



Minutes of a meeting of the Audit & Assurance Council held on Thursday, 15 March 2018 at the FRC Office, 8th Floor, 125 London Wall, London E2Y 5AS

Present:

Sue Harris	Chair of Council
Olivier Beroud	Member
Mary Cleary	Member
Paul Cox	Member
Bryan Foss	Member
Jane Fuller	Member
Kari Hale	Member
Stephen Oxley	Member
Jerry Wedge	Member

Observer:

Michael Gaul	PRA
Lee Piller	FCA

In attendance:

Mark Babington	Deputy Director of Audit Policy
Anu Bhartiya	Committee Secretary
Kate Dalby	Project Director
Mario Dunn	Director of Strategic Communications (For Minute 10 only)
James Ferris	Project Director
Rob Hammond	Team Inspector (For Minute 8 only)
Melanie McLaren	Executive Director, Audit & Actuarial Regulation

1. Welcome and apologies for absence

- 1.1 The Chair welcomed everyone to the meeting.
- 1.2 Apologies were noted from Council Members Scott Knight and Council Observer Shelagh McAlpine (IAASA).

2. Declaration of conflicts of interests

There were none to be reported.

3. Minutes of the last meeting and rolling actions

Minutes

- 3.1 The Council approved the minutes of the Audit & Assurance Council meeting held on 30 November 2017.

Rolling actions

- 3.2 The matters arising log which included rolling actions from previous meetings was noted.
- 3.3 It was reported that the FRC had held a round table meeting with a number of stakeholders to discuss challenges in relation to Data Analytics. A discussion paper would be presented to the Council at a future meeting with a view to developing a consultation on the topic.

4. Update from the Chair

- 4.1 The Chair reported that the Codes & Standards Committee had met on 28 February. Discussions had included early thoughts on the potential impact of Carillion on FRC Codes and Standards, in particular the revision of the UK Corporate Governance Code. The discussion was based on the information available in the public domain.
- 4.2 Ms McLaren reported that since the last Council meeting, the Board had met on 6 December 2017, 7 February and 14 March 2018. The Council noted a summary of matters considered at those meetings including an update on the FRC internal governance review and public body status.
- 4.3 In light of the FRC's Governance Review, the Chair informed the Council that she had met with the Chairs of the Actuarial Council and the Corporate Reporting Council to discuss and ensure that the remit of the Audit & Assurance Council was broadly aligned with other Councils within the governance structure. She further reported a number of points arising from the Governance Review, including:
- The clear demarcation of the roles and responsibilities of the Codes & Standards Committee and the Councils and the roles of the Conduct Committee and its sub-committees.
 - That the review was intended to enhance public confidence in the FRC's independence and the regulatory framework.
 - To enhance the responsiveness of the FRC, Council agendas would be set in accordance with FRC priorities.
 - The Council would be invited to provide perspective on the broader landscape affecting the quality of audit and assurance work. This could include some matters for discussion and comment only.
 - The Council would be asked to advise the executive on the development of the FRC Strategy and Annual Plan in so far as it was relevant to the role of the Council.
 - The Council would continue to receive regular reports from the Audit Quality Review team on any themes or observations identified during their monitoring activities which may be relevant to the Council's role.
 - It was anticipated that the work of the Council would increase in 2019-20 once work on the post implementation review of the UK implementation of the EU Audit Regulation and Directive gets underway.
 - The revised terms of reference of the Council would be shared with the Members of the Councils as soon as practicable.
- 4.4 The Council acknowledged the resourcing pressures faced by the Audit & Assurance Team and welcomed the changes intended to be brought within the roles and responsibilities of the Council. Ms McLaren thanked the Council for their valuable input during and in-between various meetings.

5. Report of the Director of Audit Policy

- 5.1 Mr Babington introduced his report which 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. Particular attention was drawn to the following matters:
- The ongoing focus on IAASB projects to which the FRC continues to make major contributions. Given that these projects include some of the most important standards (risk, quality control, estimates and group audits), this is an appropriate and important use of FRC resources.
 - The ICAEW's proposed changes to their guidance on the inclusion and positioning of a risk management paragraph (the "Bannerman paragraph") in auditor's reports

which gives undue prominence to the paragraph in comparison with other matters the auditor is required to report on or include as a result of either legislation or regulation, and which provide more important and relevant information to users of financial statements. The FRC has requested the ICAEW to revise the material to give the paragraph less prominence.

