

## **Audit and Assurance Council**

Minutes of a meeting of the Audit and Assurance Council of the FRC  
held on 27 February 2013 at Aldwych House, 71-91 Aldwych, London WC2B 4HN

### **PRESENT:**

<b>Members</b>	Nick Land (Chair) Russell Frith Ray King Scott Knight Paul Lee Robert Talbut Allister Wilson	
<b>Observers</b>	Aidan Lambe R Rottenberg  Trevor Rushe  Pat Sucher	Chartered Accountants Ireland UK, Department for Business, Innovation and Skills Irish Auditing and Accounting Supervisory Authority Financial Services Authority
<b>Staff</b>	Stephen Haddrill Melanie McLaren Marek Grabowski Keith Billing Jon Hooper Steven Leonard Mark Mainwaring Jon Grant	CEO, Financial Reporting Council Executive Director, Codes and Standards Director, Audit Policy

### **APOLOGIES**

<b>Members</b>	Sue Harris John Hughes	
<b>Observers</b>	Helen Hall	Irish Auditing and Accounting Supervisory Authority

### **1. Introduction and minutes of the previous meeting**

- 1.1 The minutes of the AAC meeting of 11 January 2012 were approved.

### ***Competition Commission report***

- 1.2 The Council discussed the recently published summary of provisional findings of the Competition Commission Investigation into the statutory audit services market and the Commission's notice of possible remedies.

### 1.3 Matters identified by the Council included:

- As well as the concerns identified by the Commission, there were also positive messages in the report, including not finding evidence that that audit firms are engaging in anti-competitive practices.
- Some Council members expressed a view that the findings over-played the problem of the agency issue and the view that auditors seek to satisfy management to the possible detriment of shareholders. However, others commented that this was a significant concern of some investors that needed to be addressed. The FRC's proposals to increase transparency in the auditor's report and in the report on the work of the audit committee should help, giving increased visibility to investors as to key audit issues.
- It is important that remedies should not undermine the role and authority of the audit committee, for example by taking reappointment of auditors away from them.
- An issue for audit committees that needs to be addressed is how they can evaluate audit quality. The Commission's proposals regarding expanding the remit and/or frequency of AQRT reporting have merit. However, by themselves, AQRT reports do not provide a total measure of a firm's audit quality and do not really help comparison between different firms.
- Other actions that could be taken that may help evaluate audit quality include:
  - Audit committees questioning the audit partner about the key issues identified and determining how well s/he understands them.
  - Facilitating open investor/auditor dialogue.
  - Aiming to ensure that the quality of expanded reporting by auditor and audit committees is high and doesn't degenerate into boiler plate stifled by risk management concerns.

1.4 It was noted that some of the possible remedies proposed by the Commission fall within the scope of the work of the FRC. Some of these are in line with FRC views and proposals but some are not and do not appear helpful to the FRC and BIS position in Europe. Staff will circulate to the Council the draft FRC response to the Commission for comment when available.

## **2. Report of the Director of Audit Policy**

2.1 Mr Grabowski introduced his report. Particular attention was given to the following matters.

### ***Proposed revision of ISA (UK and Ireland) 700***

2.2 Mr Grabowski gave an overview of the reaction of the IAASB, at its meeting in February, to the example auditor's report based on the revision proposed by the FRC. It was explained that this reaction had to be considered in the context of the fact that the IAASB had been provided only with the example report and not the full consultation paper and draft changes to ISA (UK & Ireland) 700 that set out the proposed requirement and rationale. Some members of the IAASB had expressed concerns that in practice it may be difficult to write some of the proposed auditor commentary, particularly in relation to materiality, they questioned what users would get from the information. It was also suggested by some that investors want to know more about

the company rather than the audit. However, others emphasised that the IAASB needs to listen carefully to what investors are asking for and not to be perceived to be telling investors what is best for them. Although there was in general quite muted support for the proposals from IAASB members who spoke, there remains an interest in the response to FRC Consultation to inform further consideration at the IAASB.

- 2.3 Members of the Council who had attended the IAASB's European round table event, to discuss possible revisions to the auditor's report under the IAASB's standards, indicated that a number of other stakeholders present at the event had said that they would welcome more information about the audit.
- 2.4 In terms of enhancing the role of the Audit Committee, the Council members acknowledged that, unlike the FRC, the IAASB is not able to address directly corporate governance matters such as the role of, and reporting by, the audit committee. However, it was possible that the IAASB could enhance the ISA 260 communication requirements for auditors reporting matters to those charged with governance, including the audit committee.

