



Governance *in brief*

New IESBA Code – what audit committees need to know

Headlines

- Changes to the International Ethics Standards Board for Accountants (IESBA) Ethics and Independence Code (the IESBA Code) took effect for periods commencing on or after 15 December 2022.
- The changes will impact all public interest entities as defined under the IESBA Code – this currently includes all listed entities, including entities quoted on the AIM market and on overseas markets (IESBA PIEs). It also includes banks, building societies and Solvency II insurers as they are defined as PIEs by UK legislation.
- Key areas to be aware of in the updated IESBA Code include:
 - An important new requirement for the audit committee to concur with their auditor’s conclusion regarding the provision of any non-audit service with an eye to independence, including in respect of subsidiaries and parent companies.
 - Some additional non-audit services restrictions for those IESBA PIEs that do not currently follow the FRC’s list of permitted and prohibited services.
 - Requirements for disclosure regarding non-audit services – this will affect IESBA PIEs that are not captured by existing disclosure requirements, mainly overseas entities listed in the UK, listed universities and small or medium-sized entities listed elsewhere than the LSE.
- Audit committees are encouraged to take prompt action to communicate within their group structure to ensure processes in the group reflect the need for the audit committee’s concurrence with provision of non-audit services by their auditor to other entities within the group. This will be a particular challenge for audit committees of IESBA PIEs that are not at the top of their ownership chain.
- For many groups that are headed by an existing UK public interest entity and have a less complex group structure, no action will be necessary.

The updated IESBA Code

Changes to the [IESBA Code](#) take effect for periods commencing on or after 15 December 2022. Although they do not apply directly to companies, the largest audit firms globally have all committed to follow the IESBA Code and many local regulators, including the UK's Financial Reporting Council (FRC), take account of the IESBA Code when setting local ethical standards for auditors. As such, changes to the IESBA Code can impact those charged with governance of almost all large entities that are required to have an independent auditor, since any breach of that Code compromises the auditor's independence.

The IESBA Code introduces a category of public interest entity to the UK landscape that includes all listed entities, including entities with a listing on markets that are not generally considered regulated markets. In the UK context, this includes therefore entities that are quoted on the AIM market and on overseas markets. It also includes entities that are not companies but are listed (for example, universities), and in line with the existing UK requirements for determining what is a public interest entity, it includes unlisted banks, building societies and Solvency II insurers. We have used the shorthand IESBA PIEs in this publication to cover all these categories.

The audit committee should be aware of the following key areas of change in the updated IESBA Code:

- An important new requirement for the audit committee to concur with their auditor's conclusion regarding the provision of any non-audit service with an eye to independence, including in respect of subsidiaries and parent companies.
- Some additional non-audit services restrictions for those IESBA PIEs that do not currently follow the FRC's list of permitted and prohibited services.
- Requirements for disclosure regarding non-audit services – this will affect IESBA PIEs that are not captured by existing disclosure requirements, mainly overseas entities listed in the UK, listed universities and small or medium-sized entities listed elsewhere than the LSE.

Throughout this publication, where the term "audit committee" is used and an entity has no audit committee, equivalent responsibility rests with those charged with governance, generally the board.

Where the term "auditor" or "external auditor" is used, this means not only the auditor, but also members of its network and non-network firms used in the audit of the IESBA PIE. The audit committee will be able to request the relevant details from their auditor if needed.

Concurrence for non-audit services

Individual IESBA PIEs

The FRC's Ethical Standard 2019 (the Ethical Standard) requires audit committees or those charged with governance to evaluate and approve the provision of non-audit services by the external auditor, in addition to the auditor having to develop their own assessment and determine whether the services are permissible. The IESBA Code has a similar but not identical requirement for the audit committee or those charged with governance to concur with the auditor's determination that the service is permissible.

In practice, most entities that are existing PIEs under the Ethical Standard (FRC PIEs) will have suitable processes in place, however it is worth considering whether the audit committee wishes to adapt the process or any forms in place to better meet the IESBA terminology. Audit committees may also wish to consider the wording in non-audit services policies for periods commencing on or after 15 December 2022 (also see Additional non-audit services restrictions).

Groups

There are particular complexities under the IESBA Code in respect of groups. This results from the goal of ensuring that audit committees of IESBA PIEs have sufficient information about non-audit services provided by their auditor to other group entities to judge independence.

The IESBA Code requires concurrence from the audit committee of an IESBA PIE in respect of non-audit services planned to be carried out by the auditor of the IESBA PIE and provided to:

- The IESBA PIE itself
- Any undertaking controlled by the IESBA PIE (directly or indirectly) – for instance subsidiary undertakings
- Any undertaking that controls the IESBA PIE (directly or indirectly) – for instance an immediate parent undertaking, all the way up to the ultimate parent undertaking of the group

Most groups are already set up with suitable processes – perhaps with minor tweaks – to address the need for concurrence in respect of the IESBA PIE and its controlled undertakings.