- Ongoing discussion with BEIS in respect of proposed changes to the legislation for audit standard setting procedures following Brexit.
- As a result of FRC intervention, including meetings with both BEIS and DWP in respect of audit arrangement for Master Trust providers, DWP have proposed amendments to audit requirements for providers of Master Trusts that better align with the requirements of the Companies Act in respect of going concern, and which also comply with the requirements in the Accounting Directive.

5.2 In response to a query, it was noted that that the work to revise PN 19 – *The Audit of Banks and Building Societies in the United Kingdom*, would commence once the IAASB had completed its work on ISA 540.

5.3 The Council discussed the potential implications of the Parliamentary Select Committee’s hearings on Carillion on the FRC’s Going Concern project. It was noted that the FRC would consider how to respond best to any recommendations made by the Select Committee. It was highlighted that the material on going concern had already been expanded by the FRC to support a more rigorous assessment on the part of the auditor. It was noted that the FRC is currently mapping the current requirements in ISA 570 to the risk ISAs (ISAs 315 and 330) to assess whether there are ways in which the standard could be further strengthened. It was suggested to consider broadening the scope of the project to consider separate assurance engagements on the viability statement.

5.4 It was reported that the FRC audit quality thematic review on the implementation of the International Standard on Auditing (UK) 720 would be presented to the Council at a future meeting and would inform how auditors discharge their responsibilities relating to ‘Other Information’.

5.5 The Members were invited to submit suggestions on topics to be included on the agenda for discussion at the Council Away Day in September 2018.

6. Standard Setting Reform – Matters arising from the Monitoring Group’s Consultation and next steps

6.1 Mr Babington provided an update on this matter; it was noted that:

- The Consultation, which closed on 9 February 2018, had received 180 responses. Due to the high response rate there would be a slight delay with the overall timetable. Following a review of responses further outreach would be undertaken to inform the development of final proposals which would be issued for a 3-4month consultation period in November 2018.
- In the interim, the Monitoring Group would publish a neutral factual feedback statement which would highlight the main themes contained in the responses. The statement would be supported by a public interest framework to demonstrate how to assess whether the public interest is served in standard setting. These documents would be used for discussion during the outreach process and would underpin the final proposals for consultation.

7. AAT Project Update

Ethical Standard – Issues arising from restructuring of the Code of Ethics

- 7.1 The Council noted that, subject to the PIOB approval, the restructured IESBA's Code of Ethics was expected to be released in April 2018 and be effective from 15 June 2019. Though the FRC does not adopt the IESBA Code, the intention was that the FRC Ethical Standard would continue to adhere to the principles of the Code, and the requirements in the Ethical Standard will not fall below those required by the Code (i.e. be less stringent). Based on the work undertaken to respond to the IESBA consultation, it is expected that there would be a small number of areas where the Ethical Standard may need to be revised to align with strengthened Code requirements.
- 7.2 Depending on the extent and nature of differences identified in the review of the Ethical Standard to the IESBA Code, the FRC suggested presenting a summary of differences at the next meeting and then to seek advice on whether the revisions to the FRC Ethical Standard should be proposed to be effective by June 2019 or delayed until the wider post Audit Regulation and Directive implementation review has been undertaken. A Council Member also added that by next Council meeting, there would be a better view of any matters arising from the AQR inspections and how those could be fed into the project.

Project Update – Going Concern

- 7.3 It was noted that the first meeting of the working group, which would be set up to support the project, would take place after Easter. The group would consist of members from broader areas to give the project a wider perspective. Ms Dalby agreed to provide the Council a written project plan before the next Council meeting.

