

**Minutes of a meeting of the Audit and Assurance Council of the FRC
held on 12 October 2016 at the FRC Office, 8th Floor, 125 London Wall, EC2Y 5AS**

PRESENT:

Ray King (Chair)
Bryan Foss
Jane Fuller
Kari Hale
Robert Hingley
Scott Knight

IN ATTENDANCE:

Kate Acott	Project Director, Audit Policy
Mark Babington	Deputy Director of Audit Policy
James Ferris	Project Director, Audit Policy
Michael Gaul	PRA Observer
Melanie McLaren	Executive Director, Audit
Susanne Minocha	Council Secretary
Mike Suffield	Head of AQR
Henry Irving	ICAEW (item 7 only)
Martin Martinoff	ICAEW (item 7 only)

Apologies and welcome

Apologies were noted from Sue Harris, Conall O'Halloran, Stephen Oxley and Jerry Wedge (Council members) Marek Grabowski (Director – Audit Policy) Josephine Jackson (Technical Advisor) and Keith Billing (Project Director, Audit Policy). A quorum being present, the Chairman declared the meeting open.

1. Minutes of the previous meeting

- 1.1 The minutes of the Audit & Assurance Council meeting held on 7 September 2016 were approved for publication.
- 1.2 It was noted that Council had also met by conference call on 4 October 2016, the minutes for which would be presented at its next meeting.
- 1.3 The rolling action log was noted.

2. Chairman's update

- 2.1 The Chairman updated the Council on matters considered by the FRC Board at its meeting on 7 September 2016 and at its recent Away Day, making reference in particular to:

- The number of issues currently happening in the public domain (e.g. Brexit and the Prime Minister's Corporate Governance proposals), and the FRC's response to those;
- The speed of dealing with conduct cases and the FRC's commitment to speed up dealing with those cases; and
- The results of stakeholder surveys on the performance of FRC.

2.2 Consideration would be given to these matters at future board meetings and at a Codes and Standards Committee Away Day, following which the Chairman would share ideas emanating from it with the Council. There would also be an opportunity for members to air their ideas at a private session of the Council at the end of this meeting.

3. Introduction of Head of AQR

3.1 The Chairman introduced Mike Suffield (MS), who had recently joined FRC as Head of AQR from the National Audit Office.

3.2 MS reported that there was a team of 35 experienced people in AQR working well. He was keen to find opportunities for them to work more broadly across the FRC and draw on their experience of audit inspection. One of his objectives was to expand the team's capability in the areas of financial services, banking, insurance and IT.

4. Report of the Director of Audit Policy

4.1 Mark Babington (MB) reported to the meeting in the absence of Marek Grabowski (MG), who was currently attending an IAASB ISA 540 Working Group and next week would be attending one on ISA 315. The attention of the meeting was drawn to the following matters in MG's paper:

IAASB

4.2 MB reported that it was understood that the IAASB would release an exposure draft on ISA 540 by the end of the year; however, there were concerns as to whether the work could be completed within what was a very challenging timetable.

4.3 At a meeting of the Codes and Standards Committee (CSC) on 11 October 2016, the Committee recommended that the Board adopt ISA 800 and ISA 805 for use in the UK, with one modification, for periods commencing on or after 1 January 2017, with early adoption permitted.

4.4 It was noted that the steer from the Board was that a focus on international influence and promotion of the UK's high quality standards in a post-Brexit world was important.

4.5 Council, in discussion, endorsed the work of the executive in this area and noted that delivery of an ISA 540 which responds to the needs of the market in time for the introduction of FRS 9 in 2018 would be challenging, particularly when ISA 315 was still being considered.

4.6 It was reported that representatives from various groups had provided comments on the development of ISA 540, and the IAASB Board had discussed the standard at its last

meeting in September. The FRC would provide its comments on the exposure draft in due course once it was issued for consultation.

- 4.7 It was noted that the aim was to reach a principles-based standard for general application, taking into account the public interest. It was agreed that MG provide an update at the next Council meeting, at which there should be further discussion about what MG is aiming to achieve as part of the Working Group and about what new requirements will be introduced into the new ISA 540 over and above the current level of work effort required by the existing standard.

EU Great Repeal Bill

- 4.8 The implementation of the government's EU Great Repeal Bill was noted. In due course, consideration would need to be given to the implications for audit and standards issued by the FRC.

