

31 October 2023



**Response to the Financial
Reporting Council
Consultation: Revisions to
the FRC Ethical Standard**

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1. Introduction

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ICAS' diverse membership is made up of over 23,000 world class business professionals who work in the UK and in more than 80 countries around the globe. Members of ICAS are also known by the letters CA, an exclusive professional designation in the UK.

ICAS members operate at the forefront of ethical and sustainable business. Educated, regulated, and led by the highest standards of ethical leadership since 1854, they are at the top of their game. They are trusted professionals, that transform business and support one another for the greater good.

Acting in the public interest is the guiding principle of all that ICAS does and we continually work to maintain trust in the finance profession. That ethos is enshrined in the ICAS Code of Ethics – which applies to all members, students and member firms, and is underpinned by our Royal Charter commitment.

ICAS is a member of the Chartered Accountants Worldwide Network, a global family that brings together the members of 15 leading institutes to create a community of over 1.8 million Chartered Accountants and students in more than 190 countries.

Any enquiries should be addressed to Ann Buttery, ICAS Head of Ethics.

2. Key Points

Overall, we are generally supportive of the FRC's proposals outlined in its consultation although we have highlighted a specific concern in relation to "inadvertent breaches". Our comments on this matter are included in our response to question 2 below.

In addition, whilst we agree with the FRC's inclusion of paragraphs to reflect the International Ethics Standards Board for Accountants (IESBA) 'Technology-related revisions to the Code', we have concerns that the FRC's proposed provision is not as stringent as the IESBA provision. This is discussed further below in our response to question 6.

We would also like to note that we found the highlighting of the key changes within the FRC's "Ethical Standard 2023 – Key Changes" document to be very helpful.

3. Responses to the specific questions

Withdrawal of the OEPI Category

- 1. Do you agree with the proposal to remove the category of OEPI from the Ethical Standard once the government's revised statutory definition of a UK PIE becomes effective?**

We agree that the UK economy, including the audit market, will benefit from the simplest possible definition of what a Public Interest Entity (PIE) is.

However, first and foremost, no change should be made until the government has made changes to the PIE definition. If the government does widen the scope of PIEs, then we

believe that the FRC should undertake a separate consultation to evaluate whether the Other Entity of Public Interest (OEPI) definition should be retained.

Part B: Section 1 - Breach reporting by audit firms to the FRC

2. Do you agree with the revisions in respect of breach reporting by firms? Could they be further enhanced?

We question whether the revisions actually improve the clarity of what is deemed an inadvertent breach. We are fully supportive of the inclusion of “a deliberate breach of this ethical standard by an individual or firm cannot ever be considered to be inadvertent” in the new paragraph within 1.25. However, it is the next part of this new paragraph that causes us concern. This implies that any breach by an individual or firm which a firm’s policies and procedures failed to prevent or detect cannot be deemed inadvertent. We therefore believe that the FRC ought to give further consideration to the wording of this paragraph to provide clarification.

Part B: Section 1 – Application of Prohibitions to different categories of entity

3. Does the revised paragraph 1.46 enhance the accessibility of the ES? Are there other areas where similar enhancements could be made?

We believe that the revised paragraph 1.46 will assist users navigate the Ethical Standard because including the description of the related paragraphs enables users to see immediately which areas of the Ethical Standard contain additional requirements for particular categories of entity.

We appreciate that the cross references have not been updated yet, so do not comment on those, however we do note a small typo in relation to paragraph 5.118 “Entity in distress relevant to an engagement” which is noted as “5118”.

We note that the Ethical Standard may need to be re-visited in light of revisions to the IESBA Code in IESBA’s “Final Pronouncement: Revisions to the Code Relating to the Definition of Engagement Team and Group Audits”.

Part B: Section 2 – Personal Financial Independence and Part B: Section 3- Partner and staff rotation

4. Do you agree that the changes made to paragraphs 2.3 & 2.4, and 2.5 to 2.10; and the addition of additional guidance in paragraphs 3.22 to 3.23 enhance the clarity of ES?

We believe it is helpful to include the Glossary definition of financial instruments in paragraph 1.2, however could each category of financial instrument be numbered (1) to (11) as per the Glossary to further increase clarity? (It may be the numbers have just been lost in the formatting in the consultation paper).

