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Dear Kate

### **Consultation on proposed changes to ISA (UK) 250A and Proposed ISA (UK) 2(X)0**

Mazars is an internationally integrated partnership specialising in audit, accountancy, advisory, tax and legal services. Operating in over 90 countries and territories around the world, we draw on the expertise of 47,000 professionals – 30,000+ in the Mazars integrated partnership and 17,000+ via the Mazars North America Alliance. In the UK, Mazars has approximately 160 partners and over 2,900 employees, and is ranked one of the top 10 firms nationally.

#### **General comments**

We welcome the opportunity to comment on the proposed changes to ISA (UK) 250A and the introduction of ISA (UK) 2(X)0 based on extant ISA (UK) 250B. We set out here our general comments on the proposal and responses to the questions in the invitation to comment are set out below.

#### ***Proportionality***

These proposals represent a significant change in the scope and nature of the work required of auditors in relation to laws and regulations. We note that the FRC is keen to distinguish between its proposals and those of the PCAOB which garnered significant negative feedback earlier in the year. Unfortunately, the public pronouncements by the FRC in this regard are not necessarily reflected in the proposed standards themselves. A key distinguishing feature described by the FRC is that the auditor's work begins with management's assessment; however, this is not as clear in the proposed standard and further clarity in this regard is needed.

In our view, the FRC has not fully articulated its reasoning for these proposals and has not identified the deficiencies in audit work that have led to the need to enhance requirements and increase work effort and cost, referring only to its concerns that risks may not be identified. In the absence of a clear reason for their introduction, it is difficult to conclude whether the proposals are in the public interest. Without a clear description of what is being fixed by the proposals, the FRC risks raising an expectation that might not be met - namely that company failure and corporate scandals will be prevented by these measures.

Given the recent correspondence between the Secretary of State and the FRC, including the request that the FRC actively looks at proportionality of its rules, we urge the FRC to consider whether these proposals are indeed proportionate to the issue being addressed, given the additional burden on both auditors and management, as well as increased costs.

### ***Scalability***

It is important to note, in comparing these proposals to those of the PCAOB, that the US standard applies only to SEC registrants whereas the UK proposals will apply to all engagements.

We are concerned that the proposals in ISA (UK) 250 (Revised) are not sufficiently scalable, at either end of the spectrum. For large, complex, international group engagements, more consideration needs to be given to the impact on group audits under ISA (UK) 600 (in particular the impact on components outside of the UK). At the other end of the spectrum, the impact on audits of SMEs could be significant, especially as the starting point for the auditor is intended to be management's assessment, which for such entities will not always be sufficiently well developed.

### ***ISA (UK) 2(X)0 proposals***

In the absence of statutory protection for auditors, as envisaged by the Government in its response to audit and corporate governance reform in 2022, we believe that the proposals in ISA (UK) 2(X)0 are fatally flawed and should not be introduced until such time that appropriate statutory protection is in place.

Further, we believe that much greater clarity is required over the definition of "reportable matters", including the provision of clear examples of the sorts of matters which the FRC would consider to be reportable and those which it would not. This will give clarity to auditors, regulators and wider stakeholders as to the types of issues which are envisaged to be reported under these proposals.

### ***Implementation of the standards***

As noted above, we believe that the proposals in ISA (UK) 2(X)0 are inappropriate in the absence of statutory protection for auditors and that this standard should not be introduced until such protection is in place. We have also highlighted significant concerns regarding the proposals for revisions to ISA (UK) 250. Given that these two standards are intrinsically linked, we believe that the proposals should be finalised and the revised standards issued at the same time.

We suggest, therefore, that the FRC considers further outreach to clarify its proposals and the public interest benefits thereof, and issues both standards only when appropriate protections are in place under ISA (UK) 2(X)0.

## **Responses to Consultation questions**

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

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

It is difficult to conclude whether the proposals address the public interest as the FRC has not, in our view, clearly articulated its reasons for making the proposed changes. In particular, the FRC has not identified the deficiencies in regard to audit work on laws and regulations which these proposals are intended to address. In the invitation to comment the FRC notes that "*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*". However, no evidence is provided by the

FRC to support this concern and there is, to our knowledge, no evidence from audit quality reviews (either by AQR or QAD) of systematic findings in this regard. We do not agree that this distinction between direct and indirect laws and regulations impacts the identification of risks.

Without a clear understanding of the reasons for the proposed changes, we do not believe that the proposals, which will add time and cost to auditors and preparers, is proportionate or in the public interest.

The proposals are likely to lead to an increase, sometimes significant, in the work effort and cost involved in complying with the requirements compared to extant standards. We believe that the FRC has underestimated this increase in work effort in its impact analysis. It is not clear that this increased cost of audits is necessarily in the public interest in the absence of a clear rationale supporting the proposals.

