses a basic practical issue. There needs to be clarity where and how to report in the absence of a relevant supervisory body.

The auditor may already be reporting to those charged with governance but if they do not act we believe there could be an expectation by external stakeholders that the auditor should have publicized the issue. Any publicizing of such matters by an auditor could lead to lengthy court proceedings.

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:

- **Listed entities**
- **Charities**
- **Other entities in regulated industries**
- **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.

We believe that there are already sufficient reporting requirements for the other regulated entities as listed to report to the relevant authority and therefore agree with the proposed scope of ISA (UK) 2X0 being limited to public interest entities.

For example, auditors of charities currently have an obligation to report to the relevant Charity Commission.

Regulated entities in the financial sector already have numerous reporting requirements set out in laws and regulations. In general, these requirements set out an appropriate framework for reporting significant matters. We feel that it is not necessary to add an additional requirement for regulated entities.

9. Do you support the definition of Reportable Matters?

We do not support the expansion of the definition of Reportable Matters to include matters that “the auditor...has determined is of such significance that it is in the public interest to report even where law, regulation or relevant ethical requirements do not require it” as it creates significant difficulty for the auditor as noted above in question 7.

In addition, paragraph 18 and the definition of a reportable matter seemingly has some circularity in its logic. Paragraph 18 says “Where a reportable matter exists but there are no law, regulation or relevant ethical requirements identified in accordance with paragraph 11, the auditor considers whether the reportable matter is one that should be reported in the public interest to an appropriate authority outside the entity”. However, the definition of reportable matter (in the definitions list in paragraph 10) already includes this assessment: “Reportable matter – Information about which the auditor becomes aware during the audit that the auditor: (iii) Has determined is of such significance that it is in the public interest to report even where law, regulation or relevant ethical requirements do not require it.”

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?

We do not believe that the proposals will enhance or strengthen the auditors’ identification of matters that should be reported.

Without revisions to the underlying law, regulation or ethical requirement setting out the auditor's obligation to report, the definition of "matters of such significance" in paragraph 10 is too broad to be effective.

As commented above the identification of the appropriate authority that the auditor is expected to report to is not clear.

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

Application material in an auditing standard needs to be supportive of the requirements. We do not believe that the proposed requirements are appropriate therefore we are unable to comment on the application material at this point.

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

With regards to an effective date for the proposed standard, it will only be after the concerns addressed in this response have been resolved that auditors would be able to begin the process of implementing any amended standards, and that period would need to include time for any additional training and procuring of resources with the appropriate legal or other skill sets.

Additional comments

In addition to the matter above we noted the following matters:

In relation to ISA (UK) 250 while the distinction between direct and indirect laws and regulations have been removed elsewhere in the draft standard, it seems to have been retained in paragraph 29.2(a)(ii).

Paragraph 29 (b) requires documentation of any indications of non-compliance with laws and regulations. This seems to be quite an onerous requirement, we believe this should refer to “material”, or “suspected”. We do not believe that this step is very practical.

Paragraph 30 refers to identified or suspected non-compliance which appears to be a more realistic audit requirement.

Consequential changes to reporting need to be considered and appropriate changes to ISA (UK) 700 will be required.

Paragraph 23 in ISA (UK) 250 states

“Unless all of those charged with governance are involved in management of the entity, and therefore are aware of matters involving identified or suspected non-compliance already communicated by the auditor,⁴ the auditor shall communicate, unless prohibited by law or regulation, with those charged with governance matters involving non-compliance with laws and regulations that come to the auditor's attention during the course of the audit, other than when the matters are clearly inconsequential.”

and paragraph 15 in ISA(UK) 2X0 states

“Unless all of those charged with governance are involved in managing the entity, the auditor shall communicate, unless prohibited by law or regulation, with those charged with governance potential reportable matters that come to the auditor's attention during the course of the audit”

In our view ISA (UK) 260 will also need to be updated as part of this process amendment.