

Email to: AAT@frc.org.uk

For the attention of Kate Dalby

9 January 2024

Dear Kate,

FRC Consultation on Proposed International Standard on Auditing (UK) 250 (Revised), Consideration of Laws and Regulations in an Audit of Financial Statements and Proposed International Standard on Auditing (UK) 2X0 (Revised) Special Considerations for Public Interest Entities - Communicating and Reporting to an Appropriate Authority Outside the Entity

RSM UK Audit LLP (RSM) welcomes the opportunity to comment on the FRC consultation on the proposed revisions to ISAs (UK) 250 A and B.

This response takes into account views of audit practitioners and the firm's technical audit and legal departments. Representatives of RSM have also attended FRC Roundtables and Webinars and contributed to the ICAEW response via representation on the ICAEW working party on the proposed revisions to ISA (UK) 250. As a consequence, we have considered the feasibility of the implementation of the proposed ISAs, the practical impact on our audit service line and the potential legal considerations for us as a firm.

GENERAL OBSERVATIONS

1. We have sought to understand the audit failings or lack of audit quality that the standard aims to address. Our understanding from the FRC's Audit Quality and Supervision reports is that consideration of laws and regulations is not an area of weakness highlighted. Nor have we been able to find an example of a high-profile audit failing in which enhanced requirements around the auditor's consideration of laws and regulations would have improved the outcome. The rationale for the proposed revisions accordingly remains unclear to us, and in this context, we would query the necessity and proportionality of wholesale amendment to existing ISA 250 (UK).
2. Despite the acknowledgement in paragraph 15 of the Invitation to Comment 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', we do not feel that this is reflected in the proposed revisions to the standard.
3. According to the consultation's impact assessment, the estimated recurring time cost of the new required risk assessment procedures and follow up activities is 15 hours per audit. This would add, on average, thousands of pounds of chargeable time to each audit and despite the alleged scalability, even the smallest audits would be disproportionately impacted.

THE POWER OF BEING UNDERSTOOD
AUDIT | TAX | CONSULTING

4. The removal of the distinction between ‘direct’ and ‘indirect’ laws and regulations will mean that auditors will need to actively confirm compliance with previously ‘indirect’ laws and regulations. This may not be feasible in many cases due to regulators and other enforcement bodies not issuing certificates of compliance or the fact that governing bodies may not conduct compliance assessments on a regular basis.
5. The proposed revisions run the risk of increasing the expectation gap with regard to the extent to which the public considers that the financial statements audit addresses an entity’s compliance with laws and regulations.
6. There is a fundamental and unresolved tension between the proposed reporting threshold and the risk of auditor liability for breach of confidence in such circumstances. Without specific and corresponding statutory protections to address this risk, and where (as acknowledged in the application material) ‘public interest’ is a concept that is not capable of general definition, the auditor is placed in an unenviable position as between the demands of the Proposed Revisions and the prospect of liability.

SPECIFIC RESPONSES

ISA (UK) 250 – CONSIDERATION OF LAWS AND REGULATIONS IN AN AUDIT OF FINANCIAL STATEMENTS

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

We do not agree that the revisions are in the public interest for reasons stated in point 1 above. We are not aware of failings concerning ISA (UK) 250 and therefore do not consider that the revisions would increase audit quality. In fact, they may distract from other areas where revision of the Standards and application material is more pressing such as the need to better reflect the use of technology in the 500 series.

The increased costs discussed in point 3 above would inevitably be passed to audited entities through increased fees. There would also be increased costs for the entities themselves in collating the information and reports required by auditors and also evidencing their own compliance.

The additional work required by audit firms and the increased need for legal advice could lead to a reduction in the pool of auditors with the resources to audit some regulated entities, especially those operating in multiple jurisdictions with an abundance of applicable laws and regulations. Less competition in the audit market would not be in the public interest.

Question 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?

