



Financial Reporting Council

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25 June 2025

**Consultation Paper: Collective Investment Vehicles and Pension Funds – Auditor Independence**

Dear Ken,

The Financial Reporting Council (FRC) welcomes the opportunity to comment on the International Ethics Standards Board for Accountants (IESBA) request for input on the independence considerations with respect to audits of Collective Investment Vehicles (CIVs) and Pension Funds. The FRC has a strong interest in ensuring that the IESBA Code continues to underpin the global integrity of the accountancy and audit professions. Although the FRC does not mandate the International Independence Standards (IIS) for UK auditors, its Ethical Standard is designed to be at least as rigorous, ensuring alignment with the IESBA Code's fundamental principles. Additionally, professional accounting bodies in the UK adopt the Code as the basis of their codes of professional ethics.

Accordingly, the FRC strongly supports the IESBA's strategic vision to ensure that its ethical standards remain a cornerstone of ethical conduct for the accounting profession and beyond.

Due to the often complex and unique structures of CIVs and pension funds, it is essential that the Code's provisions — particularly those addressing related entities and Connected Parties — can be applied consistently and with appropriate professional judgement across different contexts.

We believe there is value in re-examining the conceptual framework for auditor independence as it applies to CIVs and pension funds. This review should consider whether the existing definitions and criteria remain appropriate and sufficient, and/or whether further illustrative non-authoritative guidance may support more consistent application in practice.

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Our responses reflect a commitment to promoting robust, independent audit and assurance practices that serve the public interest effectively. Where we have not commented on certain specific matters, this should not be interpreted as either approval or disapproval by the FRC.

Our specific responses to the questions set out in the consultation are included as an annex to this letter. If you have any questions relating to this response, please contact myself or Sonya Patel ([S.Patel@frc.org.uk](mailto:S.Patel@frc.org.uk)).

Yours sincerely



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## **Annex: Responses to the questions set out in the consultation document**

### *1. Does the Code's definition of related entity capture all relevant parties that need to be included in the auditor's independence assessment when auditing CIVs/pension funds?*

We consider that the current definition of "related entity" within the Code is, in general, sufficiently broadly framed and generally effective in identifying, based on financial interest relationships, the key parties that should be included in an auditor's independence assessment when auditing collective investment vehicles (CIVs) and pension funds. The definition appropriately captures entities that have control or significant influence over the audited entity, as well as those that are controlled or significantly influenced by it.

Importantly, the Code's principles-based framework also recognises that independence considerations may extend beyond financial interest relationships. It requires auditors to consider other relationships or circumstances involving entities where the auditor is aware, or has reason to believe, that such factors are relevant to the independence assessment. This principles-based approach is particularly valuable in the context of CIVs and pension funds, which often involve complex and multi-layered external relationships, and which continue to develop and change over time. It is important that the Code also remains sufficiently principles-based and flexible, to be able to address ethical and independence issues arising from new structures. In the UK for instance, the government has announced legislation which is likely to result in a significant expansion of collective defined contribution schemes.

However, we note that the current definition may not fully encompass all relevant relationships. In particular, it may not adequately address situations involving Connected Parties who exert control or significant influence through contractual arrangements or by performing key management functions, without holding a direct financial interest. These types of relationships can still give rise to significant threats to auditor independence and, in our view, merit further consideration by the IESBA.

### *2. Do you believe the criteria set out above are appropriate and sufficient to capture Connected Parties that should be considered in relation to the assessment of auditor independence with respect to the audit of a CIV/pension fund?*

We consider that the proposed criteria are, in principle, appropriate and directionally helpful in identifying Connected Parties that should be considered in the auditor's independence assessment in relation to the audit of a collective investment vehicle (CIV) or pension fund. The criteria appropriately reflect the potential for such parties to influence the governance, operations, and financial reporting of these entities—factors that are central to a robust independence evaluation.

The inclusion of entities involved in decision-making, those capable of materially affecting the financial performance of the CIV or pension fund, and those with influence over the preparation of financial statements is particularly relevant to protect the public interest. These criteria help

distinguish parties with substantive roles in shaping the investment scheme's policies and operations from those providing standardised or administrative services, who may not pose the same level of independence risk.

