

**Minutes of a meeting of the Audit and Assurance Council of the FRC
held on 21 March 2017 at the FRC, 8th Floor, 125 London Wall, London, EC2Y 5AS**

PRESENT

Ray King	Chairman
Olivier Beroud	Member
Jane Fuller	Member
Kari Hale	Member (from Minute 4)
Sue Harris	Member
Conall O'Halloran	Member (from Minute 6.2)
Stephen Oxley	Member
Jerry Wedge	Member

OBSERVERS

Lisa Campbell (IAASA)

IN ATTENDANCE

Kate Acott	Project Director
David Andrews	Head of Delivery Unit (for minute 9)
Mark Babington	Deputy Director of Audit Policy
Anu Bhartiya	Committee Secretary
Keith Billing	Project Director
Marek Grabowski	Director of Audit Policy
Josephine Jackson	Technical Director
Melanie McLaren	Executive Director of Audit
Alana Sinnen	Communications Manager
Rebecca Smart	Risk and Assurance Manager (For minute 9)

1 Welcome and apologies

1.1 The Chairman welcomed everyone to the meeting and in particular Alana Sinnen, Communications Manager who was attending the meeting as an observer. Apologies were noted from the Council Members – Paul Cox, Bryan Foss and Scott Knight and the Observers – Lee Piller (FCA) and Michael Gaull (PRA).

2 Declaration of interest

2.1 There were none to be reported.

3 Minutes and Rolling Actions

Minutes

3.1 The minutes of the Audit & Assurance Council meeting held on 13 February 2017 were approved for publication.

Rolling actions

3.2 The matters arising log was noted.

4 Chairman's update

4.1 The Chairman gave an update on the matters that were considered at the Board meeting held on 9 March 2017. The following reports, points and observations were made:

- The key matters under the Chief Executive's report included the planned meeting with the BEIS Minister on the Green paper, review of the Corporate Governance Code, Powers with respect to directors, and the Draft FRC Plan & Budget 2017/18 Consultation on which 14 responses had been received.
- The AQR 2016/17 cycle was drawing to a close and the Board would receive a presentation on the process and its findings at a forthcoming meeting. Mike Suffield will join the April Council meeting to provide an update.
- The Board were updated on the review of the governance and oversight arrangements of the International Standard Setting Boards.
- The Board considered the Actuarial Monitoring regime proposed by the IFoA for monitoring the quality of actuarial work.
- An update on the Financial Reporting Lab activities including exploring a case study on 'Single Figure Remuneration' disclosures and new forms of longer term remuneration.
- Board appointments included appointment of Mark Zinkula as an FRC Board Member and reappointments of the Chair and the Deputy Chair of the Board.
- Feedback on 2017 Effectiveness review findings included streamlining of the governance structure, risk responsibilities and length of papers.
- CEO's report on the FRC Culture and the mechanism for measuring changes to the culture of the FRC.
- Revising ISA (UK) 250 – The Consultation was approved for issue.
- FRED 67 Draft amendments to FRS 102 Triennial Review incremental improvements and clarifications for consultation was approved.
- Enforcement Review included findings to support speed and efficiency of case examination, investigative and disciplinary processes.
- Sanctions Review taking place under the leadership of an independent panel which will be announced soon.

5 Report of the Director of Audit Policy

- 5.1 Marek Grabowski (MG) introduced a suite of papers on his report that included the Activities Log since the last Audit & Assurance Council meeting, the draft minutes of the Codes & Standards Committee (CSC) meeting held on 22 February 2017, the Executive Director's report to the CSC and the Council forward agenda.
- 5.2 Melanie McLaren (MM) gave a brief update on the developments with the investor group meetings. She also informed that in the light of the FRC's role as the Competent Authority for audit, FRC has a responsibility for monitoring the audit market and would be proposing counteractive measures to mitigate risks to that market.
- 5.3 The Council Members discussed and enquired certain aspects of MG's report and the following reports, points and observations were made:
- The IAASB was in the process of obtaining copyright on the Data Analytics video which discusses how data analytics might be in the future to support high quality audit. The Council requested if the link, when obtained, could be circulated for information.
 - The Technical Advisory Group was working well and seemed to be the natural vehicle for discussion on broader issues of the application of the revised Auditing and Ethical Standards. The longevity of the Group will depend upon issues emerging from year end audits carried out using the revised standards, and whether there are Brexit-related issues that need to be discussed.
 - The CEAOB coordination on interpreting some of the matters from the ARD is taking a long time to develop; in the meantime other member states do appear to be interpreting the ARD without going through the central coordination.