From our participation in the FRC roundtable on the consultation, we understand that the FRC intend that the auditor be guided by management on which laws and regulations relevant to the entity could have a material effect on the financial statements. We do not feel that this is clearly communicated in paragraphs 12-2-12-3 as in contrast to paragraph 13 of the extant Standard, the onus appears to be on the auditor to identify laws and regulations with which non-compliance may have a material effect on the financial statements. It is also unclear how this requirement is consistent with the level of professional scepticism that an auditor is expected to exercise.

To fulfil the requirements of 12-2 and 12-3 would require a complete list of laws and regulations applicable to the entity with an impact assessment. This would be an arduous task for management and auditors alike for even seemingly less complex entities, let alone multinational groups.

Paragraphs 12-2 and 12-3 include several specific requirements and therefore in this respect the proposed Standard is not risk based. This approach also calls into question the scalability of the proposed Standard.

Paragraph 12-3(b) could be read as requiring the auditor to obtain legal confirmations, but the nature of these legal confirmations is not clear, and we question the practicality of obtaining them.

Question 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, on the basis of our response to Question 2 above. We believe that the existing requirements of ISA (UK) 250 together with ISAs (UK) 315, 570 and 240 provide an adequate basis for the auditor to identify the risks of material misstatement of the financial statements due to fraud or error relating to non-compliance with laws and regulations.

Question 4: Have appropriate enhancements been made to the application material?

The application material includes only limited practical guidance on how to determine whether non-compliance with laws and regulations may have a material effect on the financial statements including how to perform and assess the outcome of the risk assessment procedures required by Paragraphs 12-2 and 12-3. Specifically, these risk assessment procedures include an assessment of controls, however, it is not clear whether and how the auditor's assessment of the appropriateness of those controls otherwise impacts the extent of the auditor's procedures (if at all).

The application material does not acknowledge that non-compliance may be a matter of interpretation at any point in time as new legal rulings and clarifications are issued.

The application material does not include guidance on the stand back requirement contained in Paragraph 16-1. This is particularly concerning as for previously 'indirect' laws and regulations the need to obtain sufficient appropriate audit evidence regarding whether there is a material misstatement of the financial statements relating to non-compliance is a significantly more onerous requirement than the performance of the specific procedures contained in paragraph 15 of the extant Standard.

A11-3 suggests gaining an understanding of the whistleblower program and inspecting the files for 'any tips' that may allege non-compliance with laws and regulations that are not under investigation by the entity. Besides placing the auditor in a subjective role vis-a-vis the reliability of such whistleblowers' reports, this detailed suggestion adds little value as management seeking not to disclose non-compliance to the auditor would be unlikely to maintain files of incriminating reports from whistleblowers.

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

No, we do not. It is useful to auditors as it serves as a reminder of our legal obligations outside of the ISAs.

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

It is not clear when the final ISAs will be issued, but as the consultation deadline is 12 January 2024, we question whether there will be enough time for the profession to design methodology and train audit teams in advance of the affected period ends.

ISA (UK) 2X0 - SPECIAL CONSIDERATIONS FOR AUDITS OF PUBLIC INTEREST ENTITIES - COMMUNICATING AND REPORTING TO AN APPROPRIATE AUTHORITY OUTSIDE THE ENTITY

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

A33-1 of the ISA (UK) 250 A describes reporting in the public interest and applies to all audited entities. The new paragraph A33-1 in the proposed ISA (UK) 250 says reports are only to be made in accordance with ISA (UK) 2X0 and so therefore only applies to public interest entities (PIEs). We feel that this in fact goes against the public interest. Our understanding is that no findings in FRC AQR or QAD reports have pointed to any shortcomings in the application of the current ISAs in relation to making reports to an appropriate authority, and so there are no public interest concerns to address.

Question 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 do not think that limiting ISA (UK) 2X0 to public interest entities is appropriate. Our view is that reporting an instance of non-compliance with laws and regulations may be in the public interest regardless of the type of entity.

