



FRC CONSULTATION ON ISA (UK) 250 (REVISED), CONSIDERATION OF LAWS AND REGULATIONS IN AN AUDIT OF FINANCIAL STATEMENTS

Issued 12 January 2024

ICAEW welcomes the opportunity to comment on the Financial Reporting Council's 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 published by the FRC on 18 October 2023, a copy of which is available from this [link](#).

For questions on this response, please contact the ICAEW Audit and Assurance Faculty at tdaf@icaew.com quoting REP 10/24.

ICAEW welcomes the Financial Reporting Council (FRC) consultation on the revision of auditing standards relating to non-compliance with laws and regulations. Our main concerns relate to:

- The lack of statutory protections for auditors reporting in the public interest, without which we believe proposed ISA 2X0 is fatally flawed.
- The impact of the proposals on costs for preparers of financial statements as well as auditors, and the creation of unrealistic expectations about what the proposals can achieve.
- The lack of evidence of shortcomings in auditing standards that result in deficiencies in auditing practice.
- The need to improve corporate governance through the UK Code rather than auditing standards.

These issues are further explained in the main body of this response.

This response of 12 January 2024 has been prepared by the ICAEW Audit and Assurance Faculty. Recognised internationally as a leading authority and source of expertise on audit and assurance issues, the faculty is responsible for audit and assurance submissions on behalf of ICAEW. The faculty has around 22,000 members drawn from practising firms and organisations of all sizes in the private and public sectors.

ICAEW is a world-leading professional body established under a Royal Charter to serve the public interest. In pursuit of its vision of a world of strong economies, ICAEW works with governments, regulators and businesses and it leads, connects, supports and regulates more than 166,000 chartered accountant members in over 146 countries. ICAEW members work in all types of private and public organisations, including public practice firms, and are trained to provide clarity and rigour and apply the highest professional, technical and ethical standards.

© ICAEW 2024

All rights reserved.

This document may be reproduced without specific permission, in whole or part, free of charge and in any format or medium, subject to the conditions that:

- it is appropriately attributed, replicated accurately and is not used in a misleading context;
- the source of the extract or document is acknowledged and the title and ICAEW reference number are quoted.

Where third-party copyright material has been identified application for permission must be made to the copyright holder.

KEY POINTS

OVERALL OBSERVATIONS

1. We welcome the opportunity to comment on these proposals. We have consulted a wider range of stakeholders than usual because of the potential impact on preparers of financial statements. This response therefore reflects views expressed by our Corporate Governance Committee, Financial Reporting Committee, Non-financial Reporting Committee, Sustainability Committee, our Internal Audit Community and members of our Financial Services Faculty, as well as ICAEW groups representing auditors. This response reflects ICAEW's position as well as being representative of the views we heard from of all these constituencies.
2. We understand that the proposed revisions to this standard are part of the FRC's response to the three independent reviews of the audit market. ISA (UK) 250 (Revised) was highlighted as in need of review. However, the omission of audit reform from the November 2023 King's Speech and the withdrawal of the Statutory Instrument introducing a proposed material fraud statement give rise to concerns about many of these revisions. Furthermore, evidence-based standard-setting demands that the proposals demonstrably address shortcomings in extant standards resulting in deficiencies in audit practice. We do not believe that the FRC has provided any substantive evidence to justify the very significant changes proposed.
3. The proposals as they stand risk undermining confidence by implying that there are significant deficiencies in the current requirements, which we do not believe is correct, and by creating expectations that cannot be fulfilled by implying that these deficiencies, and more, will be remedied by the implementation of the proposals, which we believe is equally incorrect. Stakeholders we engaged with were keen that any suggestion that some recent, high-profile corporate scandals might have been prevented had the proposals been in place, is avoided. It is critical, in the context of compliance with laws and regulations, to keep in mind the responsibilities of directors for running companies in accordance with the law. There is also the potential for undermining confidence in business, particularly smaller businesses, if this proposed widening of audit scope results in qualified audit reports due to limitations in audit scope.
4. The need to determine the impact of indirect laws and regulations on a global basis for complex and international group audits in the UK, represents a significant extension in audit scope which will come at a cost to preparers who will need to provide the relevant information to auditors, as well as to auditors. Additional specialist legal expertise will be required. We urge the FRC, if it proceeds with these proposals, to ensure that revisions emphasise the responsibility of management for a robust internal control framework covering compliance with all relevant laws and regulations. The FRC should consider whether the root cause of its concerns lies in a need for some companies to improve internal controls over what are currently classified as indirect laws and regulations. If that is the case, it should consider how best that objective can be achieved. The FRC should enhance corporate governance through the UK Code, not auditing standards.
5. Preparers continue to express concerns about competition and choice in the audit market, and the reduced pool of auditors available to listed companies. These proposals seem very likely to further detract from the attractiveness of the PIE audit market to challenger firms.