- The IESBA Safeguards, Applicability and Structure Exposure Drafts and related papers are extensive and therefore the Council Members were encouraged to read the discussion papers online rather than them being included in the meeting papers.
- It was suggested to include a briefing on Enforcement on a future agenda.
- The IAASB has approved the Exposure Draft of the ISA 540 which includes significant changes, improvements and clarifications. In terms of timing, the document is likely to be published in middle of April. It was agreed that the draft document would be circulated to the Members when available and key points for the direction of travel would be sought at the next meeting. The consultation period would be up to 1 August which is slightly less than the usual period of 4 months.

6 IAASB Update

6.1 MG gave a presentation on the impact of advancements in information technology (IT) on the audit, particularly in respect of the project to revise ISA 315¹ (slides tabled at the meeting). The following was noted from the presentation:

- There is a general concern that the standards do not reflect the rapid developments in IT.
- In particular, as IT is now the medium in which nearly all audit evidence is established, it becomes increasingly important to understand an entity's IT system, including how the integrity of the information is maintained. This is the case whether such audit evidence is produced by, or available from sources external to, the audited entity
- As a result, the relevance and reliability (appropriateness) of audit evidence is becoming more critically dependent on the IT processes and controls that shape its creation, processing, storage and communication.

6.2 The Council considered questions relating to how the audit approach would be affected – including the impact on: other elements of the audit; a substantive only approach to further audit procedures; seeking comfort on the relevance and reliability of audit evidence; how can auditors use IT to improve audit quality; what assurance an data analytics can provide. The discussion included the following points and observations:

- Greater reliance on evidence generated from IT systems means greater reliance on General Information Technology and Controls (GITCs). This may result in a greater need for IT specialists.
- There have been PCAOB standards and inspection led guidance developed in respect of the Information Provided by Entity (IPE) and the Information used in Controls (IUC) and the development made in expectations on the auditors in relation to the IUC is significant.
- It is not about simply testing the information but data integrity is critical too, as data combined to produce that information can originate from different systems.
- Another challenge is if the standards are made too rigid, it would be difficult to adopt them with the continuing developments in IT.
- Auditors find it difficult to apply a materiality judgement when the client's IT department communicates directly with the auditor's IT specialist about the adequacy or otherwise of the IT controls in place (e.g. where the user IDs of leavers from an entity have not been deleted).

7. Project Updates

PN 11 – The Audit of Charities in the United Kingdom

7.1 MB introduced the paper by highlighting the reasons for supporting more extensive guidance for auditors of charities on the application of ISA 570 – Going Concern. MB highlighted the recent Parliamentary Committee reports from the Committee of Public Accounts and the

¹ ISA 315 (Revised) Identifying and Assessing the Risks of Material Misstatement Through Understanding the Entity and its Environment

Public Administration and Constitutional Affairs Committee on Kids' Company and the focus on the failure on the part of the trustees and, in turn, the auditor to consider and robustly challenge the impact of a business model which operated with almost no unrestricted reserves and very limited financial resilience on going concern. It was noted that the working group had suggested the removal of significant amounts of the application guidance additionally inserted into the Practice Note by Kate Acott (KA) as it was not specific to the charity sector.

- 7.2 KA added that there are ongoing dialogues between the charity regulators, trustees and other users of the financial statements which have been shared with KA that demonstrate that there is a lack of understanding from these stakeholders about when an auditor should include a section on a material uncertainty related to going concern.
- 7.3 The Council considered the project and discussed the guidance on ISA (UK) 570 in the Practice Note in detail and the following points and observations were made:
- Whilst there were benefits in the approach taken for revising the material on going concern, one Member felt that it would be difficult for charities to build up reserves, as the duty of a trustee was to ensure that charitable funds were spent delivering the objectives of the charity. However, trustees need to make an assessment of going concern based on all relevant information, including the business model, reserves and policies.
 - Guidance to help auditors assess the judgements made by the Trustees is included in the practice note.
 - It was viewed that watering down the provisions of going concern in the Practice Note could have significant negative implications for audit quality and public interest.
 - The Practice Note needs to draw a clear distinction between the trustees' responsibilities for assessing going concern and the auditors responsibilities to audit the trustees' assessment.
 - The Practice Note should make it clear that there is a difference between the disclosures required by the accounting framework for going concern and longer term issues such as viability.
 - The discussions between the trustees and Charity Commission and other regulators about the communication and education of the trustees should be highlighted in the material.
 - With regards to smaller charities, the going concern issue is much more likely to be short term. Therefore their ability to continue as going concern will be on a similarly short time period. If there are events or conditions around going concern, then that needs to be explained in the financial statements and charities' trustees should be held to account if there is not enough focus on disclosure and risks.