However, we note that the application of broad principles across jurisdictions may present practical challenges, and it may not be possible to refine criteria enough to promote consistent application, given the significant diversity in CIV structures globally. The use of qualitative descriptors such as "substantially" and "significantly" introduces a degree of subjectivity that may lead to inconsistent interpretation and application, particularly in the absence of clear guidance or benchmarks. For instance, what constitutes a "substantial" impact on financial performance, or how "significant" influence over financial reporting is measured in the absence of a financial interest, may differ considerably in practice.

While we understand the rationale for the introduction of the new concept of Connected Parties, we are mindful that this may introduce additional and unnecessary complexity to the Code. There appears to be a degree of conceptual overlap between the proposed definition of Connected Parties and the existing definition of related entities. Introducing a new term may lead to inconsistent application, especially across jurisdictions. Rather than introducing a new term, we believe that the intended objectives could be more effectively achieved through targeted enhancements to the current definition of "related entity," supported by additional guidance and illustrative examples to aid consistent application across jurisdictions.

3. *Where there are such Connected Parties, do you believe that the application of the conceptual framework in Section 120 of the Code is sufficiently clear as to how to identify, evaluate and address threats to independence resulting from interests, relationships, or circumstances between the auditor of the CIV/pension fund and the Connected Parties? If not, do you believe the application of the conceptual framework in the Code as applicable to Connected Parties associated with Investment Schemes warrants additional clarification?*

We consider that the conceptual framework set out in Section 120 of the Code provides a sound and principles-based foundation for identifying, evaluating, and addressing threats to auditor independence, including those arising from relationships with Connected Parties in the context of audits of collective investment vehicles (CIVs) and pension funds.

The conceptual framework's emphasis on the application of an inquiring mind, the exercise of professional judgement and the use of the reasonable and informed third party test offers valuable guidance for navigating complex independence considerations. These elements are particularly relevant in the CIV and pension fund environment, where external parties often perform functions that, in a traditional corporate context, would typically be undertaken internally.

Nonetheless, we recognise that the structural complexity of CIVs and pension funds can make it challenging to consistently identify all relevant Connected Parties and to assess the associated threats to independence. This complexity may lead to variability in how different auditors or

firms apply the conceptual framework, potentially resulting in inconsistent conclusions, which is why we believe there may be merit in further provisions.

While we acknowledge that Section 120 of the Code is designed to be globally applicable, we also recognise that certain jurisdictions may face specific issues not fully addressed by the current framework. In such cases, we believe that the relevant national standard setters are best placed to provide supplementary guidance or requirements, provided these remain aligned with the overarching principles of the Code, rather than IESBA. Many jurisdictions have already developed and implemented independence rules tailored to their local regulatory and legal environments, particularly in relation to Connected Parties. These jurisdiction-specific adaptations should be carefully designed to ensure they remain aligned with the fundamental principles of the Code, thereby supporting overall harmonisation.

*4. Do you believe that the conceptual framework in Section 120 of the Code is consistently applied in practice with respect to the assessment of auditor independence in relation to Connected Parties when auditing a CIV/pension fund?*

As the UK does not adopt the IESBA Code but instead applies the FRC's Ethical Standard, we are not in a position to comment on the consistency of application of Section 120 of the Code in practice. However, we are aware that the application of principles-based frameworks—such as that in Section 120—can lead to inconsistency in practice, particularly in complex audit environments such as those involving collective investment vehicles (CIVs) and pension funds. The reliance on professional judgement, while essential, may result in differing interpretations and conclusions, especially where auditors have varying levels of experience or where the structures involved are particularly intricate.

In our experience, the complexity of identifying relevant Connected Parties in the context of CIVs and pension funds can present challenges that may not be fully addressed by a high-level conceptual framework alone. This reinforces the importance of providing additional non-authoritative guidance, illustrative examples, or jurisdiction-specific considerations to support consistent and effective application. This is something that IESBA could draw on support from its Jurisdictional Standard Setters group.

We would encourage IESBA to consider how further clarification or practical support could enhance the usability of the framework in this context, while recognising that national standard setters may also need to tailor their approaches to reflect local regulatory and market conditions.