In particular, we feel that excluding charities and pension schemes from ISA (UK) 2X0 ‘muddies the water’ with regard to other legal whistleblowing requirements that auditors have for these entities.

We also note our professional responsibility under Section 360 of the ICAEW Code of Ethics to consider whether further action is needed in the public interest where a non-compliance with laws and regulations is identified regardless of the type of entity.

As it stands, Paragraph A33-1 of ISA 250 A requires auditors to consider reporting in the public interest, regardless of the type of entity, whereas the proposed equivalent paragraph limits auditors to make this consideration in line with ISA 2X0, excluding non-public interest entities. We consider that the existing requirement is more appropriate with regards to the public interest and is in line with ethical requirements.

Question 9. Do you support the definition of Reportable Matters?

No, we do not. Of particular concern to us is that part b) iii) of the definition which refers to information that should be reported ‘even where law, regulation or relevant ethical requirements do not require it’ because the matter is in the ‘public interest’, however, ‘public interest’ itself is not defined. This makes the definition highly judgemental in an area which could have legal repercussions for the auditor, including the risk of liability to the audited entity for breach of confidence. We note that, during a roundtable meeting, the FRC noted that plans in place for ‘safe harbour’ provisions to be incorporated into legislation would need to be revisited due to changes in the legislative timetable. Without such statutory protections, we are concerned that the implementation of ISA (UK) 2X0 will put auditors in an impossible position.

Part b) ii) requires significant judgement as to whether the auditor thinks it ‘appropriate’ to make a report. We are concerned that, with the benefit of hindsight, the FRC could determine that auditors acted inappropriately in either failing to make report or, indeed, making a report.

In addition, we do not think that there is sufficient guidance as to when it would be appropriate to make a report under part b) ii). The proposed standard does not make it clear in which circumstances, if it is not required by law, regulation or ethical requirement (part i) and it would not be required in the public interest (part iii), that reporting would nonetheless be an appropriate action.

Question 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?

As described in our response to Question 9 above, reportable matter is not clearly defined. There is also a lack of explanatory material or examples of matters which would be reportable to an authority outside of the entity where reporting is not explicitly required (see further our response to Question 11 below).

The impact assessment of the additional work effort of ISA (UK) 2X0 per the invitation to comment is ‘Most requirements already exist so no additional work effort.’ Our understanding of this is that no additional matters will be identified and therefore the auditor’s identification of matters will be neither enhanced nor strengthened.

In practice, however, given the change in the definition of Reportable Matter, and the accompanying exposure to subsequent criticism from the FRC and/or legal liability to the audited entity, we envisage that auditors would consider it necessary to expend significant additional work effort in seeking to satisfy the requirements of new ISA (UK) 2X0.

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


We do not think so due to the removal of the appendix on money laundering, terrorist financing and proceeds of crime legislation and the lack of examples of reportable matters which would meet the new reporting threshold, and those which would not. Whilst we note that paragraph A56 of ISA2X0 notes that an auditor “uses professional judgment to determine whether the auditor’s misgivings justify the auditor in carrying the matter further or are too insubstantial to deserve reporting”, we believe that some specific and nuanced examples are necessary to clarify how such a determination can be made in practice. We would also suggest that the application material would benefit from clarifying the factors which the FRC would have regard to in circumstances where it was subsequently alleged that auditors should, or should not have, made a report; for example, whether regard would be had to the fact that the auditor sought legal advice in reaching their determination.

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

It is not clear when the final ISAs will be issued, but as the consultation deadline is 12 January 2024, we question whether there will be enough time for the profession to design methodology and train audit teams in advance of the affected period ends.

For questions on this response, please contact Emily Seiorse at emily.seiorse@rsmuk.com quoting ISA 250 (UK) Consultation.

Yours sincerely,

A handwritten signature in black ink, appearing to read 'Jonathan Ericson', with a long horizontal line extending to the right.

Jonathan Ericson

Head of Audit

RSM UK Audit LLP