PN 15 – The Audit of Occupational Pension Schemes in the United Kingdom – Consultation Paper and Impact Assessment and Exposure Draft

- 7.4 Keith Billing (KB) introduced the paper and noted that the material had been revised with the help of representation from audit firms, the pensions industry and the Pensions Regulator (TPR). There was a need to revise the PN 15 to take account of revisions to ISAs (UK), IFRS 102, the Pensions SORP and address the emergence of mater trusts as providers of pension schemes and other changes to the regulatory landscape. Major revision has been made to remove non-pension specific material and cross refer where other possible sources of guidance (such as TPR Codes of Practice).
- 7.5 The Council made reference to the 'going concern' aspect of a pension scheme and queried whether ISA 570 was covered in sufficient depth. The Council discussed the auditor's responsibilities relating to going concern and the following points and observations were made:

- KB highlighted that the Pensions SORP explains that the going concern concept does not play the same role in the measurement and classification of assets and liabilities in the financial statements of occupational pension schemes as it does in the financial statements of commercial entities. However, it is still a consideration that needs to be addressed and trustees need to make disclosure about any doubts over going concern
- The Practice Note should be expanded to include more guidance on the auditor's responsibilities and expectations.
- The Practice Note has to be aligned with the reporting regime. The trustees have an obligation to consider the ability of a scheme to continue as a going concern, and to make relevant disclosures of events or conditions affecting 'going concern' as required under the reporting regime. The auditor should carry out appropriate steps to evaluate the trustees' assessment of going concern and subject it to meaningful challenge.
- It was essential that the requirements on going concern in ISA (UK) 570 should be appropriately addressed in the pension schemes Practice Note, having regard to the particular nature of pension schemes.

7.6 KB agreed to take into account the above points raised in the discussion and reflect them in the version of the Practice Note submitted to the Codes and Standards Committee for approval to proceed with the consultation.

Withdrawal of PN 16 – Bank Reports for Audit Purposes in the United Kingdom – Consultation Paper on Minor Consequential Changes to ISAs 330 and 505

7.7 MB outlined that the Bank Reports for Audit Purposes PN in the United Kingdom was dated and was no longer needed to support the work of auditors seeking bank confirmations to support an audit engagement. The proposal was to replace the practice note with an additional application material to ISA (UK) 330 and a footnote to ISA (UK) 505 with links to pro-forma templates to obtain bank confirmations on the British Bankers' Association website.

7.8 The Council Members present agreed to recommend to the Codes and Standards Committee that they approve for consultation the withdrawal of Practice Note 16 – Bank Reports for Audit Purposes in the United Kingdom and the amendments to ISA (UK) 330 and ISA (UK) 505.

Preliminary Announcements

7.9 MB outlined the purpose of the paper which was to discuss ways to enhance and strengthen the value of preliminary announcements, and to consider what assurance over these announcements the auditor should be required to provide. He informed the Council that a lot of research had been done to show how preliminary announcements are extensively used by firms to communicate details of their performance and earnings to shareholders. The intention is to have a dialogue with broad range of stakeholders with a view to updating FRC's current bulletin on the auditor's responsibility for preliminary announcements and maximising its utility.

7.10 The Council Members considered the paper and discussed the responsibilities of auditors in respect of preliminary announcements. The following reports, points and observations were made:

- Thoughts were required on the role of Annual Report and other communication mechanisms with shareholders, and how the FRC can help to maximise the value of these communications.
- It is a legal requirement that the preliminaries cannot be issued unless the auditor has confirmed their agreement to the announcement.
- The options in the discussion paper are deliberately left open as the intention is to stimulate debate and invite stakeholders to share innovative ideas and emerging

practices. The FRC will hold roundtables to get stakeholder views, and will also discuss the results from the outreach with the FCA.

- The results of the outreach and a consultation would be brought to the Council with a proposal as to what steps would be required with the current guidance on auditors responsibilities on preliminary announcements.

7.11 The Council Members present agreed to recommend to the Codes and Standards Committee that they approve for consultation the Discussion Paper on Preliminary Announcements.

8. Strategy – Horizon Scanning and Forward Work Plan

8.1 MB introduced the paper and noted that the Audit & Assurance Team's forward work programme had been aligned with the FRC's forward plan and strategy, the priority projects for the audit division and strategic risks. The focus continued to be in the areas of policy and research, IAASB and international influencing work, implementation and embedding of the ARD Requirements, updating FRC's back catalogues and outreach and influence work to inform and support FRC's mission.

