



# Are you and your auditor prepared for the revised ethical standard?

**The Audit Committee Institute**  
Part of the KPMG Board Leadership Centre



The Financial Reporting Council (FRC) has issued a major revision to its Ethical Standard, the [Revised Ethical Standard 2019](#). The changes aim to help strengthen auditor independence, prevent conflicts of interest and ensure stronger investor protection resulting from high quality audit.

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 large private companies into the scope of the non-audit services restrictions previously applicable only to Public Interest Entities (PIEs).

## Non-audit services

The provision of non-audit services to PIEs has been heavily restricted by the FRC Ethical Standards since 2016.

Whilst the previous guidance included a list of prohibited services, there was always a significant area of grey where audit firms were 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 new standard defines a list of allowable services – and any services not on the list are considered to be non-permissible for audited entities.

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 are closely related to the audit but could be provided by others, such as interim reporting.

While only the latter are subject to the 70% fee cap, all services continue to be subject to the requirement for the audit firm 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 and pre-approval from the audit committee prior to accepting the work.

**“** High quality audit supports the effective functioning of capital markets and gives investors confidence. Where audit fails, that confidence is undermined.”

Sir Jon Thompson, Chief Executive of the FRC

## New entities in scope

As well as defining the list of permissible non-audit services, the new standard brings additional entities into scope of these additional non-audit service restrictions.

In addition to PIEs, the FRC has identified a new group of companies to be included in scope – the ‘other entities of public interest’ (OEPI). That is: ‘an entity which does not meet the definition of a Public Interest Entity, but nevertheless is of significant public interest to stakeholders’.

This includes:

- Large AIM listed entities;
- Lloyd’s syndicates;
- Large private sector pension schemes; and
- Large private companies, i.e. those subject to the governance requirements of The Companies (Miscellaneous Reporting) Regulations 2018.

These OEPI companies will be subject to the same restrictions on permissible non-audit services as PIEs, although they are not subject to the 70% ratio cap nor mandatory audit firm rotation rules, among others.

## Cooling in period

The revised standard extends the services subject to “cooling in” restrictions for PIEs to include internal audit services. This will prohibit a new external auditor from providing internal audit services in the twelve months prior to the start of the first period for which they are external auditor.

It remains to be confirmed by the FRC if “cooling in” restrictions will be applied to OEPI.

## Timing

The revised standard is effective (with the exception of OEPI) on 15 March 2020.

Transitional arrangements are as follows:

- audit engagements commenced prior to 15 March 2020 may be completed on the basis of the existing ethical standard; and
- engagements to provide previously permitted non-audit services, entered into before 15 March 2020, and for which work has already commenced may continue until completed.

The restriction on allowable non-audit services to OEPI is effective for accounting periods commencing on or after 15 December 2020. The Revised Ethical Standard does not currently provide any specific transitional arrangements for OEPI.

## Summary

The clarity regarding permissible non-audit services will potentially make it easier for Audit Committees to understand which services they may approve their audit firm to provide.

However the increase in scope of entity caught by the non-audit services restrictions could lead to some significant changes in the way in which OEPI interact with their auditor.



Visit the Financial Reporting Council's (FRC) website to read the full new [Revised Ethical Standard 2019](#)

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