

Audit and Assurance Council

Minutes of a meeting of the Audit and Assurance Council of the FRC
held on 14 October 2015 at the FRC Office, 8th Floor, 125 London Wall, EC2Y 5AS

PRESENT:

Ray King (Chair)
Bryan Foss (from minute 3)
Jane Fuller
Kari Hale
Sue Harris
Scott Knight
Maggie McGhee
Stephen Oxley

IN ATTENDANCE:

Kate Acott	Project Director, Audit Policy
Mark Babington	Deputy Director, Audit Policy
Keith Billing	Project Director, Audit Policy
Francesca Carter	Council Secretary
Susan Currie	Conduct Project Director (minute 5 only)
Ufuk Cengiz	Economist, FRC (minute 4 only)
James Ferris	Project Director, Audit Policy
Michael Gaull	Incoming PRA Observer
Marek Grabowski	Director of Audit Policy
Stephen Hadrill	Chief Executive (to minute 5 only)
Josephine Jackson	Technical Director, Audit Policy
Melanie McLaren	Executive Director, Codes & Standards
Lee Piller	FCA Observer
Pat Sucher	PRA Observer

Apologies and introduction

The Chair welcomed Bryan Foss and Stephen Oxley to their first Council meeting.

Apologies were noted from Robert Hingley, Conall O'Halloran (Council Members) and Eileen Townsend (IAASA Observer).

1. Minutes of the previous meeting

- 1.1 The minutes of the meetings held on 14 September 2015 were approved for publication.
- 1.2 The Council noted the status of the actions set out on the rolling action log and queried the status of the action to develop a succinct definition of audit quality. In response Melanie McLaren (MM) reported that a number of strands of work are being progressed throughout

the FRC to inform the development of an FRC 'strategy for audit' and to identify objective criteria through which the quality of audit can be assessed. MM also reported that once the FRC assumes its role as the single competent authority, it will be required to report on the audit market and audit quality. Accordingly, work to establish the objective set of criteria must conclude before June 2016. The Council highlighted the importance of ensuring that the criteria established are outcome and not just input and process based and takes a holistic view.

- 1.3 The Council noted that work to consider audit requirements for the SME market would commence following conclusion of work to implement the Audit Directive and Regulation. Marek Grabowski (MG) reported that it is the intention that a small group of individuals with relevant experience be brought together in the near future to consider issues faced by SMEs before the matter is brought to the Council.

2. Chairman's update

- 2.1 The Chairman reported on the Board Strategy Day held on 17 September 2015. The Council noted that the Board had agreed with the Councils' advice in respect of the proposed prohibition on the provision of tax services on a contingent fee basis. The Council also noted that whilst the Board had accepted Council's advice regarding the reliefs proposed for smaller listed (AIM) companies with a market capitalisation of below £100 million, the Board had concluded that if a company fell back below the £100 million threshold, the ethical requirements would continue to apply for two financial periods before the reliefs applied. The Chairman reported that, subsequent to the Board meeting, the Consultation on amendments to the Ethical Standards and Auditing Standards had been issued.
- 2.2 Stephen Haddrill (SH) summarised the strategy conclusions reached by the Board on 17 September. The Council noted that the Board had agreed:
- The changes introduced by the FRC over the past few years have been successful and good progress has been made in respect of raising confidence in the quality of audit, however, the FRC should now seek to help embed the changes that have been introduced and refrain from introducing new requirements.
 - In response to the findings of the McKinsey review on the effectiveness of the FRC's AQR and CRR work, the FRC should seek to adopt an 'improvement' stance.
 - The FRC will, subject to the outcome of the BIS consultation, be the single competent authority for audit and hold sole responsibility / accountability to Parliament for the quality of audit.
 - The FRC will formally respond to the Government's deregulatory agenda.
- 2.3 The Council also received an update on matters considered and views expressed by the Codes & Standards Committee (CSC) at its meeting on 7 October 2015. It was confirmed that the CSC had approved the Client Assets Assurance Standard as recommended by the Council and that the approval to issue the Standard would be sought from the Board at its meeting on 20 October.