However, many parent undertakings may not have considered the need to share information throughout their group structure or to gain concurrence from audit committees of subsidiaries.

This will be particularly complex in situations where an IESBA PIE lower down in a group structure is audited by an audit firm that is not the auditor of its parent company or of the rest of the group.

Where there is more than one IESBA PIE in a group structure, each IESBA PIE will need to provide this concurrence in respect of the entities in its ownership chain (as set out above), although it is possible under the IESBA Code to put an agreement in place that allows concurrence at a different level (for instance, an IESBA PIE agreeing that its parent company audit committee can provide concurrence on behalf of both audit committees). This can be much more complex in circumstances where there are joint audits within the group, or where there are recently acquired entities.

What do audit committees need to do now?

At a high level, processes within a group need to reflect the requirement for approval/concurrence for non-audit services not just flowing down the ownership chain but up the chain as well. This will involve understanding the group structure and using, or in some cases establishing, good communication links throughout the group.

Since it is permissible under the IESBA Code for IESBA PIEs to establish a policy that gives pre-approval to non-audit services,¹ a pragmatic approach is likely to be for audit committees to evaluate proactively the nature of services that may be provided to parent and other controlling undertakings and determine what they consider requires individual concurrence. This will vary according to the nature of group relationships. It is worth bearing in mind that there is currently no requirement under the Ethical Standard for the audit committee to approve services provided by their external auditor to entities upstream in the ownership chain, so the requirement relates solely to concurrence under the IESBA Code.

In considering the nature of services that the audit committee will pre-approve under the policy, areas to consider in terms of whether there is a risk to the auditor's independence could include:

- How integrated are the IESBA PIE's systems and personnel with those elsewhere in the group – for example, could an IT implementation project, tax advice, or an internal audit service provided by the IESBA PIE's external auditor at group level affect the audit of the individual IESBA PIE further down the group.
- Are there services that by their nature the audit committee is not comfortable with their auditor providing to a controlling undertaking – for example, decision-making about the future ownership of the individual IESBA PIE.
- Are there other industry-specific, restructuring or personnel services that the audit committee considers could affect the independence of their external auditor.
- Could the service impact anything that has the potential to be subject to audit procedures

¹ This is set out in IESBA Code 600.20 A2 from the auditor's perspective, covering the provision of information about services (including the risk of sensitive or confidential information), the entities to which the process might apply, any services that as a general policy do not require specific approval, establish how those charged with governance have determined where authority is allocated, and determine how to resolve any issues not covered by the process.

In the UK, for FRC PIEs and other entities of public interest, the external auditor must follow the Ethical Standard's list of permitted and prohibited services in respect of the UK parent undertaking, but there is no equivalent restriction for overseas parent undertakings or other controlling undertakings. Audit committees may wish to bear in mind other existing restrictions in the relevant jurisdictions.

Audit committees will need to act to ensure that other group companies are able to go about their business without unnecessary red tape and to ensure that the audit committee is not itself unduly affected by the need to evaluate and concur with multiple small projects that they do not consider will affect the independence of their auditor.²

A ten-step approach to put the processes in place could look like:

1. Review existing governance and approval/concurrence arrangements
2. Refresh understanding of group structure to determine which other group entities are affected and where responsibility sits for concurrence (for instance, have any IESBA PIEs within the group agreed that another audit committee can concur on their behalf)
3. Refresh understanding of communication processes within the group
4. Consider at audit committee level the nature of services that the audit committee is comfortable to pre-approve and those that the audit committee wishes to evaluate on a case-by-case basis
5. Discuss this conclusion with the external auditor to ensure they have a consistent understanding of how the audit committee wishes to proceed
6. If necessary, discuss this conclusion with other audit committees and company secretaries within the group
7. Document concurrence policy explaining permitted services, those that require case-by-case evaluation and the information that the audit committee needs to assess those, including any process where information may be sensitive or confidential, and those that may require active oversight by the audit committee
8. Share concurrence policy with affected fellow group entities and the external auditor
9. Set up regular review process to ensure the approach is working effectively and to determine how to resolve any issues not covered by the process
10. Revisit concurrence policy side-by-side with own non-audit services policy on an annual basis

Where an audit committee is confident that "upstream" services will not affect the independence of their external auditor, for instance because their arrangements are sufficiently stand-alone, this might be covered by a simple letter to the auditor and to other group audit committees and an equivalent addition to the non-audit services policy, along the following lines:

"The audit committee of [XYZ plc] has evaluated the nature of non-audit services that may be provided to upstream group entities that control us, directly or indirectly, by our external auditor [Firm A]. [Here a list of such entities may be provided if desired.] As our systems and personnel are not linked to the rest of the group, we do not consider there to be circumstances in which [Firm A] providing such services will jeopardise their independence as our external auditor. Therefore we pre-approve our concurrence with any such services."