Proposed ISA (UK) 2X0

6. The application of proposed ISA (UK) 2X0 is particularly problematic in the absence of necessary protections for auditors which were promised by government in its May 2022 response to the consultation on strengthening the UK's audit, corporate reporting and corporate governance systems. Without these protections, which are not in place, the proposals are fatally flawed. We understand the FRC is discussing this issue with the Department for Business and Trade (DBT). To the extent that ISA (UK) 250 and ISA (UK) 2X0 remain linked in substance, despite the proposed decoupling, we believe that the finalisation of both standards should be deferred pending the implementation of these protections.
7. We note that the scope of ISA (UK) 2X0 potentially excludes non-PIE entities in the financial services sector, such as unlisted fund managers. However, given the current uncertainty over the definitions of PIEs, the FRC should consider the number and nature of companies potentially excluded, and engage with the FCA and others on this issue.
8. We understand that ISA (UK) 2X0-style reports are already being made to regulators, including the FRC, under extant ISA (UK) 250B application material. It is not clear what the FRC does with these reports, or what it might do with more reports. The transparency objective which these proposals address also applies to the regulators in receipt of such reports. In the absence of any information, even at a high level, about the number of such reports made, their nature, extent and what actions are taken as a result, their purpose is called into question. It is not sufficient simply to assert that these reports are necessary in the public interest. The purpose of this type of reporting should be clarified.

Proposed ISA (UK) 250 (Revised)

9. We do not believe that the FRC has clearly articulated the deficiencies in audit practice these revisions are seeking to address. We understand that the FRC has seen shortcomings in recent enforcement actions, but there has been no reference to these in AQR reports. Without a proper understanding of these deficiencies, it is hard for respondents to provide constructive feedback. Unsubstantiated, generalised concerns about an issue are not a sound basis for regulation and the lack of clarity regarding the nature and extent of areas in which auditors are currently falling short, means that auditors, and audit inspectors, will struggle to calibrate the enhanced work effort required.
10. Concerns have also been expressed about the imposition, in effect, of new requirements for directors via auditing standards. Emissions and cladding regulations that were pertinent to the recent VW and Grenfell cases are examples of regulations auditors will need to assess. If management, having performed a risk assessment, fails to highlight any potential non-compliance, in the absence of other indications that non-compliance might be an issue, it is not reasonable in our view to expect auditors to investigate further. However, with hindsight, the proposed revisions will strongly suggest that the 'auditors should have known' and the potential for the promotion of this view by these proposals is regrettable.
11. The invitation to comment acknowledges that the auditor's responsibilities cannot be open-ended. However, it is clear from our engagement with stakeholders that the proposals as they stand are being read as an open-ended requirement – similar in effect to the parallel proposals of the PCAOB, even if this was not intended – and that the additional work effort required of both preparers and auditors will be a great deal more than that apparently envisaged by the FRC in its impact analysis. The PCAOB proposals only apply to the largest of audits whereas the FRC's extend to all audits. The likelihood that the management of SMEs, even where they are well-run, will be able to provide a complete list of laws and regulations that may potentially have a material effect on the financial statements globally is low.
12. We urge the FRC to consider the proportionality of the proposed requirements in the context of the 22 November 2023 [letter](#) to the FRC from the Secretary of State for Business and Trade. A *de facto* requirement for auditors or preparers to identify a complete list of laws and regulations globally that may have a material effect on the financial statements, and to

perform a detailed risk assessment, is not proportionate. This is important in the context of the regulation of sustainability reporting, which is immature and often high-level, particularly in the context of Scope 3 emissions. Preparers are currently preparing to apply new sustainability reporting standards, representing a significant increase in work effort and requiring new methodologies – all of which is in the public interest. Significantly enhancing audit requirements at this time is not proportionate, particularly in the absence of a clearly articulated rationale.

Consistent enforcement and consequential amendments

13. The FRC is an enforcement regulator and significant concerns have been expressed about how the proposed revisions will be enforced. The breadth of laws and regulations that might have a material impact on the financial statements is highly judgemental (ISA (UK) 250), as is the concept of matters being of such significance as to require reporting in the public interest (ISA (UK) 2X0). FRC reports do not indicate which laws and regulations the FRC believes auditors are failing to address. Without examples, both auditors and enforcement regulators will be unable to calibrate their judgements, which will inevitably lead to inconsistent application by both.
14. The impact of this standard on ISA 600 on the audit of groups, particularly those with non-UK components, has not been followed through in the proposals. There is no guidance on reporting under ISA 700 where the auditor is unable to obtain sufficient appropriate audit evidence, and no mention of the need for a specific representation from management on the completeness of the list of laws and regulations to be provided to auditors under ISA 580. The audit of UK listed global groups will be hampered by these proposals, and it currently seems unlikely that the IAASB will follow either the FRC or the PCAOB lead in this case.

