

**Minutes of a meeting of the Audit and Assurance Council of the FRC
held on 16 January 2017 at the FRC, 8th Floor, 125 London Wall, London, EC2Y 5AS**

PRESENT

Ray King	Chairman
Oliver Beroud	Member (from Minute 2.1)
Paul Cox	Member
Bryan Foss	Member
Jane Fuller	Member
Kari Hale	Member
Sue Harris	Member
Scott Knight	Member
Conall O'Halloran	Member
Stephen Oxley	Member
Jerry Wedge	Member

OBSERVERS

Lee Piller (FCA)
Michael Gaull (PRA)

IN ATTENDANCE

Kate Acott	Project Director
Mark Babington	Deputy Director of Audit Policy
Wendy Barnes	Templar Executives (Minute 4 only)
Anu Bhartiya	Committee Secretary
Keith Billing	Project Director
James Ferris	Project Director
Marek Grabowski	Director of Audit Policy
Josephine Jackson	Technical Director
Claire Lindridge	Assistant Director AQR (Minute 7 only)
Melanie McLaren	Executive Director of Audit
Marian Williams	Director of Audit

Welcome and apologies

The Chairman welcomed everyone to the meeting and in particular Anu Bhartiya to her first meeting as the Secretary of the Council. Apologies were noted from Michael Kavanagh (IAASA observer)

1 Minutes and Rolling Actions

Minutes

- 1.1 Subject to minor amendments, the minutes of the Audit & Assurance Council meeting held on 15 November 2016 were approved for publication.

Rolling actions

- 1.2 Mark Babington (MB) undertook to consider whether the action relating to PWC presentation on separating financial statements from annual report and the action relating to the role of the INE was the same subject matter.

- 1.2 In response to a query relating to the discussion paper on Preliminary Announcements, it was reported that the paper would be presented to Council in March 2017. The ICAEW was working on some updated guidance on prospective financial information, which would be followed up. The discussion paper would be used to gain wider stakeholder consultation.

2 Chairman's update

- 2.1 It was reported that the work relating to the BEIS Select Committee – Corporate Governance was progressing. Melanie McLaren (MM) informed the Council that the process of collecting evidence was still ongoing and would continue through January. The recommendations would be developed and responded to the Government in mid-February.
- 2.2 It was also reported that the Developments in Corporate Governance and Stewardship 2016 report had been published in early January. The report gave an overview of the state of governance during 2016.
- 2.3 MM gave an update on various matters and the following was noted:
- There has been a lot of focus on Corporate Reporting and Corporate Governance in relation to Audit & Actuarial Regulation which debates around holding directors and senior management accountable.
 - Sir Win, Stephen Haddrill and MM had visited United States before Christmas to attend the PCAOB Institute. The Institute had also held a series of stakeholders meetings.
 - There had been a meeting with the AICPA and the Centre of Audit Quality who were not in support of Regulations but relied on Sarbanes Oxley Act for good internal control. However, they had expressed their interest in the requirements of auditors' independence.
 - The first meeting of the CEAOB Inspections sub-group had taken place and was attended by 27 member states of the EU. Some members thought that there should be stronger central communication and guidelines whereas others supported for a softer approach. There is a likelihood of holding a round table discussion for questions and answers on substantive matters and sharing of the outcomes internally rather than issuing as public guidance.
 - The PCAOB had been active in their enforcement in Brazil and Mexico and have taken actions in the Netherlands against the auditors in respect of entities having UK listing.

3 Report of the Director of Audit Policy

- 3.1 Marek Grabowski (MG) gave an update on his report to the Committee and the following was noted:
- ISA 540 – Audit of Accounting Estimates – Following on from the IAASB meeting held in December 2016, the Board had discussed the drafting proposals of the TF regarding the auditor's risk assessment procedure and response requirement. There were a large number of changes being made to the standard including to address current value accounting estimates and related disclosure requirements.

