

Audit and Assurance Council

Minutes of a meeting of the Audit and Assurance Council of the FRC
held on 22 October 2014 at the FRC Office, 8th Floor, 125 London Wall, EC2Y 5AS

PRESENT:

Nick Land (Chair)
Jane Fuller
Sue Harris
Robert Hingley
John Hughes
Ray King
Scott Knight
Maggie McGhee
Conall O'Halloran
Allister Wilson

IN ATTENDANCE:

Keith Billing	Project Director
Francesca Chittenden	Council Secretary
Marek Grabowski	Director of Audit Policy
Stephen Haddrill	Chief Executive (minutes 2-5 only)
Steven Leonard	Project Director
Melanie McLaren	Executive Director, Codes & Standards
Bex Smart	FRC Intern
Pat Sucher	PRA Observer
Marian Williams	Director, Codes & Standards (minutes 2-4 only)

Apologies and introduction

Apologies were noted from Lee Piller (FCA Observer) and Eileen Townsend (IAASA Observer)

1. Client Assets – New Assurance Standard Consultation

- 1.1 The Council received a presentation from Steven Leonard (SL) that provided the Council with an overview of Client Assets and the context in which the new assurance Standard is being developed. The Council welcomed the presentation and noted the wide scope that Client Assets can cover.
- 1.2 Following the presentation SL introduced a paper that summarised progress on the Client Assets Standard Project. The Council noted that a Steering Group, comprising users and a small number of Council Members, and a Working Group, comprising audit practitioners and CF10a practitioners, had been established to assist the Executive in the development of the Standard and that internal consultation with colleagues in the Conduct Division would be on going throughout the development of the Standard. It was also noted that the FCA are

closely involved in the development of the Standard and hold a seat on both the Working group and the Steering Group, and SL reported that the FCAs involvement has proven to be particularly useful where members of either Group has raised queries relating to the interpretation of the FCA rules.

- 1.3 The Council discussed the scope of the Standard and noted there are likely to be in the region of 100 requirements. Through discussion it was clarified that the Standard would not attempt to interpret FCA Client Asset Rules but would set out the framework within which the auditor should work and the process that should be followed. The Council noted that this approach would avoid the need to constantly update the Standard to reflect any changes in the Client Assets rules and the risk of the FRC misinterpreting those rules.
- 1.4 The Council discussed a concern identified by the Working Group that that the proposed approach to materiality appears to conflict with the adoption of a risk based approach. The Council noted the issues associated with defining materiality and that the Executive are working to redraft the approach so as to clarify that the auditor is not expected to discover all breaches. The Council highlighted that there is a possible gap between public expectations in relation to the protection the Rules / Standard can offer and what the Rules / Standard actually can offer. MG confirmed that the executive are looking to address this potential gap.
- 1.5 The Council endorsed the proposed approach and the steps being taken by the executive to address the issues that had been raised by the Working Group.

2. Minutes of the previous meeting and rolling actions

- 2.1 The minutes of the Audit & Assurance Council meeting held on 12 September were approved for publication.
- 2.2 The Council noted the status of the actions listed on the action log. In response to a query it was confirmed that a presentation on the ICAS Audit Skills research project would be presented to the Council once the report had been finalised.
- 2.3 The Council discussed the status of the 'Vision for Audit' project. It was noted that the Statement issued in May set out immediate priorities for the FRC to address and that work on the 'bigger picture / vision' would be included in the FRC's 2016-19 plan.

3. Chairman's update

- 3.1 The Chairman informed the Council Members that there was nothing to report that was not covered elsewhere on the agenda.

4. Report of the Director of Audit Policy

- 4.1 Marek Grabowski (MG) introduced a paper that provided an update on development relating to UK and International auditing standards, FRC audit research activities and other FRC matters not covered elsewhere on the agenda.

4.2 MG drew the Council's attention to feedback from the September meeting of the IAASB and it was noted that the auditor reporting project had concluded with the approval of ISA 701, revisions of ISAs 700, 570 and 706 and conforming amendments to other standards including ISA 705 and ISA 260. The Council noted that the FRC had been active in the development of ISA 701 and the revisions to ISA 700, 570 and 706 so that those standards could be adopted by the UK with 'ISA-pluses' where necessary.