If the parent undertaking is in the UK, the following sentence can be added:

"In respect of [ABC plc], our immediate UK parent undertaking, our concurrence is predicated on the requirement that any such non-audit services are permitted (and are not prohibited) under the FRC's Ethical Standard 2019."

² The IESBA Code does not change the requirements or methodology for calculating the 70% cap on non-audit services, for those entities to which this Ethical Standard requirement applies.

Case study 1: Overseas headquartered private equity group with UK IESBA PIE holding

XYZ Inc owns a portfolio of private equity holdings, including ABC plc in the UK. ABC plc is an IESBA PIE that has recently become a controlled undertaking of XYZ Inc via an ownership chain of four overseas entities. As a recent acquisition, ABC plc has its own personnel, IT and finance systems. ABC is audited by Firm A. The rest of XYZ Inc's private equity group is audited by Firm B.

ABC plc's audit committee determines that there are no services that Firm A could provide to the upstream controlling undertakings that would jeopardise Firm A's independence as external auditor and notifies Firm A and the upstream controlling undertakings of its conclusion.

Case study 2: Overseas headquartered listed group with UK IESBA PIE holding

XYZ Group has a fully owned subsidiary, ABC plc, which has listed debt on the LSE. ABC plc is audited by Firm A. XYZ Group and the intermediate overseas holding companies are audited by Firm B. ABC plc uses XYZ Group's financial accounting systems and personnel, in addition to various services provided via the Group's centralised teams.

ABC plc's audit committee determines that it needs to be aware of and to evaluate and concur actively with any services provided by Firm A in respect of XYZ Group's IT systems, recruitment services, internal audit or internal controls processes and notifies Firm A and XYZ Group of its conclusion.

The audit committee also notes that it concurs with the provision of any other services by Firm A to upstream controlling entities in XYZ Group without needing to be further consulted on those other services.

In respect of new acquisitions audit committees may also wish to consider adding a clause to their policy that addresses M&A requirements and pre-approval of permissible services to controlled entities to apply when the transaction closes – this could either be forward-looking or apply only to services that have already commenced or been contracted for prior to the transaction closing.

Additional non-audit services restrictions

In almost all cases the existing UK Ethical Standard list of permitted and prohibited services cover and go beyond the IESBA Code requirements. However, there are a few changes that should be taken into account for different types of entity:

- For existing FRC PIEs there will be minimal change, however the evaluation of the self-review threat to the external auditor should be undertaken for each service as well as on an overall basis.
- For other IESBA PIEs, audit committees reviewing non-audit services policies should consider incorporating the restrictions on bookkeeping services as well as the prohibition of services that create a self-review threat.

In respect of pre-approvals of non-audit services, audit committees may wish to incorporate the following IESBA Code-related language into non-audit services policies:

"The auditor may provide non-audit services classified as "other non-audit services", if the services are not prohibited by regulations, will not create a self-review threat, and do not create other threats to the independence of the auditor or, if any such threats are created, they would be at an acceptable level before provision of a non-audit service by the external auditor is agreed."

Requirements for disclosure regarding audit and non-audit fees

The majority of IESBA PIEs are entities that already report audit and non-audit fees under the UK Companies Act 2006 and equivalent regulations. These entities will be able to take advantage of a deemed exemption under IESBA Code R410.30 which does not require further disclosure if there are adequate existing laws and regulations applying regarding and non-audit services and fees.^{3,4}

For entities that are **not** already required to report audit and non-audit fees, the auditor is required to discuss appropriate disclosure with those charged with governance. Disclosure should include fees for the audit of the IESBA PIE; fees for non-audit services charged to the IESBA PIE and its consolidated controlled undertakings; any other fees charged to the IESBA PIE and its controlled undertakings; along with disclosures on fee dependency as discussed above. If the entity does not include the disclosure, the audit firm is required to publicly disclose it instead.

A practical expedient will be for audit committees of these entities to elect to follow the rules applicable to UK large companies.⁵

Deloitte view

- Audit committees will need to take action to minimise the disruption of these new rules that apply to their external auditor, whilst taking advantage where appropriate of the regulatory climate that newly permits them to evaluate non-audit services provided by their auditor to entities in the ownership chain.
- We encourage the FRC to incorporate practical guidance and examples in the update to their Ethical Standard, expected to be issued for consultation during 2023, and to put thought to how this could affect managed shared audit in due course.

For further information

- [2022 IESBA Handbook](#)
- [FRC Revised Ethical Standard 2019](#)

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³The UK requirements via the Companies Act and equivalent regulations apply to all existing FRC PIEs and almost all other listed entities, with the exception of listed universities, overseas listed entities, and companies or LLPs that qualify as small or medium sized and are on a market other than the LSE.

⁴In addition to these existing requirements, under the IESBA Code there is a need to report on fee dependency if the total fees received by the audit firm from the IESBA PIE exceed 15% of the total fees received by the audit firm for two consecutive years.

⁵An alternative scenario could be where there are other applicable rules, for example a small UK company listed on an overseas exchange and applying the rules of that overseas exchange.



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