- PN 16 – Bank confirmation reports – Following the discussion with the BBA and ICAEW regarding Practice Note 16, FRC is considering withdrawing the PN and providing a link on the FRC website to the BBA’s confirmations website which contains the current templates. In response to a query as to how it would be ensured that the page link was always available, it was clarified that, based on conversations with BBA, it was expected that the linked web page would be maintained. In addition, application material in ISA (UK) 330 – *The Auditor’s Responses to Assessed Risk*, would be supplemented to encourage auditors to consider how to gain audit evidence about lines of credit or guarantees provided by an entity’s banking provider.

4 Cyber security

4.1 Wendy Barnes (WB) gave a presentation on Information Risk and Cyber Security and the role of audit firms, audit and assurance in managing information and data. A hard copy of the presentation was tabled at the meeting. The following points were highlighted in her presentation:

- The nature and threat of cyber risk, the growing vulnerability and limitations in protecting information from all threats.
- Three steps to smarter cyber resilience including understanding the threats, deciding what matters and then taking actions.
- The major players of cyber threat - outsiders including criminals, spies and espionage, hackers and hacktivists and terrorism and warfare. 31.5% of the threats are from malicious insiders and 23.5% from inadvertent actors.
- The consequences of threats lead to reputational risk, financial loss, business disruption, market and customer confidence and fines.
- Legal regulations applied to IT, security and terrorism. Data should be handled as per the Data Protection Act 1998 and the General Data Protection Regulation 2017 (GDPR). Information Commissioners Office have issued 12 steps guide to prepare organisations for GDPR.
- Audit firms should be looking at securities and mitigations in place to manage loss of data sets and conduct cyber security audits as part of internal and external audits.
- Expansion of audit committee role beyond financial assurance and the external auditors to seek endorsement of systems and processes and review cyber security and resilience on data.
- The need for Boards to demonstrate compliance with standards regulations as there is no independent regulator for cyber and information resilience.

4.2 In response to a query relating to Cloud computing, it was noted that this is an area of concern as the organisation should be aware as to where the data is stored, how it is retrieved, who has access to it and how is it used. There are ways of managing this risk.

4.3 Good practice in this area would include the three lines of Defence and External Audit including cyber resilience in people, processes and technology, operating within the risk appetite. Good practice in internal audit would include oversight of policies and standards and risk appetite. Reporting data breaches is important under the GDPR.

4.4 Following a query in respect of trends and popular targets in cyber-crime, it was reported that the major victims were the big retailers who manage credit card information. The players in the cyber area are organised criminals who try to access

data to support their crime. In recent times, the weakest link for criminals has passwords and to tackle this, password systems often now include enhanced verification steps seeking additional information when a password is entered through a different device.

4.5 The Chairman thanked WB for the useful presentation.

5 High Quality Audit

5.1 MB provided an update on High Quality Audit to the Committee highlighting the discussions and the outcomes of the away day and the meeting in October 2016. The paper included the key attributes on the definition of the high quality audit identified by senior stakeholders and the draft definition that resonates with the stakeholders' expectations than just complying with legal requirements and regulations.

5.2 In response to a query relating to the words in the definition, *High Quality Audit that provides strong deterrent effect against actions that may not be in the public interest*, MB clarified that the purpose was to deter actions being taken that are not in the public interest, and to underpin stakeholder confidence in audit in this respect. It was suggested that the wording could be further reviewed to clarify this purpose.

5.3 It was suggested that consideration be given to further shortening the definition. MB reminded the Council Members that one of the challenges in promoting justified confidence in high quality audit, was the lack of a definition of what a high quality audit looks like. It was highlighted that, given the FRC's responsibility for overseeing audit in the UK, there is a need to be able to articulate this. The definition drafted in the paper incorporated the aspects of a high quality high quality audit previously discussed, including reference to influencing public interest behaviour to underpin stakeholder confidence in audit.

5.4 The Council members commended the work undertaken and the following observations were made in respect of the definition:

- Its primary focus was rightly on the quality of audit in inspection activity, whilst recognising the value to high quality reporting of auditor insights to the Board.
- It clearly demonstrates that, to achieve high quality audit, means going further than merely meeting legal requirements.