### ***ICAEW guidance on assurance relating to LIBOR***

- 2.5 The Council noted the publication of the ICAEW's exposure draft. The Council's advice is that the FRC should submit a response to it, setting out the concerns that had been identified at previous Council meetings.

### ***Other matters***

#### Narrative reporting

- 2.6 Ms McLaren informed the Council that the FRC will be updating the OFR guidance to address the new narrative reporting regime when it comes into effect.

#### Code of Practice for the relationship between the external auditor and the supervisor

- 2.7 Ms McLaren informed the Council that the FSA Code of Practice is being updated by the FCA. The update will include some significant changes to the FSA guidance, including reference to the duty of the auditor to report certain matters to the FCA. The FSA had not done so as this was clearly covered by the law and the ISAs. The FCA has been asked to make reference to the auditing standard that addresses the auditor's right and duty to report to regulators in the financial sector (ISA (UK and Ireland) 250, Section B).

#### FCA observer

- 2.8 It was questioned whether, once reorganisation of the FSA is completed, in addition to a PRA representative, a representative of the FCA should be invited to attend Council meetings as an observer. Ms McLaren undertook to follow up on this with the FCA.

### **3. Bulletin 3**

- 3.1 Mr Leonard introduced the agenda item on proposed Bulletin 3, addressing the use of third party administrators, which is designed to supplement the current guidance on providing assurance on client assets to the FSA.

- 3.2 The Council's advice is that it supports the Bulletin and that it should be sent by email to the members of the CSC with a request that they, with the advice of the Council, approve the Bulletin for publication. It was considered necessary to do this before the next physical meeting of the CSC (scheduled for 11 April) so that the Bulletin could be published in time to be of benefit in the current reporting period.

#### **4. IAASB exposure draft of proposed revised ISA 720**

- 4.1 Mr Billing and Mr Grabowski introduced the agenda item and requested the Council's advice as to how the FRC should respond to the IAASB's proposals. To help inform the discussion Mr Billing gave a summary of the main issues that had been identified in responses to the request for comments that has been sent to stakeholder groups and subscribers to the FRC's information services (13 responses had been received of which 11 were from auditors and professional bodies).
- 4.2 The Council's advice is that it supports the staff proposal that the FRC response be generally supportive of the IAASB exposure draft, but also advised recommending improvements to the IAASB's proposals in the following areas:

##### **Auditor's report**

The wording of the auditor's report in relation to 'other information' could make clearer what work the auditor has and has not done and, in particular that the auditor is providing derivative assurance based only on the scope of work required for the audit. Therefore the auditor is not required to do additional audit or verification work on other information that is not within the auditor's understanding of the entity and its environment acquired during the audit.

##### **Initial release**

The 'initial release' date and in particular its relationship to identifying 'accompanying documents' that fall within scope of the ISA could be better explained. This may be an area where providing for national standard setters to address specific national requirements (e.g. in relation to which accompanying documents should be within the scope of the ISA) could assist clarity, rather than seeking to produce requirements that cover all possibilities internationally.

In addition, in relation to identifying what documents are in scope, it would be helpful to address specifically the position regarding documents that are referred to in the other information by cross reference or hyperlink.

##### **Responsibilities for reading and considering the other information**

Guidance is needed to help clarify who is 'the auditor' with regard to the requirement to read and consider the other information. For example, under the definition of 'auditor' in the IAASB's glossary of terms it could be the engagement partner or other members of the engagement team, or the audit firm. For the purposes of this ISA it should not be the audit firm, which would be too wide and would require an understanding of matters obtained on other engagements, if any, performed for or in connection with the audited entity.

##### **Understanding of the entity 'acquired during the course of the audit'**

This condition is intended to scope out requiring understanding of matters obtained on other engagements performed by the audit firm in addition to the audit. This could be made clearer. However, it should also be made clear that 'the auditor' with responsibility for reading and considering the other information should take into account all knowledge within their own understanding, howsoever acquired, and not

ignore knowledge that may have been obtained outside the performance of the audit (e.g. knowledge acquired in previous audits or obtained from individuals not directly associated with the audit).

