



Changes in audit regulation

PRESENTED BY MARK BABINGTON

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Today's presenters



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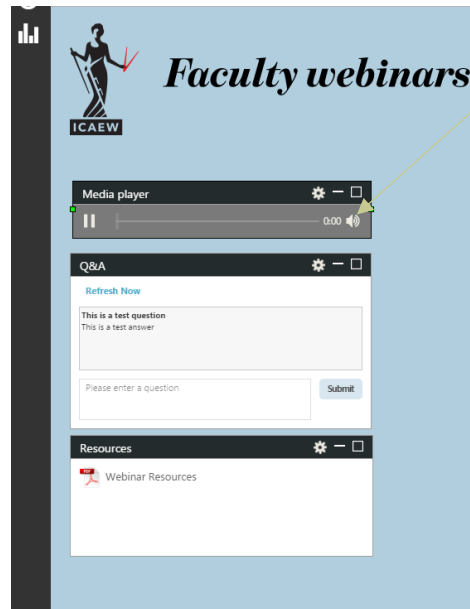
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2019 Revision of the UK Ethical and Auditing Standards

Mark Babington
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October 2019

Context

- Greater concerns about the quality of some audit and greater external scrutiny
- Audit reform in the UK – Kingman, CMA and Brydon

Objectives

Simplification and Removing Duplication

Strengthen Auditor Independence

- Reduce the risk that non-audit services offered by an auditor will cause an actual or perceived conflict of interest
- Strengthen the role of the Ethics Partner within audit firms and codify best practice – ensure that Ethics Partner (EP) become more of a focal point for the application of the principles of the ES. To encourage a more reflective and integrated principles based discussion within the firms.

Enhance Audit Quality

- Better and more transparent auditor reporting, including on Key Audit Matters and Materiality
- Increased work effort and better reporting on Going Concern, Non Compliance with Laws and Regulations and Other Information.

Timetable

- Consultation on revised ES and AS (July – September 2019)
- Finalisation of Going Concern ISA (UK) 570 (September 2019 – effective periods on or after 15 December 2019)
- Finalisation of ES and AS (November 2019 – effective periods tbc but after 15 December 2019)

Ethics and Independence

Key Changes to Ethical Standard

- Non Audit Services
- Objective, Reasonable and Informed Third Party Test
- Extension of Scope
- Ethics Partner
- Audit Fees

Ethics and Independence

Non Audit Services (PIEs)

- **Introduction of a list of permitted non-audit services for auditors of Public Interest Entities (PIEs)**, all of which are 'closely related' to an audit or required by law and/or regulation.
- This has the beneficial effect of removing ambiguity about which services are, and are not, permitted. [e.g. in provision of IT related services, corporate financing etc.]
- No other services can be offered, and this will apply globally to the auditor and their network firms.
- Challenge to identify and describe the right population of permitted services.

Ethics and Independence

Non Audit Services (All entities)

- **Removal of SME exemptions (<€200m capitalisation).** Previously the ES allowed exemptions for certain services in some circumstances – e.g. litigation services where no significant management judgement was allowed. Many firms weren't utilising these (insofar as they were understood) and we have therefore removed them. This change brings greater consistency with the IESBA Code. **Exemptions for small unlisted entities remain.**
- **Outright prohibitions: contingent fees.** We believe the self-interest threat where a fee is contingent on a particular outcome is too great to be mitigated. [Previously allowable in certain circumstances based on materiality of the fee and/or whether fee was contingent on the outcome of the engagement relating to a significant judgement.]
- **Outright prohibitions: internal audit services.** Previously allowable for non-PIEs where the firm did not expect to place reliance on the work done, and where the firm was not performing a management role.
- **Outright prohibitions: recruitment services.** Previously limited to services related to key management personnel.



Ethics and Independence

Objective, Reasonable and Informed Third Party test (ORITP)

- Re-defined and strengthened 'Third Party Test' which is critical to the application of ethical principles, including in areas where there are no specific rules or prohibitions. The current test requires practitioners to take account of the perspective of an 'objective, reasonable and informed third party', and whether such a person would probably conclude that, were a course of action be taken, that would compromise the ethical outcomes required by the standard.
- We are proposing to strengthen the focus of this test on third parties who are not practitioners:

Such a person is informed about the respective roles and responsibilities of an auditor, those charged with governance and management of an entity, and is not another practitioner. The perspective offered by an informed investor, shareholder or other public interest stakeholder best supports an effective evaluation required by the third-party test, with diversity of thought being an important consideration



Ethics and Independence

Objective, Reasonable and Informed Third Party test (ORITP)

- The definition draws attention to the s172 CA 2006 Duty on Directors to promote the success of the company for the benefit of its members, having regard to other stakeholders including employees, suppliers, customers, the community and the environment.
- The practical challenge for auditors will be how to make an assessment which takes account of non-practitioners, and how to demonstrate that they have done so.