5.5 In the light of the above discussion, a few drafting suggestions were made and MB agreed to revise the definition and circulate to the Committee before the next meeting.

6 Audit and Assurance Technical Advisory Group

6.1 MB provided an update on the TAG meeting held in December to discuss matters relating to ethical standards. He noted that the Group had discussed the application of the requirements of the audit regulation and directive and of the new ethical standard, in relation to a Power of Attorney and Prohibited tax services. Subject to any advice received from the Council, the guidance notes and the rolling actions will be updated on the FRC website. MB also noted that a further TAG meeting had been arranged in for follow up of any matters that arise out of the forthcoming year-end audit season.

6.2 Following a suggestion by a Council member, MB agreed to amend the references to 'law' in the Prohibited Tax Services guidance note to 'law and regulation'. (*Secretary's post meeting notes: Following the meeting, MB checked the Audit Regulation and noted that it only refers to 'law', and since all of the FRC material is consistent with the*

Regulation, MB agreed with the Council Member that the proposed amendment would not be appropriate.)

- 6.3 The Council noted the minutes and the rolling actions and were content with the guidance notes being updated in the FRC website with a note that the AQR had participated in all meetings with the TAG and had participated internally in debating the matters from an FRC policy point of view.

7 Draft best practice guidance – Audit tendering

- 7.1 Claire Lindridge introduced a paper that highlighted revisions to the FRC's notes on best practice in audit tendering. The audience of the original document, which was published in 2013, was Audit Committees of FTSE 350. Following the implementation of the Audit Regulation and Directive, the requirements of audit tendering and auditor rotation are extended to all Public Interest Entities.
- 7.2 The Council debated whether it would be appropriate for the Audit Committee Chairman to engage with investors to explain how the decision was made and how conflicts were managed. After a thorough discussion, the Council agreed that there were opportunities for the non-executives of the company to establish engagement with the investors and therefore to include non-executives as an option, rather than just the Audit Committee Chairman.
- 7.3 The Council discussed various aspects of the audit tender further and the following suggestions were made:
- Examples of critical success factors could be added.
 - More emphasis on audit quality could be made in the introduction and decision making sections.
 - To include obligations to a regulator for regulated PIEs. (*Secretary's post meeting note: Following the meeting, CL discussed this with the person who had suggested it, who thought, on reflection, that it was not necessary to add to the regulators' own rule books.*)

8 Project Updates

Practice Note 20 – The Audit of Insurers in the United Kingdom

- 8.1 James Ferris gave a brief update on the paper highlighting that the consultation had formally closed on 16 December. Overall, the stakeholders had supported the revisions to the PN 20 and withdrawal of PN 24. The respondents had requested that the FRC consider providing more precise and technical descriptions in illustrative auditor's reports of the scope exclusion which results from the PRA's audit requirement and European regulations.
- 8.2 The Council noted that the main part of this work was in response to the Prudential Regulation Authority's requirement for mandatory external audit of elements of Solvency II public reporting in the insurance sector. The proposed revisions to PN 20 were drafted in consultation with an expert working group led by FRC staff, non-executive members of the FRC, audit practitioners, the PRA as regulator and professional and trade bodies.
- 8.3 It was also noted that in respect of SFCR audits, the guidance notes met the needs of investors, simplifying the description of items which are in and out of scope of audit providing clearer communications in the auditor's report, and managing auditor expectations by including additional material covering the audit of the internal model.

- 8.4 MB noted that subject to the advice received from the Council, the Codes & Standards Committee would be reviewing the guidance notes on 18 January and if approved, the updated guidance would be published.
- 8.5 The Council agreed to recommend to the Codes & Standards Committee that the CSC should approve the guidance notes on PN 20 and the withdrawal of PN 24.