Project Update - SIRs

- 7.4 Mr Ferris provided an update on this topic and noted that all SIRs require small updates to reflect changes to relevant legislation, regulations and rules. These include changes to the Takeover Code, Listing Rules and the EU Prospectus Directive. The SIRs also need to be updated to reflect relevant changes to the ISAs (UK) and the Ethical Standard (2016). Consideration would be given whether a new SIR would be required to deal with Quantified Financial Benefits Statements (QFBS), or whether the current SIR 3000, and current market practice provides a sufficient basis for these types of engagements.
- 7.5 The Council noted that a small working group of practitioners, preparers and investor representatives would be established to advise on detailed changes to the SIRs. Kari Hale, Council Member, offered to join the group. The project would also include outreach to investors in liaison with the Accounting & Reporting Policy Team who are conducting complimentary outreach on other forms of market communications. It was anticipated that a consultation document would be presented to the Council for advice in November 2018.

Project Update – ISRE 2410

- 7.6 Mr Ferris highlighted that the objective of a review carried out under ISRE 2410 is narrow in scope and as a result provides limited assurance on the interim statements covered by the report. Therefore, while the FRC updates ISRE 2410 to reflect changes in the regulatory, auditing and corporate governance environment, it would take an opportunity to have a wider dialogue with users about their expectations from this type of review. This would help to eliminate any expectation gap between the users of the reports produced and the auditors who prepare them. The Council advised that while having dialogue with the investor community, the cost benefit perspective of having a wider review should be highlighted. The Council noted that the project would encompass initial market research and outreach with investors and practitioners during March – July 2018,

followed by a publication of a discussion document outlining options. It was anticipated that a formal consultation on changes would be published in January 2019.

Staff Guidance Note 01/2018 The Auditor's provision of restructuring services to public interest entity participants in bank lending or bond funding syndicates

- 7.7 Mr Babington introduced the paper and reminded the Council that the approach to the Guidance had been changed because one audit firm had chosen to commission legal advice. Subsequently, the FRC had sought its own independent legal advice on the approach taken to developing guidance which supported the approach taken by the FRC but required some amendments to the SGN. The FRC had consulted with audit committee chairs of banks to better understand market practices and obtained feedback from the TAG's sub-committee to develop principles-based guidance.
- 7.8 In response to a query in relation to a standard 'deemed' amount to be used for the value of services provided for the purposes of monitoring against the non-audit services fee cap, it was noted that this had been developed as a way of supporting the practical application of the Guidance. It was clarified that this deemed amount should be consistent with the audit committee's assessment of what is trivial for the purposes of being approved through a standing procedure.
- 7.9 With regards to another query in relation to determining to whom are the restructuring services provided when the fee was paid by the borrower, it was clarified that careful application of judgement to facts and circumstances should be applied. It was noted that it does not matter who pays the fee if the entity was owed the duty of care and was benefitting from the services.
- 7.10 Following a query in respect of unintended consequences, it was noted that entities would have to be careful about the restructuring services approved through a standing procedure subject to the application of the non-audit service fee cap applicable to PIEs. This was further explained by using an example of a non-EU global bank with a small UK or EU PIE subsidiary.
- 7.11 In response to a query in relation to the effective date of the Guidance for those entities that have transactions in progress up to 1 April 2018, it was clarified that firms are aware that the FRC is developing guidance on the application of 'restructuring services' and the guidance is based on current market practice. The legal requirements have been in place since June 2016, and therefore it was important to apply the Guidance to all new engagements.
- 7.12 Given the wider interest on the publication of the Guidance, the Council felt that it was not advisable to delay the effective date and provided its advice in support of publication of the Guidance.

Rolling Record Appendix: Guidance on Ethical matters for Reporting Accountants

- 7.13 The Council noted a paper that addresses the ESRA issues from the Ethical Standard in a Q&A format, which would be attached as an appendix to the rolling record of actions.
- 7.14 In response to a query, it was clarified that the subject matter of a particular transaction that is the subject of an engagement may be price sensitive and therefore access to that knowledge is restricted to a small group carrying out the reporting engagement. It was agreed that the sentence would be reviewed and clarified, if required. Subject to that, the Council provided its advice in support of the publication of the Guidance on Ethical matters for Reporting Accountants.