UK auditing and technical standards

- 4.9 CSC had raised an issue in relation to Practice Note 20 (PN20) which related to the proposed treatment of capital add-ons in the auditor's report. The way the illustrative auditor's report had been prepared in PN20 made reference to the application of capital add-ons in the UK as a member state option which the UK has exercised. In the Working Group discussions, the Group felt that it should be made clear that this is part of the financial reporting framework, and any add-ons will be contained within the capital numbers. CSC asked the executive to remove the separate reference, as it would be covered by the audit work on capital and the related disclosures. It was decided, in response, to add a specific question in relation to this in the consultation on PN20 due to be released following consideration and approval of ISAs 800 and 805, by the FRC Board.
- 4.10 In response, MB noted that the FRC has been working to provide practitioners with a way of carrying out Solvency II audit engagements in accordance with the ISAs (UK), which is one of the requirements of the PRA Rules. It was noted that some careful thinking had been required to enable practitioners to do this, including the way in which aspects of the information included within the Solvency II return were scoped out of these engagements. Melanie McLaren (MM) will be writing to the PRA pointing out how the FRC has addressed the PRA's requirement, and the issues caused by the scope of the engagements as required by the PRA.

Auditor's Responsibilities for the Audit of Financial Statements

- 4.11 As a result of recent changes to the FRC's ethical and auditing standards, the statement of auditors' responsibilities in the audit of the financial statements on the FRC web site requires updating. A paper was tabled at the meeting with "track changes" amendments to show Council what the executive was proposing – a clean version had been included in the papers for the meeting.
- 4.12 It was agreed that Council members should provide comments to MB by the end of the week for inclusion in the statement which would be finalised during the following week.

General

- 4.13 It was noted that there were a number of substantial items on the Agenda for the November Council meeting.

5. IAASB Agenda reform

- 5.1 Council discussed the pre-circulated paper setting out the status of the Monitoring Group's Working Group to develop proposals for the reform of the Standard Setting Boards (SSBs).
- 5.2 MB reported that the SSBs were overseen by a Monitoring Group, which was formed from a number of international regulatory bodies. It had established a Working Group drawn from Monitoring Group member organisations, with support from a small group of staff including MB from the FRC. Originally, the proposal had been to use staff drawn from the larger audit firms; however, this approach had been changed following push back from MG members and through IFIAR members. The project would consider SSB governance issues, in particular the nomination process, the composition of the SSBs and the composition of task forces.
- 5.3 There had been considerable discussion in relation to further reform of standard setting bodies, including:
- How to make sure SSBs adequately take account of public interest in setting standards;
 - How responsive are the SSBs to the needs of the audit market when the SSBs are considering how they respond?
- 5.4 MB reported that there are 18 members of each of the boards, of which 9 are practitioners, 6 non-practitioners (usually previous practitioners who had been away from practice for a minimum period) and three public members. There is concern that the weighting of membership is heavily in favour of the Profession and as a result the SSBs may not be sufficiently responsive to users' needs or reflect the public interest, or they may be motivated by self-interest.
- 5.5 Appointments to board are made through the IFAC Nominations Committee. It was questioned whether the process of nominations to the SSBs should be independent from the Profession.
- 5.6 The Working Group aims to develop a charter for reform looking at the public interest and independence of the SSBs from the profession, with a view to coming up with a straw man for consideration by the Monitoring Group by the end of the year. More detailed proposals would follow in the first half of next year and be presented to Council. There would be a new chairman of the IAASB from January 2018, who is likely to be the one tasked with implementing reform over their three year term of office.
- 5.7 The meeting discussed the level of support which was necessary to support the project. Resourcing had not yet been fully scoped out: membership of the Working Group was voluntary and supported by the organization from which the member emanated. Separately, MM, MG and MB had met with the Secretary General of the PIOB, about whether the current level of volunteer resource could, with the support of the audit firms be monetized to provide independent funding which would support the independence of the SSBs. The executive would be reviewing examples of other standard setting processes, e.g. IASB, which has full time, remunerated board members.
- 5.8 Other considerations included:

- whether the SSBs are able to provide sufficient strategic challenge to ensure standards were fit for purpose and properly represent the public interest;
- whether the Chairman of the PIOB should take chairmanship of the Nominations Committee for the purposes of membership of the SSBs;
- possible standardization of the standard setting process; and
- wider adoption and international implementation of standards issued by the SSBs.