Practice Note 15 – The Audit of Occupational Pension Schemes in the United Kingdom

- 8.6 Keith Billing (KB) introduced the report and updated the Council on the progress on the revision of PN 15. The Council noted that it would be presented with the draft revised PN in March for discussion and advice. The following was noted:
- PN 22 which was issued in 2001 to give guidance to auditors on what were then new accounting requirements introduced by FRS 17 had not been updated since then and were significantly out of date. It was proposed by the executive that PN 22 should be withdrawn and at the same time the FRC should identify the auditing standards that now address the matters dealt with in PN 22.
 - A proposed amendment to the draft ‘Pension Schemes Bill’ had been discussed at the House of Lords, which suggested a change to the audit regime for participating funding organisations of master trusts. If this requires amendment for auditing and reporting on pension schemes, practice note 22 will address those changes.
 - FRC is responsible for oversight of the actuarial regime which includes actuaries’ responsibilities and accountabilities and the FRC is also responsible for the corporate reporting regime. It was reported that there have been challenges from low interest rate environment about discount rates, valuation techniques and decision making.
- 8.7 The Council was content with the approach being taken to revise PN 15 and the approach suggested in relation to withdrawing PN 22.

9 Draft Consultation Responses

Supporting credibility and Trust in emerging forms of external reporting

- 9.1 MB drew attention of the Council Members present to the draft response of the FRC to the IAASB’s discussion paper concerning supporting credibility and trust in emerging forms of external reporting. The response had been drafted along the lines of the proposed paper submitted to the Council at its last meeting. It was noted that the response in the letter was based on contributions received from UK stakeholders, audit firms and investors representatives.
- 9.2 It was noted that the draft letter had been circulated to Codes & Standards Committee for their input.
- 9.3 MG informed the Council that FRC has encouraged its interest in this area. Our stakeholders have raised with us a growing demand for external reporting, supported by assurance to underpin user confidence. In response to a query as to which would be the best placed to audit the emerging forms of external reporting (e.g. internal or external audit), it was stated that since some areas of reporting were still relatively immature in terms of the reliability of data and the robustness of the underlying processes, it was best for now, to recognise that this remains an area that will continue to develop.
- 9.4 The Council supported the report and the letter to the IAASB.

Exploring the growing use of technology in Audit, with a focus on Data Analytics

- 9.5 MB provided a brief update on FRC's joined up approach for working with thematic review on the Use of Data Analytics in the Audit of Financial Statements. MB reported that the FRC's response to the IAASB's request (attached as appendix 2A to the report) reflected the outcomes of the data analytics thematic report which had attracted significant stakeholder interest.
- 9.6 It was queried whether there was work to be undertaken around the conceptual framework for audit and designing the audit programmes that involved the use of data analytics. The Council was informed that an IAASB advisory group had been set up which was having discussions with stakeholders to get an insight into the implications of different audit technology and the possible need for change in the auditing standards.
- 9.7 In response to a query whether LAB had a role to play in this area, MW reported that there was an ongoing Financial Reporting Lab project on the digitalisation of Corporate Reporting, which would provide any information to anyone at any time. The first phase of the project has been completed. The observations arising from this project would be rolled out internationally as there was a considerable interest. There would be practical consequences that standard setters would need to consider and therefore the exercise would be repeated in three years' time.
- 9.8 Council members observed that one of the challenges to address with Data Analytics was the set of tools which is used for risk assessment in an audit. These tools could be used to evaluate data Integrity.
- 9.9 Following a query, it was reported that the work of Big 6 audit firms with respect to the controls built in SAP and Oracle platforms were examined which appeared to be approaching in similar ways in respect of cleansing data, packaging in a bespoke way and feeding it.
- 9.10 The Committee was content with the text of FRC's response to the IAASB.

10 Any Other Business

- 10.1 The Chairman reminded the members present to complete the Council effectiveness survey by 29 January.
- 10.2 The Committee requested to feedback any messages arising from the meeting with the Audit Committee Chairs Independent Forum.
- 10.3 The next meeting of the Council – 13 February 2017.