Part B: Section 2 – Personal Financial Independence

We believe that proposed paragraphs 2.3 and 2.4 are clearer than extant paragraphs 2.3 and 2.4, and therefore we welcome these amendments. We do note that there appears to be a change in the scope of the paragraphs as the prohibitions for the firm’s key audit partners set out in extant paragraph 2.4(b) now appear to extend to each partner in the firm in proposed paragraph 2.3 i.e. extant paragraph 2.3 (b) only prohibited material indirect financial interests for partners in the firm who were not key audit partners whereas this has now been extended to any financial interests, other than an immaterial indirect financial interest held through a diversified collective investment scheme, which would therefore also now prohibit immaterial indirect financial interests for all partners in the firm.

We also believe that further clarity could be provided (perhaps in the Glossary) as to the definition of a “diversified collective investment scheme” for the purposes of the Ethical Standard.

Paragraph 2.9

We also welcome the proposed change to paragraph 2.9 as the provision is now clearer.

Part B: Section 3- Partner and staff rotation

We agree with the inclusion of the table at paragraph 3.22 to summarise the “Rotation Period for Key Audit Partners” as we believe this will be helpful for users of the Ethical Standard.

We also agree with including paragraph 3.23 within the Ethical Standard as this is helpful guidance from the FRC’s Technical Advisory Group’s (TAG’s) “Rolling record of actions arising” which will help provide further clarification to users of the Standard. We do however wonder if the paragraph could be further extended to include some or all of the following additional information from the TAG guidance: “Such a period of absence will not ‘reset the clock’ for determining rotation requirements as set out in paragraphs 3.10R and 3.11 of the Ethical Standard unless it is at least equal to the required cooling off period (e.g. a partner who goes on a one-year period of maternity or paternity leave after having been engagement partner for three years cannot on returning to work commence another five year period as engagement partner for the same entity).”

We also suggest the following small amendments (in red) to paragraph 3.10:

“In the case of listed entities, save where the circumstances contemplated in paragraph 3.13 and 3.14 apply, the firm shall establish policies and procedures to ensure in respect of a recurring engagement that:

- (a) no one shall act as engagement partner for more than five years, this includes time spent participating in an engagement, where an audit engagement has moved between firms; and
- (b) anyone who has acted as the engagement partner for a particular entity for a period of five years, shall not subsequently participate in the engagement until a further period of five years has elapsed; and
- (c) on completing their time in that role, the engagement partner, shall not continue to have significant or frequent interaction with senior management or with those charged with governance of the entity they have previously audited until the cooling off period has elapsed; and
- (d) once ceasing to be Engagement Partner, after completing the maximum allowed period, **the engagement partner** shall not act as Engagement Quality Reviewer for the engagement until a period of five years has elapsed.

Part B: Section 4 – Fees

5. Do you agree with the changes made to section 4 on fees?

Contingent fees

We note that in the extant Ethical Standard paragraphs 4.6 to 4.8 discuss contingent fees and there is a proposal in the consultation to essentially retain only extant paragraph 4.7. However, we feel that the content which is proposed to be deleted in paragraphs 4.6 and 4.8 is not entirely covered by the content that would be remaining in the Ethical Standard and therefore would suggest that it would be more helpful for users to retain the content as it is in the extant Ethical Standard in paragraphs 4.6 to 4.8.

This would also keep the provisions more in line with the provisions regarding contingent fees in the IESBA Code. That said, the first sentences in extant paragraphs 4.6 and 4.7 both define contingent fees and therefore it is arguable that only one of those definitions is needed.

We suggest extant paragraphs 4.6 to 4.8 could be re-arranged as follows:

~~4.6 Contingent fees are fees calculated on a predetermined basis relating to the outcome or result of a transaction, or other event, or the result of the work performed. Additional or supplementary fees paid over and above an agreed engagement fee, which do not cover the cost of additional work, but reward an outcome which was not agreed at the time of the engagement letter are also, for the purposes of this Ethical Standard, contingent fees. Fees shall not be regarded as being contingent if a court, competent authority, or other public authority has established them.~~

4.6⁷ A contingent fee basis includes any arrangement made at the outset of an engagement under which a specified commission on or percentage of any consideration or saving is payable to the firm upon the happening of a specified event or the achievement of an outcome (or alternative outcomes). ~~Additional or supplementary fees paid over and above an agreed engagement fee, which do not cover the cost of additional work, but reward an outcome which was not agreed at the time of the engagement letter are also, for the purposes of this Ethical Standard, contingent fees.~~

4.7 Differential hourly fee rates, or arrangements under which the fee payable will be negotiated after the completion of the engagement, or amended to cover changes to work, risk or responsibility identified as necessary during the engagement, and which do not change the outcome of the engagement do not constitute contingent fee arrangements. A reduced fee payable where an engagement is ended also does not constitute a contingent fee arrangement. ~~Fees shall not be regarded as being contingent if a court, competent authority, or other public authority has established them.~~

4.8 Contingent fee arrangements in respect of engagements create self-interest threats to the integrity and objectivity of the firm and covered persons that are so significant that they cannot be eliminated or reduced to a level where independence would not be compromised.”