8.2 The Council Members considered the forward strategy and work programme and the updated horizon scanning assessment. The following reports, points and observations were made:

- There was huge list of work to be delivered with limited resources; therefore there were challenges to meet the FRC Priorities and the Divisional Priorities. A number of things would be 'demand led' as the negotiations proceed to deliver Brexit and FRC would need to ensure that it is well placed to respond to support government in the area of audit and assurance.
- There will be a substantial focus and resource allocated on IAASB matters and the requirement to update the FRC material and the standards (the FRC has committed to review all material on a five year cycle) and post implementation review of the ARD.
- From time to time, an equivalent of this paper would be presented to the Council to review the progress made against the plan and have a steer on priorities.
- Not much can be done in preparation for Brexit but FRC stands ready to develop any requirements in a short period of time.

8.3 It was noted that there were areas within the programme that required education and training for Council members to understand the direction and dimension of changes in order for it to provide steer and advice. It would also be helpful for members to understand how Council was performing its role and whether it was meeting management's expectations.

8.4 In response to a query relating to the 'expectation gaps' highlighted within the themes of the forward plan, it was clarified that those were the areas that were based on research and surveys done and there are differences in expectations. Engagement with stakeholders will be required to close the gap by improving quality disclosures around those issues and challenges.

9 FRC Risk Reporting

9.1 David Andrews (DA) gave an overview of the paper and summarised the key points including:

- The Risk Register has been updated and discussed at the Audit Committee meeting and the Executive Committee would be discussing the risk tolerance and the mitigating actions.
- The key element would be to join up the risks from the horizon scanning within the overall risk framework and Councils' input on the risks relating to their areas of specialisation.

- In the responses to the FRC Budget and Plan Consultation, one of the common risk highlighted was in relation to Brexit.
- The Board had identified risks relating to possible disruption within the audit market, enforcement, FRC's powers to tackling poor quality audit, having the right skills with right funding.

9.2 The Council Members reviewed the FRC Principal risks and mitigating actions to assess whether they are adequately described from the perspective of their audit responsibilities and the following reports, points and observations were made:

- Whether point number 8 - 'Failure to maintain as safe information security system' should be made general. DA informed that FRC has been consciously monitoring its IT security. He also informed that the biggest resourcing risk related to funding.
- Cultural shift, meeting audit expectations with rapid change in technology, People and Talent were also major areas of risks.
- One of the actions to mitigate the risk of number 3 - 'Reduction in Audit quality' should be FRC's responsibilities in encouraging the audit firms to achieve the right balance between the consultancy and audit parts of the business.
- The economic vulnerabilities from Brexit including audit requirements for exchange rate, inflation, interest rates, asset values, etc should be included in the Risk Register. DA confirmed that these attributes are included within the risks relating to Audit market and Brexit.
- The expectation gap between the wider remit and inadequate powers of FRC could be viewed as a major risk.
- The risk of relationships with other bodies and the ability to influence should be included in the Risk Register. DA confirmed that the Risk Register includes the risk:
 - that the FRC does not have the right relationship with the bodies;
 - that the bodies themselves don't have the right relationship with their member firms; and
 - of not engaging effectively with audit profession on issues around the audit quality.
- Whether the scenarios such as a FTSE 100 company or a major fund manager has an audit failure in custodianship of assets were considered in the Risk Register. DA confirmed that these risks would be implicitly covered by the Principal risks.
- The risk relating to the impact of tendering on costs and economics of big firms, the revenues, the profits on engagements through tendering, growing portfolios should be focused upon.

9.3 DA confirmed that in future, it would be valuable to have the Council's contribution in this area more regularly and therefore this item would be considered twice a year when the forward strategy and horizon scanning matter is discussed.

10 Review of Council Terms of Reference

10.1 MB drew Council's attention to a typographical error on point number 2 of the paper.

10.2 In response to a query relating to the AQR Committee, which reports to the Conduct Committee it was clarified that there were many other working groups set up within the FRC which advised its relevant Council / Committee and this paper addressed the approval requirement of the groups under the Audit & Assurance Council.

10.3 The Council considered the papers and agreed to recommend to the Codes and Standards Committee (i) the retention of the Public Sector Advisory Group; (ii) the dissolution of the Irish Consultative Committee; (iii) the retention of the Audit and Ethics Technical Advisory

group (TAG) and (iv) the retention for a further year of the Investment Circular and Client Assets working groups.

11 Any other business

11.1 MB informed the Council that the paper on 'High Quality Audit Definition' had been circulated to the Conduct Committee and had received no comments.

11.2 He also informed that the papers for the next meeting would be presented in a new format.

12 Date of next meeting

24 April 2017