5. Activities since last meeting

5.1 The Council noted the list of activities since the last formal meeting on 12 September 2014.

6. Feedback from the FRC Board Strategy day (inc Vision for Audit)

6.1 Stephen Haddrill (SH) provided feedback from the discussions that were held at the FRC Board Strategy day. It was noted that the Board had reconfirmed support for the FRC mission and had considered proposals for the 2016-19 strategy.

6.2 SH summarised the strategic proposals that had been agreed in relation to audit, it was noted that during the 2016-19 period the FRC intend to:

- place a stronger focus on driving cultural change and to ensure consistency through firms as a whole, including a review with RSBs as to how they can contribute to an improvement in quality;
- continually strengthen the alignment of FRC standards and regulations to meet the needs of firms and investors;
- review the role of the independent non-executive director;
- develop an international integrated plan to drive change and ensure Group UK audits are supported by firms overseas;
- facilitate innovation so that audits meet the needs innovate to support the needs of investors, potentially through the establishment of an investor advisory group;
- Use the enhanced authority that a flipped regulatory structure would offer proactively.

6.3 Melanie McLaren (MM) summarised proposals that had been considered by the Board in relation other aspects of the FRCs work, it was noted that three key projects of relevance to the Audit and Assurance Council are:

- plans to promote a common vision for the Annual Report and develop principles to inform how it can better meet users' needs; and
- plans to seek evidence of the quality of reporting accountants' work and if necessary seek powers or stronger collaboration to retrospectively monitor prospectuses and also keep under review the need for the Corporate Reporting Review Team's work to other aspects of the Annual Report and Accounts; and
- Plans to review and take a consistent approach to where there are Standards in issue and where there are SIRs in issue, and the appropriateness of SIRs in light of the inability to enforce against compliance with SIRs.

6.4 It was noted that the FRC intends to undertake a full implementation review of the Stewardship Code including a review of the adherence to the Code.

6.5 The Council welcomed the proposals and reiterated the importance of engaging with investors, highlighting the need to distinguish between sub-sets of investors.

7. EU Audit Directive and Regulation – FRC Position on Member State Options

7.1 Keith Billing (KB) introduced a paper that set out the Member State options available under the EU Audit Directive and Regulation. KB reported that it is anticipated that BIS will issue an initial consultation on the proposed UK policy direction in December 2014 and that an FRC consultation, seeking input on the how the FRC might exercise the Member State options should it have a delegated power to exercise them, would be issued at about the same time or shortly thereafter.

7.2 KB invited the Council to discuss and give its advice on the approach the FRC should take in relation to the Member State options set out in the Regulation that had not previously been considered by the Council. Through discussion of the options the following observations were made and advice was given:

- The Council noted that the Member State Options set out in the Regulation are only applicable to Public Interest Entities (PIE) and agreed that a clear definition of what type of entity would fall within the scope of a PIE is necessary. The Council undertook to consider and provide KB with suggestions for a definition and examples of entities Members consider would fall within the scope of a PIE.
- The Council was unable to advise on the option ‘to exclude certain cooperatives and savings banks from the scope’ on the basis that it is unclear which types of entity would be subject to the exclusion. The Council noted that colleagues in the Audit Quality Review division (AQR) had considered the option and advised that co-operatives and savings banks do fall within the scope of AQR reviews. The Council suggested that advice be sought from BIS to clarify the nature of entities that would fall within the scope of the inclusion and also suggested that the FRC consider including a question in the consultation to gauge whether size criteria would be appropriate.
- The Council noted that the Regulation establishes a requirement for a report to be submitted to the audit committee of the audited entity and that Member States may additionally require that this additional report be submitted to the administrative or supervisory body of the audited entity. The Council agreed with the proposal that the power to require the additional report could fall within the remit of the FRC but suggested that advice to clarify who the relevant administrative / supervisory body would be was required before final advice could be given.
- The Council advised that the Member State option establishing a requirement for auditor reports about matters such as breaches of laws by the audited entity to be reported to the competent authority responsible for oversight of the auditor should not be provided for unless it was made clear what the FRC would be expected to do on receiving such a report and that was agreed as reasonable and appropriate.
- The Council noted that the Regulation sets out a Member State Option which would allow more stringent cap requirements to be set for Non Audit Service (NAS) fees and suggested the option should not be exercised on the basis that the basic EU requirement is sufficiently stringent. The Council highlighted that the establishment of a ‘white’ list, specifying allowed NAS would also support not needing a more stringent provision.