Enhancement of 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

We agree with the changes that have been made [to paragraphs 4.21, 4.22, 4.23, 4.25, 4.27 & 4.29] 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, although additional guidance may be required in this area.

Part B: Section 5 – non-audit/additional services

6. Do you agree with the changes made to section 5 which extend some existing restrictions on the provision of non-audit or additional services?

Materiality in relation to financial statements

We note that the IESBA Code of Ethics in Section 600 “Provision of non-assurance services to an audit client” paragraphs 600.10 A1 and 600.10 A2 (noted below) includes guidance in relation to materiality. We believe that similar provisions within the FRC’s Ethical Standard would be helpful for users.

“600.10 A1 Materiality is a factor that is relevant in evaluating threats created by providing a non-assurance service to an audit client. Subsections 601 to 610 refer to materiality in

relation to an audit client's financial statements. The concept of materiality in relation to an audit is addressed in ISA 320, *Materiality in Planning and Performing an Audit*, and in relation to a review in ISRE 2400 (Revised), *Engagements to Review Historical Financial Statements*. The determination of materiality involves the exercise of professional judgement and is impacted by both quantitative and qualitative factors. It is also affected by perceptions of the financial information needs of users.

600.10 A2 Where the Code expressly prohibits the provision of a non-assurance service to an audit client, a firm or a network firm is not permitted to provide that service, regardless of the materiality of the outcome or results of the non-assurance service on the financial statements on which the firm will express an opinion."

Paragraph 5.7

We believe the proposed additional wording to the above paragraph makes the provisions clearer.

Paragraphs 5.31 and 5.33

We agree with the proposed wording in the above paragraphs.

Paragraph 5.35

There is a proposal to make the changes (in red below) to paragraph 5.35. We are unsure of the proposed term "may be clearly insignificant" as highlighted in yellow - further clarity may be required in relation to this.

"5.35 Audit related services are those non-audit services specified in this Ethical Standard that are largely carried out by members of the audit engagement team, and where the work involved is closely related to the work performed in the audit and the threats to auditor independence **may be clearly insignificant**. **As a consequence, safeguards may not need to be applied** ~~are clearly insignificant and, as a consequence, safeguards need not be applied.~~ However, such services provided to public interest entities, other than those required by national legislation law or regulation, are still subject to the 70% cap (see paragraphs 4.13 and 4.14) and still require approval by the audit committee."

Paragraph 5.40

There is a proposal to include the words "either directly or indirectly" (in red below) in paragraph 5.40 as follows:

"5.40 An audit firm carrying out statutory audits of public interest entities and, where the audit firm belongs to a network, any member of such network, shall not provide **(either directly or indirectly)** to the audited entity, to its UK parent undertaking or to its worldwide controlled undertakings, services other than those set out in the rest of this paragraph, subject to the approval of the audit committee after it has properly assessed threats to independence and the safeguards applied in accordance with this Ethical Standard"

To provide clarification, we believe additional guidance could be provided in relation to what is meant by "indirect" provision in this context.

We also believe it would be helpful to include, or refer to, the FRC's Technical Advisory Group's guidance for audit committees in relation to this paragraph.

Paragraph 5.46 – Internal Audit Services

We agree with the inclusion of paragraph 5.46 to provide clarity of the Internal Audit Services definition.

Paragraphs 5.53 and 5.54 – Information Technology Services

We agree with the inclusion of paragraphs 5.53 and 5.54 in order to reflect IESBA's 'Technology-related revisions to the Code' which will become effective 15 December 2024, however we have concerns that the FRC's proposed provision is not as stringent as the IESBA provisions (as highlighted in yellow below), as the IESBA provision states that such services result in the assumption of a management responsibility (and are therefore prohibited) whilst the FRC provision states that such services create a threat to integrity, objectivity and independence.

The IESBA has added the following provision:

“606.3 A1 Examples of IT systems services that result in the assumption of a management responsibility include where a firm or a network firm:

- Stores data or manages (directly or indirectly) the hosting of data on behalf of the audit client. Such services include:
 - o Acting as the only access to a financial or non-financial information system of the audit client
 - o Taking custody of or storing the audit client's data or records such that the audit client's data or records are otherwise incomplete.
 - o Providing electronic security or back-up services, such as business continuity or a disaster recovery function, for the audit client's data or records.
- Operates, maintains, or monitors the audit client's IT systems, network or website.