3. Report of the Director of Audit Policy

- 3.1 The Council noted a paper that provided an update on developments relating to UK and International auditing standards, FRC audit research activities and other FRC matters not covered elsewhere on the agenda.
- 3.2 The Council noted a feedback document from the International Auditing and Assurance Standards Board (IAASB) meeting held during the week of 21 September. MG reported that he is broadly comfortable with the IAASB's direction of travel and the decision to prioritise projects on quality control, group audits and professional scepticism. MG reported that the prioritised projects would be addressed in an 'invitation to comment' document intended to be issued after the December IAASB meeting.
- 3.3 The Council discussed the IAASB's decision to prioritise a project on ISA 540 and the IAASB's intention to issue project updates including tentative conclusions in the interim. Through discussion some concern was expressed as to whether developing the project updates would distract the IAASB and result in a delay to the IAASB's deliberations on the implementation of IFRS 9 for financial institutions, and whether sufficient guidance would be in place to support auditors in the necessary timescale. This was important given the complexity of the issue not just in respect of ensuring that auditors can do their part in motivating banks affected to ensure that adequate systems are in place but also to support auditors in respect of judgements they will need to make. In response to the concerns MG reported that he does not expect the project updates and tentative conclusions to be complex or lengthy documents, nor that preparing the documents would delay the IAASB's deliberations in respect of IFRS 9. MG clarified that in fact the purpose of publishing project updates and tentative conclusions is intended to support auditors both in their own preparation and in motivating banks by helping them to understand what the auditor would have to address. The Council highlighted that in the implementation of IFRS 9 by financial institutions there would likely be a significant increase in the number of disclosure requirements that will need to be considered both by financial institutions and their auditors.

4. Horizon Scanning

Quarterly Horizon Scanning and Audit & Assurance Council forward agenda

- 4a.1 Mark Babington (MB) introduced a paper that set out the horizon scanning grid considered by the Council at its Away Day in July and the Audit & Assurance team (the 'Team') forward work plan for 2015-16. MB reported that although work to draw the two documents together in to a comprehensive Council forward agenda had been delayed as the Team has been focused on the ARD, work to progress and develop the Council forward agenda would continue over the next quarter. MB confirmed that in developing the forward agenda consideration would be given to the Boards strategy proposals for 2016-19, the deregulatory agenda and the FRC's responsibilities in respect of this, the requirements of the Enterprise Bill and any other issues that are identified through the Council's horizon scanning deliberations. The Council suggested that it would be useful for the Council forward agenda to set out what, relevant to the work of the Council, the FRC has undertaken to do, what the FRC is likely to be asked to do in the near future and what the FRC would like to do.

- 4a.2 The Council discussed the AAT work plan and noted that whilst resources during the first half of 2016 will be predominantly assigned to the ARD, once complete, there will need to be consideration of whether to undertake a number of projects, including an update of PN 20 – The Audit of insurers in the UK to reflect the introduction of Solvency II. The Chairman requested that, further to discussion at the Council Away Day, consideration of smaller entities be added to the agenda for the second half of 2016. Lee Pillar (LP) queried whether the FRC intends to revise PN 21 - Investment businesses and MB undertook to explore the need for a review and the timescales for doing so.
- 4a.3 The Council discussed the Horizon scanning document and proposals as to matters the Council may wish to explore.
- The Council suggested that it would be useful to explore the auditor’s responsibility in respect of providing assurance over other information and the ‘expectation gap’. The Council welcomed that the FRC is keeping abreast of developments in this area and working with relevant professional bodies and other regulators to look at how greater assurance can best be achieved in a deregulatory environment.
 - The Council highlighted that as a consequence of EU Regulation a number of new requirements for FTSE have been introduced and represent significant change. In response MM reported that within the FRC various work streams are underway to look at the impact changes introduced in recent years have had, including a focus on first year audits by the AQR team and a review of experience of audit firm tendering.
 - The Council discussed the issues listed under the technological heading and it was suggested that, given the rapid pace of technological development, consideration should be given to whether the timeframe of 0-6 years is appropriate. Whilst it was noted the IAASB are undertaking a project on data innovation which would address some of the issues identified, the Council suggested that technological advances in audit is an area that it would be useful for an ‘Audit Lab’ to explore. The Council also discussed the possibility of client data being lost or hacked and the impact this would have on confidence in audit firms, it was suggested the Audit Firm Governance Code could be one mechanism to address this risk.
- 4a.4 MB thanked the Council and undertook to update the horizon scanning document and progress the Council forward agenda in response to the discussion.