- The Council agreed that the Member State option to establish stricter rules for the conditions under which NAS can be allowed should be available to the FRC.
- The Council noted the arguments for and against the Member State option to require the initial audit firm engagement period to be for a period of one year and concluded that a longer period should not be mandated.
- The Council agreed that the FRC should not express a view on whether different considerations should apply if there are joint auditors, and whether that would justify a longer maximum period that auditors could remain in office than if there was a sole auditor.
- The Council discussed its previous decision not to permit derogations from prohibited NAS in respect of the financial statements and suggested that the matter should be explored in the consultation, noting that there are some instances where flexibility may be necessary.
- The Council noted that the FRC does not currently provide simplified requirements in relation to audits of small entities and agreed that the FRC should recommend to BIS that the Directive be implemented in a way that would not preclude the FRC from providing for simplified requirements in the future should it determine it to be appropriate.
- The Council also agreed that BIS should be recommended to implement the Directive and Regulation in a way that would allow the FRC to add requirements to standards as is current practice.
- The Council agreed with the pragmatic approach that had been taken in relation to the remainder of options set out in the paper.

7.3 KB reported that the Codes & Standards Committee had considered the Council's recommendation to establish a 'white list' specifying allowed non-audit services and had suggested that stakeholders views on the establishment of such a list should be explored as part of the consultation.

7.4 The Council noted that an early draft of the main elements of the FRC consultation would be presented to the Council for consideration on 14 November and that FRC Board approval to issue the consultation would be sought on 10 December. The Council also noted that proposed revisions to the ethical standards resulting from the review of the ethical framework will be consulted on in 2015 at the same time as the detailed revisions to implement the Directive and Regulation.

8. Proposed Reporting by Audit Committees on Audit Quality Review (AQR) Inspection Findings Consultation

- 8.1 The Council noted and supported the recommendation that the FRC consults fully on the Competition Commission (now CMA) proposal to amend the code in 2016 and in the interim issues a statement clarifying the existing provision, specifically to confirm that:
- In accordance with the recent Code changes in respect of Audit Committee reporting any significant discussion in respect of AQR findings would be expected to be disclosed in a company's annual report; to facilitate this, the FRC would release companies from the confidentiality requirements and would expect auditors to do likewise; and

- Auditing Standards would require auditors to report by exception in their report where the disclosures made by the Audit Committee are not consistent with their knowledge of an AQR letter.

8.2 The Council noted that as part of the 2016 consultation the FRC will undertake a general review of how the reporting is operating including whether such reports fairly reflect the underlying inspection findings and will consult on possible changes to the Code in the light of experience in 2015 and 2016, including of the quality of the disclosures and feedback provided to AQR by companies on the way its findings are expressed. The Council suggested that the FRC should take the opportunity of the consultation to clarify the role of the AQR.

8.3 The Council noted that the recommendation had been approved by the Codes & Standards Committee and that a final decision would be taken by the FRC Board at its meeting on 10 December.

9. FRC Report on survey of 1st year experience of extended auditor's report

9.1 SL introduced the draft report setting out the findings of a survey on the experience of the first year of extended auditor's reports. The Council noted that the report is intended to report on the application of the Standards in the first year, describe the diversity of innovation between the auditing firms and act as a catalyst for further development. The Council also noted that the FRC intends to use the report to inform discussions with investors and auditors of their expectations and aspirations as to how auditor reporting might evolve in the second year.

9.2 The Council discussed the appropriateness of including extracts from auditor's reports in the report. Whilst mixed views were expressed it was agreed that it would be helpful to include the extracts on the basis that they make the report more informative. However, it was agreed that the narrative accompanying the extracts should emphasise that the report is not intended to be judgemental or implicitly critical and is simply showing a range of examples of what has been done in order to inform debate.

9.3 The Council suggested that the Executive consider adding a section recording the dialogue with investors (and auditors) in an attempt to identify what investors want from the extended auditor report, how useful the information that is included in the extended auditors report is and how investors use that information.