8. Audit Firm Culture thematic review report

- 8.1 Mr Hammond provided a high-level summary of the thematic review on audit firm culture and noted that the audit firms' cultural design is generally good, and firms are investing time and effort to promote their cultural design into day to day activities. He invited the Council to comment on the draft thematic review report which had been circulated in advance of the meeting.
- 8.2 In respect of the overview in the Executive Summary that the firms' cultural designs were 'generally good' it was viewed as contradictory to the statement that 'more can be done'. It was noted that the FRC has seen good examples of some firms taking positive actions to value high quality performance and behaviour. However, the firms could do more to promote to partners and staff the societal value of high quality audit and find ways to recognise positive contributions. Mr Hammond agreed that the narrative in the Executive Summary would be reviewed to present that more clearly.
- 8.3 The Council raised the following points for consideration:
- Whether the thematic review might include an assessment of the culture of taking certain decisions during challenging times by the senior leadership to achieve a desired outcome, noting that the review was based on evidence gathered, which included questionnaire and meetings with staff at firms. The questionnaire results show that partners and staff see the leadership of their firm as living their firm's values.
 - Whether there could be more reflection in the Executive Summary on tone at the top of the audit firms based on the evidence gathered, and whether the Executive Summary could also set out the scope of the review, including that the success of the firms' actions to promote their desired culture would be seen in audit quality inspection results in the years to come.
 - Members raised a question about whether the findings would align with public perceptions on audit and whether some of the challenges to audit firm culture and the need for further improvement could be more strongly emphasised. that could be better emphasised.
- 8.4 Mr Hammond explained, in response to a query as to how the FRC has evaluated the firms' culture, that the review is based on firm documentation, meetings with firm leadership and independent non-executives, web-based questionnaire, focus groups with partners and staff at firms and meetings with a selection of investors and audit committee chairs. Based on the evidence gathered, key highlights are drawn in the report, which presents an understanding of what firms are doing to shape their desired culture. The FRC has not evaluated the quality of culture of each individual firm.
- 8.5 The Council found it surprising to note that four of the eight firms did not include improving audit quality within their whole-firm strategies and further that more could be done to make auditors feel valued for the work they do. Mr Hammond agreed to consider the comments made and reflect them as appropriate in the report.
- 8.6 Following a query, it was noted that a holistic evaluation of individual firms' culture, leadership and governance would form part of the Audit Firm Monitoring project.

9. Audit Firm Monitoring Approach

- 9.1 The Council noted that the project was progressing with meetings taken place with five audit firms and one planned to take place by the end of March 2018. The project approach had been consulted as part of the FRC's consultation on the FRC Strategy for 2018-21: Draft Plan and Budget and Levy Proposal 2018/19. The responses to the consultation on this matter had been largely supportive.

- 9.2 The regulation does not give the FRC, as competent authority, specific powers with which to fulfil this responsibility. Therefore, the FRC would use influence to achieve the project proposals which would involve establishing a forum of regulators seeking support from the FCA, PRA, CMA and BEIS and recruitment of a director to lead the work.
- 9.3 Further updates would be provided at a future meeting, depending upon how the project progresses.

10. FRC Stakeholder Survey Results

- 10.1 Mr Dunn introduced the paper which highlights the outcome of the 2016/17 survey of FRC stakeholders and noted that nearly 300 respondents participated in the survey which included 48 auditors. It was noted that there was a high level of familiarity with the FRC's work among the audit professionals surveyed and slightly lesser favourability on the way the FRC regulate and enforce standards.
- 10.2 The Members considered the survey results and made a number of comments including:
- The Survey results had been published on the FRC website and shared with all Councils.
 - The favourability aspect generally becomes less with those who rarely interact with the FRC in a professional capacity. Therefore, the FRC is looking at establishing effective communication with wider constituencies.
 - With regards to stakeholders' views around enforcement, the FRC was taking steps to increase transparency and visibility of its processes and outcomes. This includes providing more narratives around enforcement decisions and the FRC has already started implementing this with the HBOS report.
 - The results do not highlight any gaps between the FRC's powers and the stakeholders' expectations. However, the point was noted and would be considered within the questionnaire for future surveys.
- 10.3 In response to a request, Mr Dunn agreed to circulate a summary of actions planned to be taken in response to the recommendations arising from the survey results.
- 10.4 The Chair thanked Mr Dunn and the Council for their contribution in the matter.

11. Any other business

There was none.

12. Date of next meeting

The next Council meeting would be held on 14 June at 1pm.