FRC Strategy - Deregulation

- 4b.1 Ufuk Cengiz (UC) introduced a paper setting out a request from the FRC Board inviting the Council to identify possible ways in which the FRC could seek to align itself with the government’s deregulatory stance. UC invited the Council to provide views on whether there are any changes that can be made to the FRCs codes and standards or enforcement activities to reduce the burden or whether there are any statutory activities that the FRC currently undertakes and should ask the Government to remove or amend. UK confirmed that the FRC is within the scope of the Government’s £10 billion red tape target.
- 4b.2 Through discussion the Council suggested the FRC consider:
- Whether it is guilty of ‘gold-plating’ and if so, whether that ‘gold-plating’ is necessary.
 - The link between standard setting at the FRC and enforcement at the FRC to see whether there are any unnecessary burdens.
 - Whether the independence requirements / thresholds are appropriate and whether there would be scope to bring in de minimis levels for engagements that are considered trivial.

- Seeking to identify where costs are incurred and what aspects of an audit have the most impact on cost.
- Whether the issue of further guidance and support materials to assist with the interpretation of standards, laws and regulation would help reduce the time requirement / burden on companies.
- The burdens associated with corporate reporting and the production of the annual report. It was suggested that a number of the reporting requirements recently introduced do not meet the needs of users of annual reports and result in boilerplate.

4b.3 The Council noted that consideration is already being given to the role of the Annual General Meeting and the custodian rights. It was also noted that the Department for Business, Innovation and Skills (BIS) is due to issue a consultation in 2016 in response to the incoming Non-Financial Reporting Directive and that it is expected the consultation will invite respondents to identify where regulation in respect of non-financial reporting can be cut.

4b.4 UC reported that recommendations, based on input from the three Councils and FRC staff, would be developed by the Executive Committee and that the Council would have an opportunity to consider the recommendations before they are presented to the Board for approval in January. The Chairman invited Council Members to submit any further suggestions to UC outside of the meeting.

5. Audit Firm Governance Code (the 'Code')

5.1 SH reported that the FRC's consultation on possible changes to the Audit Firm Governance Code had concluded and that, based on the FRC review and the findings of the consultation, a number of changes to the Code had been proposed. The Council noted the key messages arising from the consultation were that:

- The promotion of audit quality should be central to the Code.
- The Code should provide for effective governance and oversight of the firms' non-audit businesses to support the security and the work of the firm as a whole.
- Investors, whilst supportive of the Code, are keen to see enhanced transparency from the firms and clearer guidance as to the role and responsibilities of the Independent Non-Executives (INEs).
- There is debate as to where in the firm INEs should be positioned and how the Code can accommodate different structures at a global level.

5.2 The Council highlighted a lack of awareness of the Code and supported the proposal to improve transparency of the Code and to provide greater feedback to firms in respect of transparency reports they produce. The Council also highlighted a lack of visibility of INEs and agreed that, as respondents to the consultation suggest, the FRC should seek not only to facilitate meetings between investors and audit firms but should also encourage attendance INE attendance at those meetings and at shareholder events.

5.3 The Council discussed the desire from investors for more monitoring by the FRC of the firms' application of the Code. Whilst it was noted that some members of the CSC support the view of investors, the Council considered that, in light of the deregulatory environment and the fact that audit is subject to statutory a statutory inspection regime, it is right for the Code to retain its comply or explain nature and complement AQR. It was suggested that,

by improving visibility of the Code outside of the audit firm environment, audit firms may feel obliged to improve and develop the transparency reports they issue.