9.4 The Council discussed whether the material in the draft report relating to audit committee reports should be included in the published version. MG clarified, although there may appear to be duplication in the Report, that the audit committee reports on matters the auditor's report to them in respect of the accounts whereas in the extended auditor's report the auditors raise matters that directly relate to their audit. The Council concluded that this material should be included in the report.

9.5 The Council noted that the report will be revised following discussion with auditors and investors, to reflect any comments made by the Codes & Standards Committee and to reflect

comments made by the Council and that a final version would be brought to Council for advice prior to publication in December.

9.6 The Council noted that the report would not be ready to publish in time for the IMA Auditor Reporting awards on 19 November but suggested that the headline findings of the survey be presented in the FRC's Vice Chairman's speech to the event.

10. FRC response Letter – Proposed changes to Provisions of the International Code of Ethics Addressing Long Association of Personnel with an Audit or Assurance Client

10.1 KB introduced the proposed FRC response letter to the International Ethics Standards Board (IESBA) proposed changes to provisions of the Code of Ethics for Professional Accountants (the Code) addressing the long association of personnel with an audit or assurance client. The Council noted that the response had been drafted in consideration of the advice given by the Council at its meeting in July. The Council were reminded that the FRC does not adopt the Code but that the FRC aims to ensure that the FRC's Ethical Standards are not less restrictive than the Code.

10.2 The Council noted that the response letter reflects the views that had been expressed by the Council at its July meeting when discussing Ethical Standard 3 and the requirements for the rotation of engagement partners and other partners and staff is in general support of the objectives of the IESBA but with a suggestion that IESBA revise the proposals so that the time that can be served as an engagement partner are more restrictive and the 'time-off' period for a partner who was the EQCR is more restrictive.

10.3 The Council reflected on the discussion that had taken place in July and the justification for proposing more restrictive requirements. Through discussion it was noted that perception is a key driver, in order to improve trust and confidence there is a need for simple and transparent requirements and, as had previously been considered, there is limited justification, from a public perspective, for distinguishing between various groups of individuals involved in the audit. In conclusion the Council reconfirmed its view that IESBA should be encouraged to revise its proposals as set out, however, the Council suggested that response should be revised to acknowledge there may be difficulties in applying the restrictions and that there may be scope of nuances, including those who provide technical advice.

10.4 KB undertook to revise the response letter to reflect the advice of the Council. The Council agreed that in light of the relatively small amendment requested the letter did not need to be recirculated prior to submission to IESBA.

11. FRC Response Letter – NAO Consultation on Code of Audit Practice

11.1 KB introduced a proposed response letter to the NAO's consultation on the draft new Code of Audit Practice which will take the form of secondary legislation. The Council noted that the Code is written at a high level and prescribes the framework within which auditors are to carry out their statutory responsibilities for the audits of all the different types of local public body. The Council also noted that for audits of financial statements the Code requires auditors to comply with the FRC's standards. It was noted that the Code also covers auditor

responsibilities that are outside of the scope of the FRC standards and that the NAO would issue guidance for auditors (consistent with the current approach).. KB reported that colleagues in the AQR team and Conduct division of the FRC had considered the consultation and had provided input to the draft response.

- 11.2 The Council approved the response that set out support for the proposed principles in the Code and a small number of suggested improvements.

12. First discussion of issues in relation to Integrated Reporting Assurance

- 12.1 The Council noted a paper summarising the International Integrated Reporting Council (IIRC)'s consultation paper on the provision of Assurance on Integrated Reports and a list of issues the Executive at the FRC had identified in relation to the proposals. The Council noted the paper and also noted that a draft response to the consultation would be presented to the Council in November.

- 12.2 The Council highlighted the importance of establishing whether or not there is a demand from the investor community for assurance on Integrated Reports and if so, who investors consider to be best placed to provide that assurance. ??

- 12.3 Due to constraints on time the Chairman invited members to email comments on the issues that had been identified and any additional issues to the Executive for consideration in drafting the response.

13. Any Other Business

- 13.1 There was no other business. The formal business meeting closed and the Council met in private without members of the Executive for a discussion of its effectiveness.

14. Next Meeting

- 14.1 The next formal meeting of the Audit & Assurance Council will be held on Friday 14 November 2014.