*5. Are there certain interests, relationships, or circumstances between the auditor of a CIV/pension fund and its Connected Parties that should be addressed?*

Yes, we believe there are certain interests, relationships, and circumstances between the auditor of a CIV or pension fund and its Connected Parties that may give rise to threats to independence and would benefit from being explicitly addressed within the Code.

In particular, any direct or indirect financial interest in the CIV or pension fund held by the audit firm, each covered person<sup>1</sup>, and any persons closely associated with any such person, or the firm represents a clear self-interest threat. Similarly, fee dependency on the CIV or its Connected Parties may compromise objectivity and should be considered a self-interest threat.

The provision of non-audit services to Connected Parties may also give rise to self-review or advocacy threats, particularly where those services relate to financial reporting or decision-making functions. In addition, long-standing relationships with Connected Parties—especially where those parties are also audit clients of the firm—may create familiarity threats that could impair independence in both fact and appearance.

We acknowledge that some Connected Parties may not fall within the current definition of a “related entity” under the Code, yet may still pose significant threats to independence. The principles-based nature of the Code is intended to allow for such circumstances to be evaluated under the conceptual framework in Section 120. However, we are mindful that consistent application of this framework may be challenging in practice.

To support more consistent and effective application, we would encourage IESBA to consider supplementing the Code with illustrative examples that reflect common scenarios involving Connected Parties in the context of CIVs and pension funds. Such examples would help clarify expectations and promote greater consistency in the identification and evaluation of independence threats.

*6. Does your jurisdiction have requirements or guidance specific to audits of CIVs/pension funds from an auditor independence perspective? If yes, are those requirements included in audit-specific or CIV-specific regulation?*

In the UK, auditor independence requirements for pension funds and collective investment vehicles (CIVs) are governed by the FRC’s Ethical Standard 2024, which constitutes audit-specific regulation rather than sector-specific legislation.

The FRC classifies certain large pension schemes as Other Entities of Public Interest (OEPIs)<sup>2</sup>. A pension scheme qualifies as an OEPI if it has both more than 10,000 members, and more than £1billion of assets (by reference to the most recent set of audited financial statements).

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<sup>1</sup> The FRC’s Glossary of Terms defines a covered person as a person in a position to influence the conduct or outcome of the engagement.

<sup>2</sup> The FRC’s Glossary of Terms defines ‘other entity of public interest’ as an entity which does not meet the definition of a Public Interest Entity but nevertheless is of significant public interest to stakeholders.

Auditors of such pension schemes are subject to enhanced independence requirements<sup>3</sup>, that mirror those for Public Interest Entities (PIEs), without mandatory firm rotation or the 70% non-audit services fee cap.

While CIVs are not automatically classified as OEPIs, the Ethical Standard 2024 provides specific guidance on managing financial interest threats in the context of diversified collective investment schemes. Notably, the Ethical Standard 2024 makes specific provision<sup>4</sup> to allow the audit firm, each covered person, and any persons closely associated with any such person or the firm to hold an immaterial indirect financial interest through a diversified collective investment scheme for any entity relevant to an engagement for which they (or the person they are closely associated to, where applicable) are:

- (i) a covered person; or
- (ii) an entity which is an affiliate of such an entity; or
- (iii) any other entity otherwise related to such an entity in circumstances where holding such a financial interest may cause or may be perceived by an objective, reasonable and informed third party as causing, a self-interest threat.

There is also further specific provision<sup>5</sup> in the FRC's Ethical Standard 2024 that allows the audit firm, each covered person, and any persons closely associated with any such person or the firm to hold an indirect material financial interest held through a diversified collective investment scheme, in any entity relevant to an engagement in the area of activity in which they (or in the case of a person closely associated, the area of activity in which the covered person with whom they are closely associated) are involved relating to engagements.

These provisions are designed to mitigate self-interest threats by ensuring that such holdings are diversified and indirect, and therefore unlikely to impair independence in the view of an objective, reasonable, and informed third party.

This approach aligns with IESBA's conceptual framework for independence, particularly in addressing financial interest threats through the application of safeguards and materiality thresholds.

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<sup>3</sup> FRC Revised Ethical Standard 2024, paragraph 5.43

<sup>4</sup> FRC Revised Ethical Standard 2024, paragraph 2.4 (a)

<sup>5</sup> FRC Revised Ethical Standard 2024, paragraph 2.4 (b)