- 5.4 The Council noted that although there is debate as to where the INE should sit within the debate, firms are generally opposed to the introduction of prescriptions as to how their governance should be designed. Whilst the Council was supportive of the proposal to retain the flexibility offered by the Code the Council highlighted that for the INE to be effective it needs to be in a position to consider and influence strategy from a public interest perspective.
- 5.5 The Council queried whether the Code should be applicable to all firms that would fall within the new EU definition of a PIE. The executive undertook to consider the suggestion but highlighted that it may be disproportionate and bring too many firms in to scope.

6. Council Discussion – Preliminary Statements

- 6.1 James Ferris (JF) introduced a paper that set out the findings of analysis undertaken in relation to the timing of Preliminary Announcements, and, in particular, whether the auditor's report was available at the time at which the Preliminary Announcements was made. JF reported that the analysis had been undertaken in response to the Council's discussion at its July Away Day and to facilitate further consideration of the matter.
- 6.2 The Council noted a summary of the analysis, based mainly on 2014 year ends, as follows:
- 78% of FTSE 100 companies issued preliminary statements on or after the date of the independent auditor's annual report.
 - There is significant divergence between the firms in respect of achieving this outcome but no evidence as to why this is the case.
 - For those FTSE 100 companies who do publish 'unaudited preliminary statements there is significant divergence in the time difference to the auditor's report.
 - There is no obvious pattern in the nature of the companies who publish a preliminary statement before their audit report has been signed.
- 6.3 The Council discussed the suggestion that, based on the findings of the analysis, it should be possible to publish the financial statements on the date of the preliminary announcement, subject to practical considerations, and that this could be achieved without unduly impacting on the current timetable for the release of financial information to investors. Whilst the Council agreed the suggestion, the Council highlighted that there would be a number of practical issues to consider and that there would also be a need to provide 'safe harbor' provision on the basis that the auditor's report will refer to the Annual Report and Accounts which would not have been issued. The Council also discussed whether there would be scope to bring forward the release date of the Annual Report. Whilst the Council suggested this should be explored further, it was highlighted that the implications of doing so would be wider than simply affecting the auditor.
- 6.4 Through discussion it was highlighted that there is a need to fully consider what the consequences of encouraging publication of the auditor's report with the preliminary statements would be. Some concern was expressed that, regardless of whether or not simultaneous publication is mandated, market practice may result in companies following practice in order to avoid being an outlier where there are valid reasons not to delay the issue of the auditor's report.

6.5 The Council concluded that further evidence is necessary before a formal view could be taken and encouraged the executive to proceed in commissioning research on the correlation between the Annual Report and Accounts and the Preliminary Statements for FTSE Companies over the previous 10 years.

7. Project Scoping – Revision of PN 20 ‘The Audit of Insurers in the United Kingdom’

7.1 MB introduced a paper setting out various approaches to be considered in respect of revising PN20 – *The Audit of Insurers in the United Kingdom* to reflect the introduction of Solvency II. The Council noted that the provisions of the Solvency II European Directive come in to force with effect from 1 January 2016 and that the PRA will shortly be issuing a consultation on proposals covering the publication of insurers’ regulatory returns, and assurance over those returns, to support investor confidence. MB reported that, as a consequence of the introduction of Solvency II, parts of the existing PN20 will become obsolete, and, depending on the outcome of the PRA consultation, a decision will need to be taken as to whether PN 20 should be retained and updated, or whether it can be withdrawn. MB confirmed that the FRC has been in discussion with the PRA for some time to determine what actions may be needed.

7.2 Pat Sucher (PS) provided a high level summary of the requirements of Solvency II and the approach the PRA is considering. PS highlighted that the final PRA rule will not be issued until May 2016 and that whilst the output of the consultation is expected to be mainly focused on December 2016 year end reporting, there will be a number of smaller insurers who have to complete Solvency II reported for a 30 June 2016 year end. Whilst the Council welcomed the proposed approach and the desire to make the annual reporting requirements as clear and simple as possible, it was suggested that the PRA carefully explore the scope of such engagements, considering issues such as private / internal reporting on Pillar III and modeling choices. Through discussion the Council highlighted the need for the PRA to have regard to accountability and the ability to enforce against any of the requirements.