ANSWERS TO SPECIFIC QUESTIONS

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?

15. We do not believe it is possible for ICAEW to assess whether the proposals are in the public interest because the FRC has not identified the specific or general deficiencies the proposed revisions are intended to address - it merely states that it has concerns. This is not a sound basis for regulation. ICAEW is not aware of any issues in the application of extant ISA (UK) 250 and none have been cited in recent AQR or QAD reports. It is therefore difficult to assess how the proposals will impact audit quality.
16. We do not agree that the proposals can be justified on the basis that the auditor's approach to indirect laws and regulations is insufficiently risk-based. The assessment of laws and regulations as indirect is already part of the risk assessment. The distinction between direct and indirect laws is helpful, and a different level of work effort is appropriate and proportionate for the two categories. If the FRC believes that insufficient attention is being paid to indirect laws and regulations, or that auditors or preparers are classifying too many laws and regulations as indirect, those issues should be addressed.

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?

17. Proposed paragraph 12-2(c) states that those charged with governance are responsible for the entity's system of internal control over compliance with laws and regulations. This should also state that management in practice implements the system of internal controls. It is critical that the FRC communicates more clearly than it does at present, that the starting point for auditors is a complete list of laws and regulations that potentially have a material effect on the financial statements prepared by management. We note in our main points above that, in practice, management will often struggle to do this.
18. To comply with 12-2 and 12-3, preparers and auditors will need a complete population of laws and regulations to assess for material non-compliance affecting the financial statements. There are significant concerns as to whether this is possible for either preparers or auditors, with or without specialist legal advice, and about where a reasonable stopping point might be - especially in large and complex international groups. The FRC states that the auditor's obligation cannot be open-ended, but the proposals as they stand are widely being read as such.
19. 12-3(b) includes a requirement to inspect correspondence with relevant licensing or regulatory authorities. It is unlikely that auditors will be able to determine whether the correspondence obtained represents a complete population. Under the extant standard, auditors would have inspected correspondence relating to fines, penalties or other regulatory action or issues raised. Inspecting all correspondence is a significant increase in work effort, with little foreseeable gain in terms of audit quality.
20. Taken with the proposed IAASB revisions to ISA 500 (Revised), whereby all 'information' must be assessed against relevant attributes, including accuracy and completeness, there is no guarantee that the application of 12-3(b) would represent a truly complete population.

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?

21. It was suggested to us by some stakeholders that enhancing and strengthening the identification of risk in this area would be better achieved by means of raising the bar for both

direct and indirect laws and regulations. In particular, a more thorough assessment of which laws and regulations are classified as indirect might be required, as might a more robust approach and greater specificity regarding the procedures performed thereon. We are aware of the FRC's dislike of the distinction between direct and indirect laws and regulations, but given the potential problems associated with the proposals as they stand, we believe that further consideration of this as an alternative to abolishing the distinction altogether is merited.

22. Assessing the laws and regulations that may apply to complex or international groups, and determining their potential impact on the financial statements, represent a significant extension of scope requiring specialist legal expertise for many audits. The need for professionally qualified local and international legal advisers will increase costs for both auditors and preparers. The proposals also seem likely to further detract from the attractiveness of the PIE audit market and be detrimental to competition and choice within the audit market as a whole.
23. The impact of this standard on ISA (UK) 600 on the audit of groups, particularly those with non-UK components, has not been followed through in the proposals. Non-UK auditors may well struggle to deal with the significant difference between the UK and the international standard. There is no guidance on reporting under ISA (UK) 700 where the auditor is unable to obtain sufficient appropriate audit evidence, and no mention of the need for a specific representation from management on the completeness of the list of laws and regulations to be provided under ISA 580. It currently seems unlikely that the IAASB will follow the FRC or the PCAOB's lead in this area.

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

24. Other than specific issues raised elsewhere in this response, we have noted no further issues in relation to the application material.
25. Despite acknowledgement within the invitation to comment that knowledge of applicable laws and regulations cannot be open-ended, A10-1 can and is being interpreted as such.
26. Footnote 8a in A2-3 refers to section 499 of the Companies Act 2006 covering the auditor's general right to information. This should also reference section 501 covering the offences related to a failure to provide auditors with information.

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

27. No, we do not support the deletion of the appendix on money laundering, terrorist financing and proceeds of crime legislation. Auditors find this extremely useful, and we do not think that A14, even as enhanced, is sufficient or acts as a suitable replacement for that appendix.
28. Although ISA (UK) 2X0 includes a brief paragraph (A14) outlining additional responsibilities under such legislation, it deals with communicating and reporting only. The application of ISA (UK) 250 requires auditors to consider their additional responsibilities under UK legislation and therefore the appendix should be included within ISA (UK) 250.
29. The appendix might be easier to update if it were issued as a Practice Note. A6-1 refers to ISA (UK) 290 for further guidance, which appears to be incorrect.