6. Audit and Assurance Technical Advisory Group update

- 6.1 MB reported that the fourth meeting of the TAG, to discuss issues in relation to audit standards, had taken place during the previous week and been constructive. There had previously been three meetings to discuss ethics-related issues of interpretation.
- 6.2 A significant challenge exists to balance the conflict between principles based standards (i.e. matters for the auditor's professional judgment) and demands from certain areas of the profession for more prescriptive material. The FRC was managing the risks of third parties developing guidance seeking to influence or interpret the FRC's standards, which would pose a risk to enforcement activity, and which would water down the principles based approach.
- 6.3 The need had been expressed by audit firms for detailed guidance to allay concerns about responding to changes in the standards in a way that will be acceptable to the Audit Quality Review inspectors. It was noted that ICAEW representatives attended the TAG, there was regular dialogue through professional bodies to ensure consistency and engagement with small firms and material was also made available on the FRC website.
- 6.4 The Executive is also undertaking the development of staff guidance notes, and anticipates that a series will be put to the November Council meeting.
- 6.5 It was noted that a record the issues discussed is made available to the Profession as a whole via the FRC web site.

7. Audit Committee Chair's quality survey results

- 7.1 The meeting reviewed the results of the annual Audit Committee Chair (ACC) survey run by YouGov, which focused on the audits of FTSE 350 companies and a small number of additional audits to ensure appropriate representation across the six largest audit firms. There had been a slight drop in response rate from 203 in 2015 to 192 this year, and within that, response rates were varied, with some audit firms being more successful than others in encouraging audit committee chairs to participate.
- 7.2 The overall message was that ACCs' satisfaction with their auditors was high, with scores having improved. The lowest score was still the response of the audit firm to regulatory inspection and monitoring work. The Council expressed some scepticism about the very positive feedback that respondents had provided, when compared to the results of the FRC's own inspection work. It was considered that further FRC engagement with them was necessary to obtain further feedback and insight. However, expanding the survey in this way would be a more costly exercise.

- 7.3 The Council questioned whether more granular questions could be added to provide greater insight as to what ACCs saw as bring the principal components of quality. For example, a tick box survey could be replaced with structured interviews to provide greater insight and commentary, but this would require greater resources. Alternatively, additional questions could be included in the survey focusing on areas of possible improvement in audit quality.
- 7.4 The Council asked the executive how audit committees were dealing with AQR findings on a particular audit entity in their audit committee report. A significant improvement had been noted. The guidance for audit committees is now more formal and is designed to better support the Corporate Governance Code. There was evidence to show that this was leading to more engagement between audit committees and the FRC, particularly for those entities whose audits had been assessed by the AQR as requiring significant improvements.
- 7.5 In line with its responsibility as a competent authority, the FRC had recently changed its strategy on how it will make an overall assessment of audit committees. It is working more closely with Recognised Supervisory Bodies (RSB) inspectors and Audit Committees to raise their level of understanding of what is expected of them.
- 7.6 The FRC would continue to survey ACCs, noting that the survey was output focused, rather than the AQR's work which is input focused, though the format might change as it was considered that there is scope for development and education of respondents to become more challenging consumers. There were further comments and observations made by members of the Council on issues relating to the contribution of the auditor throughout the audit cycle and the definition of quality, including:
- The challenge in educating audit committees appropriately;
 - To what extent there was a need to consult with the auditor throughout the year;
 - The nature and extent of the contribution of the auditor in the publication of financial statements and throughout the audit cycle to address; and
 - That a loss of, say, 2% of respondents as a result of the measures discussed was considered acceptable.

8. Project Updates

PN 11 - The Audit of Charities in the UK

- 8.1 KA reported that the proposal to revise PN11 which Council discussed in May 2016 was agreed by the Codes and Standards Committee. A working group of representatives has been set up, drawn from a number of stakeholder groups including from a number of professional audit firms and bodies (including two of the big four firms, ICAS, ICAEW), the three charity regulators (covering England & Wales, Scotland and Northern Ireland), the Charity Finance Group (representing finance directors of charities), and a Trustee and Audit Committee Chair of Oxfam International). The first meeting of the Working Group was held during the previous week.
- 8.2 In acknowledgement of the difficulty of charities having an "investor voice" because of their nature, KA was building a network of as many different stakeholder voices as possible, principally focusing on those who review charity accounts. The Council was invited to propose contacts, and Bryan Foss offered to put KA in contact with the DMA.

