

December 2018

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# Proposal to revise Practice Note 19

## The Audit of Banks and Building Societies in the United Kingdom

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# CONSULTATION PAPER AND IMPACT ASSESSMENT

## Proposal to revise Practice Note 19: The Audit of Banks and Building Societies in the United Kingdom

### Objective

The Financial Reporting Council (FRC) proposes, subject to consultation, to issue a revised version of Practice Note 19: *The Audit of Banks and Building Societies in the United Kingdom* (PN 19). Practice Notes are intended to assist practitioners to comply with the requirements of standards, by providing additional contextual material on the application of standards in particular circumstances or in specialised sectors.

PN 19 was last updated in 2011 and needs to reflect revisions to UK auditing standards (ISAs (UK)), in particular: ISA (UK) 540 (Revised December 2018); changes in legislation and regulation; and the establishment of the Prudential Regulatory Authority (PRA) and Financial Conduct Authority (FCA) in place of the Financial Services Authority (FSA).

A Practice Note provides guidance to support best practice. Although a Practice Note is not prescriptive, the FRC's Statement on the Scope and Authority of Audit and Assurance Pronouncements states that auditors should be aware of and consider Practice Notes applicable to an engagement. Auditors who do not consider and apply the guidance included in a relevant Practice Note should be prepared to explain how the engagement standards have been complied with. The FRC has completed an impact assessment for the proposed revised PN 19 and has not identified any additional costs or separately identifiable quantifiable benefits resulting from the revised guidance included in the exposure draft.

### Invitation to comment

The FRC is requesting comments on this Consultation Paper by 5pm on Friday, 8 March 2019. Comments are invited in writing on all aspects of the Consultation Paper. In particular, comments are sought in relation to questions 1-4 as discussed below.

Comment on the Consultation Paper should be sent to:

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## Introduction

1. The FRC is committed to acting as a proportionate and principles-based regulator and balances the need to minimise the impact of regulatory requirements on business, while working to support the delivery of high-quality audit and assurance work, to maintain investor and wider stakeholder confidence in audit.
2. In mid-2018, the FRC commenced a project to consider revisions to Practice Note 19: *The Audit of Banks and Building Societies in the United Kingdom* (PN 19), which was last updated in 2011. The main drivers for revising PN 19 are:
  - revisions to UK auditing standards (ISAs (UK)), in particular ISA (UK) 540 (Revised December 2018), *Auditing Accounting Estimates and Related Disclosures*, which is effective for audits of financial statements for periods beginning on or after 15 December 2019 (early adoption is permitted);
  - changes in relevant legislation and regulation; and
  - the establishment of the of the Prudential Regulatory Authority (PRA) and Financial Conduct Authority (FCA) in place of the Financial Services Authority (FSA).

## How we revised the material

3. We established an expert working group to support the project to revise PN 19, including representation from audit firms with bank audit expertise, the banking industry, and the banking regulators. The guiding principles followed in reviewing and updating the guidance included:
  - updating the guidance to address the drivers for revision identified above;
  - taking out material that is a repeat of what is in the relevant ISA (UK) itself;
  - taking out material that an auditor would be able to find elsewhere, for example in accounting standards (in most cases replacing with a cross reference).

## Main areas of change

4. The main areas of change we are proposing to PN 19 are:
  - Legislative and Regulatory Framework: updated. In addition, References throughout the PN to the FSA Handbook have been updated for the PRA Rulebook and FCA Handbook where appropriate;

At the time of writing, there are EU Regulations, including binding technical standards, that apply to directly to UK firms and which are not, currently, duplicated in UK law or the rules of the PRA and FCA. References continue to be made to these in the proposed revised PN. It is expected that when the UK ceases to be a member of the EU, equivalent requirements will have been established in UK laws and regulations and the references will be updated accordingly for the final revised PN.
  - ISA (UK) 200: this section has been deleted after transferring the small amount of guidance specific to banks and building societies to the section on the legal and regulatory framework where it was more appropriately located;