Ethics and Independence

Extension of Scope

- We have consulted on whether the more stringent Ethical requirements for PIE auditors should be applied to additional 'entities which are of significant public interest' (without those entities themselves being designated as additional PIEs).
- In practice this is likely to apply to the auditors of non-PIEs for non-audit services.
- Auditors of all components in a group audit will be required to comply with UK ES independence requirements, regardless of jurisdiction.



Ethics and Independence

Role of the Ethics Partner (firms >3 RI partners)

- Key characteristics of the Ethics Partner are already (i) Necessary seniority (ii) Relevant experience, authority and experience levels, and (iii) With direct lines to firm's leadership board and INE's.
- To be strengthened: if, in the context of a consultation with the Ethics Partner, the firm decides not to follow the Ethics Partner's advice in relation to a PIE engagement then the matter must be reported to INE's/Competent Authority/TCWG within the firm.
- This external reporting requirement critical to enhancing the visibility and authority of the EP.
- Six-monthly reporting of all breaches to the Competent Authority (FRC/ARGA) or delegate.
- Clarification that the EP should have at their disposal 'appropriately skilled and experienced staff'.



Ethics and Independence

Audit Fee

A new requirement on the auditor to disclose to those charged with governance where the audit fee would affect an auditor's independence, and to explain the steps taken by the audit firm to ensure the delivery of a high-quality audit.

ISAs (UK)

- Overall we have:
 - integrated relevant staff guidance (group audit)
 - clarified and enhanced requirements in the auditing standards
 - issued a revised going concern standard.
- Key Changes:
 - Auditor reporting
 - Irregularities including fraud
 - ‘Other information’

ISAs (UK)

Auditor Reporting

- Further enhance audit reports by introducing additional requirements for the auditors of all listed entities, PIEs and those otherwise complying with the UK Corporate Governance Code. These include:
 - Requiring auditors to describe the significant judgements (or “findings”) made in respect of how Key Audit Matters were addressed in the course of the audit; [ISA (UK) 701, para 11 (a)]; and
 - Enhanced disclosures in respect of materiality, including the specification of performance materiality; [ISA (UK) 701, para 16-1 (a) ii].
- Sir John Kingman has recommended that a form of ‘graduated findings’ be considered, where the auditor would be additionally required to give a view on management’s decisions in areas that are key audit matters, including for example whether they were considered ‘optimistic’ or ‘cautious’. We note that nothing in the current or revised ISAs (UK) would prevent auditors from adopting ‘graduated findings’ on a voluntary basis. The Brydon review may also include this in the forthcoming report.



Irregularities including fraud

- Clearer articulation of the auditor's responsibilities in respect of non-compliance with laws and regulations, and how these responsibilities should be discharged. More explicit links between the requirements of related standards including ISAs (UK) 240, 250 (A&B), 265 and 315.
- Integrating staff guidance on compliance with laws and regulations into the reporting standard – and specifically p29-1 of ISA 700: *The auditor's report shall explain to what extent the audit was considered capable of detecting irregularities, including fraud (Ref: Para. A39-1–A39-6)* and significantly expanding the application material to be clear about what we expect auditors to consider and report.



Irregularities including fraud

- The requirement to report now applies to all audits, whereas previously it was limited to PIEs.
- Explaining the auditor's role, responsibilities and procedures in respect of irregularities, including fraud, is a critical part of restoring public and stakeholder confidence.
- Auditors are responsible for ensuring that this reporting adds value to users and avoids boilerplate disclosures.

ISA (UK) 720 Other Information

- Greater clarity over the auditor's work effort on 'other information' included within annual financial reports and enhanced application material on work effort.
- Requirement for an auditor to conclude on whether 'statutory' Other Information is materially consistent with the financial statements and knowledge obtained in the audit. [ISA (UK) 720, 22-1 & 22-4]

Brexit

- To reflect wherever we land



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