- 4.3 The Council's advice is that it supports the definition of an 'inconsistency' as given for the purpose of the ISA and the conceptual approach underlying it. However, it acknowledged that there were possible connotational issues with the word 'inconsistency'. It was noted that, if in due course the ISA is implemented by the FRC, supplementary guidance may be needed to clarify what should be determined to constitute an inconsistency in the UK and Ireland. For example, in relation to listed companies, it could include knowledge of matters which cause the auditor to conclude the other information is not 'fair, balanced and understandable'.
- 4.4 The Council's advice is also to support the inclusion of securities offering documents within the scope of the ISA in the circumstances set out in the exposure draft.
- 4.5 The staff will prepare a draft response to the IAASB and provide it to the Council for comment.

## **5. IAASB Framework for Audit Quality**

- 5.1 Mr Grant gave an overview of the background to, and development of, the proposed Framework. The starting point had been the FRC Audit Quality Framework, but the IAASB is seeking to develop a Framework that is less auditor focussed. The IAASB is aware that the Framework as issued for consultation is very long but it was designed to assist seeking views from a wide range of interested parties. Going forward it is possible that the IAASB will produce a series of more concise guidance focussed towards meeting the needs of a limited number of particular groups such as audit committees, IFIAR and the World Bank who had expressed particular interest in having guidance on audit quality.
- 5.2 In the discussion, the Council was informed that some parties had already found the draft Framework helpful in assisting developing their own specific guidance on audit quality. In due course the Framework could be helpful to the FRC in developing enhanced national guidance (applying the Framework to particular circumstances rather than seeking to rewrite the Framework completely from a national perspective).
- 5.3 The Council's advice is that an FRC response to the IAASB should be supportive of the aims of the IAASB. Possible areas to suggest for improvement include:
  - Developing more focussed guidance for audit committees, with more depth to help them evaluate audit quality and whether a particular audit is 'good'.
  - Considering alternative staffing models to the traditional 'pyramid' at audit firms (the ICAS research into competencies may be helpful).
  - Exploring how evaluation of audit quality can draw on lessons learnt from a range of audits rather than looking at individual audits as stand-alone events.

## **6. Repairing confidence in the value of the audit**

- 6.1 Mr Hooper introduced the agenda item.
- 6.2 Ms McLaren informed the Council that the FRC Board was supportive of the project and would like to see outputs begin to be produced fairly quickly.

6.3 The Council identified that a number of on-going projects will contribute to achieving the overall objective, including the auditor reporting project. Other related projects should be commenced as soon as practicable, including enhancing the ethical standards, exploring further improving communications between auditors and stakeholders and, with the Conduct division, exploring the contribution made by AQRT reporting.

6.4 The Council's discussion focused primarily on the proposals for a survey and proposed questions set out in the agenda papers. Points raised included:

#### **Survey Participants**

- Important to be aware the initial list is not a representative, balanced, group of stakeholders but is primarily designed to get views from policy makers and other parties active in influencing policy.
- Input from other stakeholders is important but may be better obtained in a second phase survey. Nonetheless it would be important to have the views of a broad range of stakeholders for inclusion in any initial survey findings document that may be published.
- Include front line audit partners – possibly in a second phase survey.
- Include corporate management representatives in addition to audit committee chairs – again possibly in a second phase survey.
- Consider including representatives of trade unions.
- Consider reducing the number of politicians in the list.

#### **Survey Questions**

- More granular questions are needed.
- Consider undertaking an initial survey with high level questions, followed up by more focussed questioning taking account of the responses received.

6.5 It was recommended that Mori or other specialists be asked to advise on who and how many participants be involved and how best to undertake the survey given the seniority/standing of the individuals being targeted.

## **7. Horizon scanning**

7.1 Matters identified were:

- Wide downgrading of the credit rating of housing associations. This is a matter that has already been identified to be addressed in the revision of Practice Note 14.
- Consideration should be given to developing more guidance on loan loss provisioning.
- Restructuring of the FSA will cause related references to be out of date in the Practices Notes and other guidance addressing the audits of financial sector organisations.

## **7. Other matters and any other business**

7.1 None.

**10. Next Meeting**

10.1 The next Council meeting is on the morning of Wednesday 3 April, starting at 9.30am.