Enhancing justifiable confidence in audit through implementation of the EU Audit Regulation and Directive

Financial Reporting Council

02 November 2015

FRC Financial Reporting Council

Introduction

Stephen Haddrill

Chief Executive, FRC

FRC Financial Reporting Council

Agenda

Time	Item	Speaker
15:30	Arrival and registration	-
16:00	Introduction	**Stephen Haddrill,** CEO
16:10	FRC Summary of main changes - what ARD means for audit and the UK	**Marek Grabowski,** Director, Audit Policy
16:35	Panel Discussion	• **Moderator: Ray King,** Chair, Audit and Assurance Council • **Melanie McLaren**, Executive Director, Codes and Standards, FRC • **Marek Grabowski,** Director, Audit Policy, FRC • **Hywel Ball,** EY Managing Partner Assurance, UK & Ireland • **Rodger Hughes,** Chairman of National Counties Building Society and former Audit Committee Chair
17:45	Closing remarks	**Ray King**
17:50	Drinks and networking	-

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Changes to Ethical and Auditing Standards

Marek Grabowski

Director of Audit Policy, FRC

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Drivers for Change

- Implementation of the Audit Regulation and Directive.

- FRC review of the ethical framework and issues identified in relation to its application.

- More public interest assurance engagements subject to FRC performance standards to be addressed.

- Revised auditing standards issued by IAASB.

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Changes to Ethical Standards

Audit Regulation

- Most significant changes apply to restrictions on non-audit services for PIEs.

- The FRC is not proposing to mandate applying these restrictions to other entities.

Audit Regulation

EU blacklist

- Establishes more outright prohibitions than current FRC requirements, in particular in relation to tax services and services that "involve playing any part in the management or decision making of the entity".

- The FRC is not extending the blacklist.

- The FRC is proposing to take up the derogations, with the condition any impact on financial statements is "clearly inconsequential" rather than "immaterial".

Audit Regulation

Cap on fees for non-audit services

- The FRC is not proposing to lower the 70% cap and make it more stringent (it cannot be raised).

- The FRC is proposing that a 'gap year' will not 'reset the clock' and, for a group audit, the cap should include network firms.

- Services required by law or regulation that are exempt for the purposes of the cap include those required by rules issued by a regulator.

Audit Directive

Changes include:

- Independence requirements extend to natural persons whose services are placed at the disposal or under the control of the firm and who are involved in the audit.

- Specific requirement to address independence issues within 3 months that may arise if an audited entity is acquired by, merges with, or acquires another entity.

- Restrictions on gifts and hospitality reduce the limits to those where an objective, reasonable and informed third party would consider the value to be trivial or inconsequential.

- Certain requirements in the current standards applicable to "immediate family members" now apply to "persons closely associated", which follows a broader EU definition.

Existing Requirements

Existing more stringent requirements for listed entities are proposed to be retained

- Certain reliefs in relation to non-audit services proposed for listed entities with a market capitalisation below £100m (where not prevented by the Regulation).

- Listed entities do not include those whose securities are not freely transferrable or tradeable.

- Requirements for communications with those charged with governance, limits on proportion of total fees from a single client, and rotation of partners are proposed to apply also to non-listed PIEs.

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Other Changes

Requirements

- Contingent fees for tax advice prohibited.

- The term 'chain of command' is removed. Requirements apply to persons in a position to influence the conduct or outcome of the engagement.

- For a group engagement, a network firm whose work is used should be independent in accordance with principles and requirements applicable to the group auditor. Other firms must at least comply with the IESBA Code.

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Other Changes

Requirements

- New requirements in relation to accepting an engagement for an entity that employs a former partner or other restricted person – consistent with the position where a partner or other restricted person leaves the firm to join an audited entity.

- Prohibition on acting as an advocate for an audited non-PIE in relation to tax including before it gets to a tribunal or court (consistent with position for PIEs under the Regulation).

Other Changes

Structure and scope

- Single ES with overarching principles and supporting ethical provisions which taken together establish a set of ethical outcomes that must be met.

- It is made clearer that where safeguards are necessary to reduce threats it must be to a level where "independence is not comprised". Independence would be deemed to be compromised if it is probable that an objective, reasonable and informed third party would conclude that it is compromised.

- Applies to all public interest assurance engagements carried out using FRC performance standards, including the forthcoming client assets standard (ESRA to be withdrawn).

- Proposing to retain the reliefs provided by the Ethical Standards for Provisions available for Smaller Entitles (ES – PASE).

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Impact on Firms

- Combined update and familiarisation required for changes
- Need to monitor provision of non-audit services and adherence to the cap
- Need to think about those in a position to influence an engagement
- Changes when partners and other restricted persons leave the firm

Changes to Auditing Standards

Introduction

- Changes arise from:
  - Audit Regulation and Directive
  - IAASB's projects
    - Auditor reporting (700 series)
    - Other information (720)
    - Disclosures (Various)
- Implementation date periods commencing on or after 17June 2016.

Summary of changes

- Increased **auditor reporting** requirements for more matters to be included in the auditor's reports for both PIEs and other listed entities (incl. AIM).

- Explicit **reporting on Other Information** for all entities and additional opinion on whether OI prepared in accordance with the appropriate framework for companies.

- Additional reporting by exception on **going concern**.

- For PIEs only, additional **reporting requirements for those charged with governance** and **regulators**.

- Specified organisational requirements for audit firms, including quality control – but little new in substance.

- The FRC will continue to be able to augment standards for national legal requirements and to the extent necessary to "add to the credibility and quality of financial statements".

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Auditor Reporting

- For PIEs and all listed entities, auditors will report:

  - Key audit matters and response to those risks

  - An overall view of the scope of the audit

  - Materiality

- For PIEs, auditors will also need to report other matters required by ARD.

Other Information

- For all entities, auditors will be required to report on whether there are material inconsistencies between the other information and financial statements/auditor's knowledge.

- Additional reporting required for auditors of companies:
  - Opinion on consistency with FS and prepared accordance with legal framework.
  - Statement on whether material misstatements identified.

Going Concern

- Report by exception on:
  - Management's use of going concern basis of accounting not appropriate
  - Management has not disclosed any identified material uncertainties.

Reporting to TCWG and Regulators

- Additional report to audit committee:
  - Independence and compliance with ethical standards
  - Non-audit services provided
  - Other matters relevant to the audit.
- Reporting to regulators:
  - Material breaches of laws or regulations
  - Material threat or doubt over continuous functioning
  - Modified audit report.

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Panel Discussion

- **Moderator: Ray King**, Chair, Audit and Assurance Council

- **Melanie McLaren,** Executive Director, Codes and Standards, FRC

- **Marek Grabowski,** Director, Audit Policy, FRC

- **Hywel Ball,** EY Managing Partner Assurance, UK & Ireland

- **Rodger Hughes,** Chairman of National Counties Building Society and former Audit Committee Chair

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Q&A

Please wait for the microphone and state your name and your organisation