606.3 A2 The collection, receipt, transmission and retention of data provided by an audit client in the course of an audit or to enable the provision of a permissible service to that client does not result in an assumption of management responsibility.”

However, the FRC's wording is as follows:

“5.53 Examples of services provided to an entity relevant to an engagement which create threats to the integrity, objectivity and independence of the firm and covered persons include:

- Storing or managing the hosting of data on behalf of an entity relevant to an engagement. Such services include:
 - o Acting as the only access to financial or non-financial information system of such an entity.
 - o Taking custody of or storing the entity's data or records such that the entity's data or records are otherwise incomplete
 - o Providing electronic security or back-up services, such as business continuity or disaster recovery functions, for the entity's data or records.
- Operating, maintaining, or monitoring such an entity's IT systems, network or website.

5.54 The collection, receipt, transmission and retention of data provided by an audited entity in the course of an audit or to enable the provision of a permissible service to that entity do not create the threats described in paragraph 5.53.”

Paragraph 5.67, 5.74, 5.80 – Tax Services

We agree with the inclusion of paragraph 5.74 as it is in line with the provisions in the IESBA Code.

We agree with the inclusion of paragraph 5.80 as it relates to FRC Technical Advisory Group guidance which will be helpful to users.

Paragraph 5.85 – Litigation Support Services

We note that proposed paragraph 5.85 amalgamates extant paragraph 5.81 (a) and (b). We can understand why the FRC has sought to do this however we feel some clarity has been lost in trying to amalgamate the 'listed entity' and 'any other entity' provisions within proposed

paragraph 5.85 (see highlighted parts of the proposed paragraph 5.85 below) and therefore we would prefer the paragraph to remain as it is within the extant Standard.

“5.85 The firm shall not provide litigation support services to **an entity relevant to an engagement, or a significant affiliate of a listed entity relevant to an engagement**, where this would involve the estimation by the firm of the likely outcome of a pending legal matter that could be material to the amounts to be included or the disclosures to be made in the **listed entity’s financial statements**, or in other subject matter information or subject matter of the engagement, either separately or in aggregate with other estimates and valuations provided.”

Extant paragraph 5.81

“5.81 The firm shall not provide litigation support services to:

(a) a listed entity relevant to an engagement, or a significant affiliate of such an entity, where this would involve the estimation by the firm of the likely outcome of a pending legal matter that could be material to the amounts to be included or the disclosures to be made in the listed entity’s financial statements, or in other subject matter information or subject matter of the engagement, either separately or in aggregate with other estimates and valuations provided; or

(b) any other entity relevant to an engagement, where this would involve the estimation by the firm of the likely outcome of a pending legal matter that could be material to the amounts to be included or the disclosures to be made in the entity’s financial statements, or in other subject matter information or subject matter of the engagement, either separately or in aggregate with other estimates and valuations provided.”

Paragraph 5.87 – Legal Services

We agree with the amendment to paragraph 5.87 as it is in line with the prohibition in the IESBA Code.

Paragraph 5.89 – Recruitment and Remuneration Services

We agree with the amendment to paragraph 5.89 as it is more in line with the provisions in the IESBA Code, although we do note that the IESBA Code also extends the provisions to network firms.

Paragraph 5.97 – Corporate Finance Services

We agree with the amendment to paragraph 5.97 as it is more in line with the provisions in the IESBA Code, although we do note that the IESBA Code also extends the provisions to network firms.

Non-audit services cap in relation to the provision of assurance on sustainability-related matters

We understand that discussions are taking place with regard to the provision of assurance on sustainability-related matters to PIEs being exempted from the 70% cap. In order to ensure a level playing field with other potential assurance providers, we believe that where such a service is provided by an entity’s financial statement auditor, the fee concerned should not form part of the non-audit services cap calculation.

7. Are there any implications for the work of Reporting Accountants or CASS assurance providers that should be considered alongside these revisions?

We are not aware of any implications.

Effective Date

- 8. Do you agree with the proposed effective date of the revised ES? Are additional transitional reliefs required?**

We agree with the proposed effective date being 15 December 2024 to align with the effective date of changes to the IESBA Code.



CA House, 21 Haymarket Yards, Edinburgh, UK, EH12 5BH

+44 (0) 131 347 0100

connect@icas.com

icas.com

 @ICASaccounting

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