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Exposure draft on the FRC Revised Ethical Standard 2019

The Audit Committee Institute
Part of the KPMG Board Leadership Centre

In July 2019, the Financial Reporting Council (FRC) released an exposure draft of the Revised Ethical Standard 2019 for public consultation. As well as redefining and restricting non-audit services to those closely related to the audit or required by law or regulation, it brings many AIM and other smaller companies into the scope of the non-audit services restrictions previously applicable only to EU Public Interest Entities (PIEs).

Non-audit services

The provision of non-audit services to EU PIEs has been heavily restricted by the FRC Ethical Standards since 2016. Whilst the current guidance includes a list of prohibited services, there is still a significant area of grey where audit firms are required to self police – to make their own determination of the impact on independence, and to gain the approval of the audit committee when looking to perform any non-audit services.

By contrast, the proposed Standard defines a list of allowable services – and any services not on the list are considered to be non-permissible for audit clients.

Allowable services fall into two types

- those which the auditor is obliged to perform due to law or regulation, such as regulatory and solvency reports;
- and those which could be provided by others (albeit there are typically significant efficiencies to be had when done in combination with the audit) such as interim reporting.

While only the latter are included in the 70% fee ratio cap, all services continue to be subject to the requirement to consult internally on the threats to independence where the fees for non-audit / additional services are expected to exceed the audit fee in any one year.

All allowable services continue to require assessment for their impact on independence prior to accepting the work.

New entities in scope

As well as defining the list of permissible non-audit services, the new proposed Standard brings additional entities into scope. In addition to EU PIE entities, the FRC have proposed that a new group of companies be included in scope – 'other entities of public interest'.

These 'other entities of public interest' are defined as those that fall within the FRC's Audit Quality Review remit. This currently includes AIM and NEX listed companies with a three year average market cap above €200 million, as well as Lloyd's syndicates and Non-EEA entities with transferable securities traded on an EEA regulated market, but is regularly redefined by the FRC.

It is proposed that these companies be subject to the same restrictions on permissible non-audit services as EU PIEs, although they do not appear to be captured by the 70% ratio cap.

Whilst the clarity regarding non-audit services will make it easier for audit firms to deal with which services they can and cannot perform, in practice it is unlikely to lead to significant differences since most audit firms are already quite robust around what should not be permitted.

However the increase in scope could lead to some significant change in the way in which 'other entities of public interest' interact with their auditor.

The proposed Standard includes no transition period and is expected to take effect for periods commencing on or after 15 December 2019.

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