- ISA (UK) 210: content has been reduced to eliminate duplication with guidance in other sections;
- ISA (UK) 220: this section has been deleted as it did not provide additional guidance specific to banks and building societies. A high level of audit quality is important for all audits;
- ISA (UK) 240: content has been reduced to eliminate some material that was duplicative of the ISAs (UK);
- ISA (UK) 250 Section A: content has been rewritten to reflect changes in the legislative and regulatory environment. Material that was duplicative of the ISAs (UK) has been deleted;
- ISA (UK) 250 Section B: edited to reflect the establishment of the PRA and FCA in place of the FSA;
- ISA (UK) 300: edited primarily to reflect the establishment of the PRA and FCA in place of the FSA;
- ISA (UK) 315: material that duplicated the ISAs (UK) has been deleted. Examples of matters the auditor may obtain an understanding of and risks of material misstatement have been updated;
- ISA (UK) 320: material that was duplicative of the ISAs (UK) has been deleted;
- ISA (UK) 330: material that was duplicative of the ISAs (UK) has been deleted. The guidance in relation to disclosures has been updated having regard to changes in accounting standards;
- ISA (UK) 402: material that was duplicative of the ISAs (UK) has been deleted. It is identified that 'external information sources' which are not service organisations are considered in ISAs (UK) 500 and 540;
- ISA (UK) 505: material that was duplicative of the ISAs (UK) has been deleted;
- ISA (UK) 520: material that was duplicative of the ISAs (UK) has been deleted
- ISA (UK) 540: this section has been rewritten to take account of the revision of ISA (UK) 540 which is effective for audits of financial statements for periods beginning on or after 15 December 2019. New guidance has been added, including to help apply the standard to the audit of expected credit losses (ECL), hedge accounting and effective interest rate accounting which are of particular relevance in banks and building societies;
- ISA (UK) 550: material that was duplicative of the ISAs (UK) has been deleted. Some other edits have been made to reflect changes in law and regulation (e.g. in relation to ring fencing);
- ISA (UK) 560: material that was duplicative of the ISAs (UK) has been deleted;
- ISA (UK) 570: material that was duplicative of the ISAs (UK) has been deleted. The examples of matters to consider in relation to banks and building societies has been updated (e.g. to include a reference to the FRC's Guidance for Directors of Banks on Solvency and Liquidity Risk Management and the Going Concern Basis of Accounting – September 2014);
- ISA (UK) 580: material that was duplicative of the ISAs (UK) has been deleted;

- ISA (UK) 600: material that was duplicative of the ISAs (UK) has been deleted. The possible use by the entity of 'structured entities' as well as special purpose vehicles, and shared services centres is recognised;
- ISA (UK) 620: the examples of areas where the auditor may involve an expert has been updated;
- ISA (UK) 700: material that was duplicative of the ISAs (UK) has been deleted;
- ISA (UK) 705: material that was duplicative of the ISAs (UK) has been deleted;
- ISA (UK) 706: material that was duplicative of the ISAs (UK) has been deleted;
- Other reports by the Auditor: The guidance on the auditor's review reports on interim net profits has been deleted as it is expected to be superseded by separate updated FRC guidance on interims;
- Appendix 1 – illustrative examples of auditor's reports – the example report for a review of interim net profits has been deleted (see above);
- Appendix 2 - the main parts of FSMA 2000 relevant to banks and building societies – updated for changes in the Act since 2011;
- Appendix 3 – FSMA 2000, BS Act 1986 and related statutory instruments: important provisions for auditors -updated for changes since 2011;
- Appendix 4 – the FCA Handbook and PRA Rulebook - updated to reflect the changes as a result of these bodies replacing the FSA;
- Appendix 5 - possible factors that may indicate going concern issues - updated;
- Appendix 6 – reporting direct to the regulators – statutory right and protection for disclosure under general law – minor edits to reflect the PRA and FCA replacing the FSA;
- Appendix 7 - the auditors' right and duty to report to the regulators: examples of reportable items - minor edits to reflect the PRA and FCA replacing the FSA;
- Appendix 8 (new) – auditing ECL – example approach for forward looking information;
- Appendix 9 (formerly appendix 8) – definitions – updated.

Overall this approach has resulted in a shortening of many sections of the Practice Note, although the section on ISA (UK) 540 is extended.

## **Impact Assessment**

5. A Practice Note provides guidance to support best practice. Although a Practice Note is not prescriptive, the FRC's Statement on the Scope and Authority of Audit and Assurance Pronouncements states that auditors should be aware of and consider Practice Notes applicable to the engagement. Auditors who do not consider and apply the guidance included in a relevant Practice Note should be prepared to explain how the engagement standards have been complied with. The FRC has not identified any additional costs resulting from the revised guidance included in the exposure draft.

## **Consultation Questions**

6. The FRC welcomes comments on all aspects of the revision of PN 19. However, we would specifically encourage views on the following questions:

- Q1 Overall do you agree with the proposed revisions to the Practice Note? If not please explain why;
- Q2 Is the included guidance appropriate, in particular that for ISA (UK) 540 (Revised December 2018)? If you believe it should be amended, please explain why and how.
- Q3 Is the guidance in Appendix 8, 'Auditing ECL – Example approach for forward looking information' appropriate and at the right level of detail? If you believe it should be amended, please explain why and how.
- Q4 Are there other aspects of auditing ECL for which examples should be provided? If you believe there are please explain what you believe should be covered and why.
- Q5 Has any extant guidance been deleted that you believe should be retained? If yes, please explain why it should be retained and whether, and if so how, it should be updated.
- Q6 Are there any other matters in relation to the audit of banks and building societies that you believe should be covered in the Practice Note and, if so, what do you believe the guidance should address?

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December 2018**



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