

Changes to the Ethical Standard proposed (Lecture A833 – 14.05 minutes)

On 8 August 2023, the FRC issued a consultation on revisions to the Ethical Standard (ES) which aim to enhance and clarify the principles of integrity, objectivity and independence. Comments on the proposed amendments will close on 31 October 2023 and the revised ES will become effective on 15 December 2024.

In addition, changes to the ES are necessary in light of the new quality management standards in the form of:

- ISQM (UK) 1 *Quality Management for Firms that Perform Audits and Reviews of Financial Statements, and Other Assurance and Related Services Engagements*; and
- ISQM (UK) 2 *Engagement Quality Reviews*.

The revisions to the ES remove references to the old ISQC (UK) 1 and update certain terminology to be consistent with the new standards (such as changing 'quality control' to 'quality review').

1.1 Headline changes

Some of the headline changes to the ES include:

Withdrawal of the OEPI category

In 2022, the FRC issued a position paper on audit market reform which confirmed that the FRC is committed to revising the ES and to consult at the same time concerning the withdrawal of the *Other Entities of Public Interest* (OEPI) category which was brought into the ES in 2019 when it was last issued. The reason the FRC are looking at withdrawing the OEPI category is because of the government's proposed changes to the statutory definition of 'Public Interest Entity'.

Breach reporting

PIE audit firms are required to report breaches of the ES to the FRC on (at least) a biannual basis. The revisions to the ES will:

- (a) Introduce a specific requirement for firms to design controls which are effective in identifying reportable breaches. This revision has been driven by concerns about potential inconsistencies in reporting between firms.
- (b) Include a specific requirement for firms to consider the perspective of an Objective Reasonable and Informed Third Party (ORITP) when assessing the implications of a breach of the ES.
- (c) Align the ES with the FRC's formal policy for reporting breaches by highlighting instances when firms ought to report to the FRC on a more timely basis.
- (d) Include the concept of 'inadvertent' breaches of the ES which do 'not necessarily call into question the firm's ability to give an audit or other public interest

assurance opinion.’ Additional material will be added to explain which breaches of the ES cannot be considered to be ‘inadvertent’.

Application of prohibitions to different categories of entity

Section 2 of the ES sets out the prohibitions and requirements in respect of personal financial independence for engagement teams and other staff in audit firms. These are combined requirements of the ES and those set in law. The dual source of these prohibitions has made the material in the ES hard to understand and hence difficult to implement. The FRC have therefore redrafted paragraphs 2.3 and 2.4 to make the requirements more succinct.

Partner and staff rotation

A table has been included setting out the rotation rules for various partners on an audit engagement. In addition, further guidance has been included (from previously published material) setting out circumstances such as maternity/paternity leave and sickness absence which may be relevant to those rotation rules.

Fees

Changes are proposed to enhance prohibitions where an audit firm’s independence could be threatened by an economic over reliance on fees from entities that are connected in substance, if not in legal form.

Non-audit and additional services

Changes to Section 5 of the ES are aimed to align more closely with changes to the IESBA Code. This is in line with the FRC’s commitment to have an ES which is as stringent as the IESBA’s. This also helps UK firms who comply with the IESBA Code as part of their membership commitment to the international Forum of Firms, or because the Code forms the basis for the Ethical Code of UK Professional Accountancy Bodies. Additional changes have been made to reflect FRC inspection or enforcement findings as follows:

- IT services to reflect stricter IESBA Code restrictions on audit firms providing hosting services to audited entities.
- Enhanced tax service prohibitions that can be provided to the majority shareholders of unlisted entities, in response to supervision and inspection findings.
- Recruitment and remuneration services, reflecting more explicit IESBA Code prohibitions where audit firms provide more related services.
- Corporate finance services where IESBA have introduced extended prohibitions relating to the provision of advice on audited entities on debt and financial instruments.