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

30. No, we do not agree with the proposed effective date. Some risk assessments will commence in late 2024, which is six months after the consultation deadline. This is not sufficient time for firms to write and release methodology.

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?

31. The omission of audit reform from the 2023 King's Speech raises concerns about the protections in proposed legislation which are essential to ensure auditors are not in breach of confidentiality requirements in applying ISA (UK) 2X0. Without those protections the proposals are fatally flawed. We do not believe that either standard should be finalised before these protections are implemented.
32. We note in our main points above that we understand that auditors are currently reporting to regulators under extant application material, including the FRC. Absent greater transparency among regulatory bodies regarding the nature, extent and actions taken in the light of these reports, it is impossible to assess whether ISA (UK) 2X0 addresses shortcomings regarding reporting by auditors in the public interest. Nothing in AQR or QAD reports suggests that this is the case and simply stating that more reports would be in the public interest is not sufficient.
33. It is unclear whether ISA (UK) 2X0 would better enable the FRC to share information reported with other relevant regulators, and to whom auditors should address such reports. If reports are being made to regulators in the public interest, but no action is being taken, it calls into question the purpose of these revisions.

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.

34. The categories of entities listed above are already covered by relevant reporting requirements. ISA (UK) 2X0 should not be extended to include these entities to avoid overlap, confusion and the risk of duplicated reports. To include 'all entities' would be wholly disproportionate. ISA (UK) 2X0 should apply to large PIEs only.
35. We note in our main points above that the proposals also appear to exclude certain entities caught by extant ISA (UK) 250, and the importance of resolving the regulatory uncertainty over the definition of PIEs.

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

36. No, we do not support the definition of reportable matters, particularly 10(b)(iii) which refers to a matter the auditor has 'determined is of such significance that it is in the public interest to report'. This definition does not provide the clarity government sought in auditing standards or stand-alone guidance. ISA (UK) 2X0 offers no criteria against which auditors or enforcement regulators can make this judgement, which is likely to lead to inconsistent application by both. In the absence of examples, it will be exceptionally difficult to calibrate judgements.
37. As noted above, there are concerns about the application of 10(b)(iii) by regulators. This requirement could be used as a tool to penalise auditors, with the benefit of hindsight, for corporate shortcomings. The FRC must clarify its expectations further. The FRC is creating an expectation that auditors will report more. Whatever auditors do, there is a risk that

enforcement regulators will simply ask for more. This does not represent good regulation and we note in our main points above the recent letter to the FRC from the Secretary of State for Business and Trade which refers to the need for proportionality. Auditors and enforcement regulators need a level of certainty around how judgement should be exercised.

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?

38. ISA (UK) 2X0 has the potential to strengthen the auditor's identification of matters that should be reported but only if:
- (a) the FRC is willing to be transparent about matters it believes are not currently being reported. We understand anecdotally that these reports are made on a regular basis to appropriate authorities outside the entity, including the FRC. Auditors who have reported issues are not aware of any action taken; and
 - (b) there are appropriate statutory protections for auditors, as there are for FCA and PRA-regulated businesses, as promised in the May 2022 government response to the consultation on strengthening the UK's audit, corporate reporting and corporate governance systems at paragraphs 11.4.22-3. That response noted that the statutory protections would cover all statutory audit work, not just audits of PIEs. Without these protections the proposals are fatally flawed. We understand the FRC is discussing this issue with DBT. To the extent that ISA (UK) 250 and ISA (UK) 2X0 remain linked in substance, despite the proposed decoupling, we believe that the finalisation of both should be deferred pending the implementation of these protections.
39. The government response went on to note that further clarification on the circumstances in which these reports should be made by auditors, especially with regards to viability and resilience, is likely to be helpful and potentially encourage reports where appropriate. It said that government would invite the regulator to consider amendments to auditing standards or the introduction of stand-alone guidance to improve clarity. The key words here are 'clarification' and 'clarity', both of which are lacking in the ISA (UK) 2X0 proposals. Application material has been elevated to a requirement but without the level of clarification auditors need to determine the circumstances in which such reports should be made.

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

40. As discussed in our response to question 5 above, even as enhanced, A14 does not act as a replacement for the extant appendix covering requirements of auditors under money laundering, terrorist financing and proceeds of crime legislation.

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

41. No, we do not agree with the proposed effective date. If the FRC decides to proceed with the finalisation of ISA (UK) 250, it should consider a later effective date, to accommodate those risk assessments commencing later in 2024, just a few months after the consultation deadline. This is not sufficient time for firms to write and release methodology. As noted elsewhere in this response, we believe that if the FRC proceeds to finalising ISA (UK) 2X0, the implementation date should be deferred until after the necessary statutory protections come into force.