7.3 The Council considered the options presented in respect of PN20 and highlighted that, should the decision be taken to issue guidance in respect of assurance over public reporting engagements, there is potential that the quality of reporting, and the level of assurance that could be provided to investors would vary. The Council suggested the PRA highlight this potential in its consultation.

7.4 MB thanked the Council for their contributions and undertook to continue to liaise with the PRA as it develops its consultation. The Council noted that a further paper would be presented to the Council in due course.

8. Compendium of Illustrative Auditor’s Reports

8.1 Kate Acott (KA) introduced a paper inviting the Council to consider the recommendation that the FRC continues to publish Compendia Bulletins with a reduced number of

illustrative examples. The Council noted that the Bulletins are designed to support and illustrate the auditor reporting requirements of ISAs (UK and Ireland) and of laws and regulations when applied to certain entities.

- 8.2 The Council discussed the advantages and disadvantages of the FRC continuing to issue the Compendia Bulletins. Whilst it was noted that the Bulletins facilitate proper application of requirements in divergent circumstances it was noted that this could discourage innovation and promote boilerplate language. It was also noted that whilst the Bulletins provide useful guidance for small practitioners who do not have the technical resources of larger firms, smaller firms can to some extent locate example reports online.
- 8.3 The Council noted that maintenance of the Bulletin in its present form is resource intensive and suggested this is not the best use of FRC resources. Accordingly the Council considered whether the FRC could identify an expert or expert group, such as a professional body, to maintain the Bulletins on behalf of the FRC - however, a number of disadvantages such as issues with oversight and the FRC's ability to control quality were identified.
- 8.4 The Council discussed the recommendation that the FRC continue to publish the contents of the Bulletin but in a more streamlined electronic form and with the number of illustrative examples be reduced. The Council supported the recommendation on the basis it is important to assist smaller firms, the streamlined approach would not be overly resource intensive and it is helpful to provide standard wording for reporting by exception in order to minimize confusion. The Council suggested that in order to reduce the burden on resources and streamline the Bulletins further consideration also be given to including extracts of reports or a modular approach to reports rather than full examples.

9. FRC Response to Exposure Draft - Proposed amendments to the IAASB International Standards – Responding to Non-Compliance or suspected non-compliance with Laws and Regulations (NOCLAR).

- 9.1 Josephine Jackson (JJ) invited the Council to agree its advice to the FRC Board to issue the proposed FRC response letter to the IAASB Exposure Draft – *Proposed Amendments to the IAASB – responding to non-compliance or suspected non-compliance with Laws and Regulations* (the 'ED'). JJ reported that the ED solicits stakeholder views on proposed limited amendments to some IAASB standards, primarily ISA 250, in order to align the International Auditing Standards with proposed revisions to the International Ethics Stakeholder Board for Accountants' Code of Ethics. JJ also reported that the ED also invites stakeholders to comment on whether they believe a more fulsome review of ISA 250 is required, and if so why.
- 9.2 The Council noted that whilst the proposed response supports the IAASB proposals the response suggests the IAASB consider:
- Introducing guidance for the auditor to consider the wider public interest when determining whether to report non-compliance to regulatory and enforcement authorities.
 - Introducing material in the requirements of paragraph 19 of ISA 250 to highlight that in some circumstances the auditor's obligation under law or regulation may override the

requirement in paragraph 19 to communicate NOCLAR with those charged with governance.

9.3 The Council noted that the response also supports a fulsome review of ISA 250 on the basis that there is a need to clarify the distinction between the different categories of laws and regulations and align ISA 250 with the risk-based approach to audit. JJ highlighted that the response also draws attention to recent findings of the FRC AQR thematic review in which a number of matters identified were related to the topics set out.

9.4 The Council confirmed its advice to recommend that the proposed response to the IAASB should be issued.

10. Any other business

10.1 The Chairman thanked Pat Sucher for the contributions she had made to the Council in her role as observer.

10.2 There was no other business.

11. Next meeting

11.1 The Council noted that the next formal meeting of the Audit & Assurance Council would be held on 9 November 2015.