

Proposed revisions to ISA (UK) 250 (Lecture A846 – 5.15 minutes)

On 18 October 2023, the Financial Reporting Council (FRC) issued an Invitation to Comment – Proposed Revisions to ISAs (UK) 250 A and B.

ISA (UK) 250, Section A *Consideration of Laws and Regulations in an Audit of Financial Statements* provides guidance to the auditor in respect of an entity's compliance with laws and regulations.

ISA (UK) 250, Section B *The Auditor's Statutory Right and Duty to Report to Regulators of Public Interest Entities and Regulators of Other Entities in the Financial Sector* deals with circumstances in which the auditor of a regulated entity is required to report information which comes to the auditor's attention directly to a regulator.

Both of these ISAs (UK) are up for revision and the FRC is requesting comments on this consultation by 12 January 2024.

1.1 ISA (UK) 250, Section A

The current extant of ISA (UK) 250, Section A makes reference to **direct** laws and regulations (ie, those which have a direct effect on the amounts and disclosures in the financial statements – such as tax legislation); and **other** laws and regulations which have an **indirect** effect on the financial statements (eg, health and safety legislation).

Currently, the auditor is required to obtain sufficient appropriate audit evidence in respect of compliance with direct laws and regulations.

In respect of other laws and regulations, the auditor is only required to carry out specified audit procedures to identify any non-compliance with those other laws and regulations which may have a material effect on the financial statements. This is because non-compliance with other laws and regulations (eg, employment law) can impact the financial statements as the entity may need to make a provision for future legal costs and fines. In the worst-case scenario, this could also affect the ability of the entity to continue as a going concern.

The FRC is proposing to make changes to ISA (UK) 250, Section A by proposing a more risk-based approach. This approach will direct the auditor's attention to identifying those laws and regulations where non-compliance may have a material impact on the financial statements. It will also enable the auditor to devise specific audit procedures to address this risk of material misstatement.

Using this risk-based approach will mean there will be more professional judgement needed on the part of the auditor. It is also likely to mean more work will need to be undertaken in identifying such laws and regulations. There will also be additional risk assessment procedures needed which will lead to an increased level of responses to those risks [of non-compliance with laws and regulations].

The FRC has established a number of additional risk assessment requirements, such as:

- Understanding those laws and regulations that relate to the applicable financial reporting framework or which arise from regulatory factors.
- Understanding management's process concerning compliance with laws and regulations and how those charged with governance oversee this.
- Determining whether there are any deficiencies in internal control relevant to non-compliance with laws and regulations.
- Making inquiries of management, those charged with governance and other individuals to obtain their views on which laws and regulations could have a material impact on the financial statements.
- Inspecting documentation for indications of non-compliance with laws and regulations.

The FRC has also proposed explicit requirements for the auditor to identify, assess and respond to the risks of material misstatement due to fraud or error relating to non-compliance with laws and regulations.

As we have seen in other revised ISAs (UK), the FRC has started to introduce 'stand back' requirements. The proposed revisions to ISA (UK) 250, Section A are no exception and the FRC plans to introduce a stand back requirement in the next edition. This will require the auditor to assess whether they have obtained sufficient appropriate audit evidence regarding whether there is a material misstatement of the financial statements relating to non-compliance with laws and regulations.

The FRC also proposes to introduce a requirement for the auditor to conclude whether non-compliance (or suspected non-compliance) with laws and regulations has resulted in a material misstatement of the financial statements.

Effective date

The FRC proposes an effective date of ISA (UK) 250, Section A (Revised) to be for audits of financial statements for periods commencing on or after 15 December 2024 (ie, 31 December 2025 year ends or short periods). Earlier adoption would be permitted.

1.2 ISA (UK) 250, Section B

The proposed amendments to this standard amount to pretty much a new ISA (UK) on the grounds that the current content is outdated and the FRC would like to introduce a more principles-based standard covering reporting and communicating to an appropriate authority. The numbering of the ISA (UK) is expected to change, and the title is expected to be *Special Considerations for Audits of Public Interest Entities – Communicating and Reporting to An Appropriate Authority Outside the Entity*.

There is a new definition of 'reportable matters' which is information about which the auditor becomes aware during the audit that the auditor is either required to report to an appropriate authority or that the auditor determines should be reported an appropriate authority outside the entity.

The FRC is also proposing to include in the definition of 'reportable matters' information that 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.

The structure of the revised ISA (UK) will be in two parts:

- Requirements 11 to 13 will apply to all audits of public interest entities.
- Requirements 14 to 21 will apply only if the auditor becomes aware of information that may relate to a reportable matter.

The proposed scope of the new standard is public interest entities. However, the FRC has stated that it is intending that the new standard will apply to all entities caught by the new definition of 'public interest entity'.

Effective date

The FRC proposes an effective date of this revised ISA (UK) to be for audits of financial statements of public interest entities for periods commencing on or after 15 December 2024 (ie, 31 December 2025 year ends or short periods). Earlier adoption would be permitted.