**Q.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 FRC has noted in roundtables and other meetings that the proposed changes are intended to require auditors to start with management's assessment of laws and regulations which are relevant to the entity, distinguishing its proposals from those of the PCAOB which require the auditor to identify laws and regulations. However, we do not believe that the standard itself is sufficiently clear that this is the starting point for the auditor's risk assessment. For example, paragraph 11-2 states that the objective of the auditor is "*To identify those laws and regulations with which non-compliance may have a material effect on the financial statements*". The FRC should consider revising this objective to refer to management's assessment as the basis of this identification.

Whether the proposals will support auditors in identifying relevant laws and regulations will be highly dependent on the work management performs to identify the full list of laws and regulations.

We are concerned that:

- Preparers and auditors will need to identify a complete population of laws and regulations. This will be challenging especially in large, complex international groups. It is difficult in such entities to see how this could be achieved without involving specialist legal advisors. If the auditor identifies concerns with the robustness of management's assessment, they would either require management to complete a more robust assessment (adding cost to the entity) or engage appropriate legal specialists to perform such an assessment (adding cost to the audit and associated fees).
- The proposed standard may not be sufficiently scalable. While we would expect management at public interest and larger entities to have systems and processes which capture relevant laws and regulations, it is likely that this will not be the case for many SMEs. There is a risk therefore that such entities may look to the auditor to support them in this exercise.
- The requirement in 12-3(b) to inspect correspondence with licensing or regulatory authorities is more onerous than the extant requirement (relating to fines, penalties, regulatory action only) and it is not clear what the benefits of such a review would be.

**Q.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 there are significant challenges in relation to both group audits and, at the other end of the spectrum, for smaller and less complex SME audits. In the latter, it is likely in many cases that

management's assessment of the impact of laws and regulations may be insufficient as a starting point for the auditor's risk assessment.

For group audits, the identification and assessment of laws and regulations in large, complex, international groups will be difficult to achieve without specialist legal input and the impact on group engagements under ISA (UK) 600 has not been fully considered in these proposals. For group audits with non-UK components, it will be difficult for local component auditors to deal with the difference between UK and international standards and the UK Group auditor cannot be expected to have a detailed knowledge of local laws and regulations in other jurisdictions without legal advice. As such the scope of group audit engagements is likely to increase. These proposals are likely, therefore, to lead to potentially significant additional costs for auditors and audited entities.

Furthermore, the proposals do not set out what the auditor should do where management's assessment of laws and regulations is insufficient, including the implications for auditor reporting under ISA (UK) 700, nor are there any requirements for representations from management/those charged with governance under ISA (UK) 580 which would seem appropriate given management's responsibilities and the starting point for the auditor's work.

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

See responses to other questions.

We believe that footnote 8a to A2-3, which refers to the auditor's rights of access to information, should also refer to the offences relating to failure to provide information under Section 501 of the Companies Act in the context of responsibilities of directors and officers.

**Q.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 of this appendix which provides useful guidance.

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

No we do not agree with the proposed effective date. There are many concerns identified in relation to the proposals and we believe that it will take some time to finalise the proposed standards. As such it is likely that the lead time for implementation for December 2025 year ends may be challenging.

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

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

We understand the driver to introduce the requirement for auditors to report certain matters even where there is no legal or regulatory obligation to do so, arising from the Kingman review. In the Government's response to that review, and others, into audit and corporate reform it stated its intention to provide statutory protections for auditors which would include, in making such disclosures, ensuring that auditors do not breach confidentiality requirements. The proposals in ISA (UK) 2(X)0 should not be introduced in the absence of such auditor protection.

It is not clear to what extent auditors already make disclosures under current requirements, nor of the outcomes where disclosures are made. Without this clarity it is not clear what public interest concerns will be addressed by proposed ISA (UK) 2(X)0.

**Q.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.**

We believe that ISA (UK) 2(X)0 should apply to Public Interest Entities only. There are already regulations in place for other sectors listed.

It would be disproportionate and inappropriate to apply the standard to all entities.

**Q.9: Do you support the definition of Reportable Matters?**

We do not believe that the definition of reportable matters (*i.e. matters that the auditor has ‘determined is of such significance that it is in the public interest to report’*) is sufficiently clear. The definition is open to significant interpretation by auditors and also by regulators and enforcement teams who might, potentially with the benefit of hindsight, come to a different conclusion.

The FRC should provide greater clarity, including through practical, real-life examples of the types of matters which it considers might be reportable and examples of those which wouldn't provide a frame of reference for auditors and regulators alike.

**Q.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 proposes will enhance the auditor's identification of reportable matters without greater clarity around the definition, along with clear examples, of reportable matters, and the implementation of appropriate statutory protection for auditors.

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

See comments to individual questions.

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

No we do not agree with the proposed effective date. We do not believe that this proposed standard should be introduced before the legal protections for auditors are in place.

#### **Further discussion**

If you would find it helpful to discuss any issues in this letter, please contact Paul Winrow, Partner - Audit Policy & Regulation. ([paul.winrow@mazars.co.uk](mailto:paul.winrow@mazars.co.uk)).

Yours faithfully

*Mazars LLP*

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