- 8.3 In the working group discussions, considerations included whether the current material in the PN added value, including whether the current level of guidance on the accounting treatment of charities was necessary. The Working Group had committed to remove such material where it did not contribute to a high quality audit.
- 8.4 KA was keen to explore with the Working Group the concern that there may be an assumption by the public that a charity auditor would be looking at whether the money spent is in line with the charity's objects (which was currently not required by legislation of auditors), similar to the concept of "Regularity". The expectation gap may therefore be even wider for an audit of a charity.
- 8.5 MB reported on two issues from the Public Administration and Constitutional Affairs Committee's report on Kids Company, which the Working Group would need to consider:
- Whether the auditor was properly considering the viability of the charity's business model as part of their consideration as to whether the charity was a going concern; and
 - The auditors' duty to report to regulators, particularly in respect of going concern matters, which was currently determined to be low.
- 8.6 The Council noted that it was particularly important that the FRC speak to small and medium charities and their auditors as these entities were much more likely to be heavily dependent on donations and grants and are unlikely to have a proper reserves policy (unlike the larger charities) and live hand-to-mouth.
- 8.7 The Council questioned whether auditors had an obligation to consider whether the charity had been set up for the purposes of avoiding tax. It was noted that this was not the main focus of the auditor, but that it would be considered as part of the assessment of compliance with laws and regulations.
- 8.8 A further paper would be submitted to the Council in March 2017 prior to the consultation on PN11.

PN15 – the audit of occupational pension schemes in the United Kingdom

- 8.9 MB summarized that the main driver for the proposal to Council to revise PN15 was to reflect the existence of master trusts. A Working Group has been set up drawing on the expertise of audit firms, the regulator, pension representatives and a representative from NEST. This had identified a number of key areas for change:
- Changes in legislative and regulatory framework;
 - Changes to accounting and audit framework; and
 - External events and media coverage together with a potentially growing expectations gap.
- 8.10 A revised PN15 was expected to be put to Council in January 2017.

Proposal to revise Bulletin 2008/2

- 8.11 Council considered a Project Scoping Form included in the Council papers. MB reported that a breakfast round table has been arranged to elicit users feedback on this proposed

project to revise the FRC's guidance on the auditor's responsibilities in respect of preliminary announcements. The FRC has received considerable feedback supporting an update to the guidance.

8.12 The Council noted that there is an increased appetite from the investor community to include more auditor commentary with the preliminary announcement. For example, the auditor's report could be released with the preliminary announcement, but the entity would still need to comply with the requirements of the Companies Act. It was noted that 70% of FTSE companies who issued a preliminary announcement had a signed auditor's report at the time of the preliminary announcement.

8.13 Council authorized the executive to progress the project.

9. What is high quality audit?

9.1 MB reported that the executive was seeking an FRC definition of "high quality audit" which can be publicised. A paper setting out stakeholders' definitions had been discussed at the Conduct Committee Away Day, and definitions of the attendees were added to the document. The result was set out in the paper before the Council.

9.2 The paper set out some of the elements stakeholders identified as contributing to a high quality audit. Stakeholders take for granted that an audit will fully comply with regulatory requirements. However, a high quality audit was one which complied with both the spirit and the letter of the regulatory framework. The paper concluded with an outline definition reached at the Conduct Committee Away Day which addresses the value the audit process brings in terms of transparency and communication with stakeholders in an unambiguous way.

9.3 Council made the following comments:

- It was noted that at the Audit & Assurance Away Day the focus of the Council was on three elements:
 - (a) vigorous and comprehensive process;
 - (b) a strong output highlighting key risks, weaknesses and qualities;
 - (c) relevant to investors, in particular, in making decisions; and
 - (d) provides insight for management.
- It was commented that the difference between a good and bad audit process should be highlighted in terms of key outcomes.
- The meaning of "necessary behaviours" was queried, together with "actions", "stakeholder" and "insight, transparency and challenge".
- It was noted that the discussion about mindset at the Audit & Assurance Away Day had not been captured in this document.
- It was suggested that the report start with the definition of audit and defining the purpose of the audit in providing confidence to investors that financial statements are true and fair and transparent outputs which provide the basis for decisions.
- The point of the audit in allowing other stakeholders to do their job properly should be included in the definition.
- A bulleted summary of the Audit & Assurance Away Day discussions would be useful.

9.4 It was agreed that the paper be reconsidered and re-presented to Council in January.

10. Blockchain presentation

10.1 MB introduced Henry Irving (HI) and Martin Martinoff (MM) from ICAEW to speak about the potential role of Distributed Ledger Technology (“DLT”), more commonly referred to as “Blockchain”, in the future of audit. Details of a survey on audit insights into cyber security were circulated to the meeting.

11. Any other business

11.1 There was no other business.

12. Next meeting

12.1 The Council noted that the meeting of the Audit & Assurance Council would be held on 15 November 2016 at 9.00am.

