



**Minutes of a meeting of the Audit & Assurance Council held on Monday, 25 February 2019 at the FRC Office, 8<sup>th</sup> Floor, 125 London Wall, London E2Y 5AS**

**Present:**

Sue Harris	Chair of Council
Olivier Beroud	Member
Paul Cox	Member (via teleconference)
Bryan Foss	Member
Jane Fuller	Member
Kari Hale	Member
Scott Knight	Member
Fiona Kordiak	Member

**Observers:**

Michael Gaull	PRA
Lee Piller	FCA
Aoife Warren	IAASA

**In attendance:**

Mark Babington	Deputy Director of Audit Policy
Anu Bhartiya	Committee Secretary
Kate Dalby	Project Director
James Ferris	Project Director
Marek Grabowski	Director of Audit Policy
Josephine Jackson	Technical Director

**1. Welcome and apologies for absence**

The Chair welcomed everyone to the meeting and in particular Aoife Warren to her first meeting. Apologies were noted from Mary Cleary (Council Member).

**2. Declaration of conflicts of interests**

There were none reported.

**3. Minutes of the last meeting and rolling actions**

*Minutes*

- 3.1 The minutes of the Audit & Assurance Council meeting held on 8 November 2018 were approved for publication, subject to minor amendments.

*Rolling actions*

- 3.2 The matters arising log which included rolling actions from previous meetings was noted.

*Council meeting dates for 2020*

- 3.3 The Council noted the meeting dates for 2020.

**4. Chair's Update**

- 4.1 The Chair informed that the recruitment exercise to appoint a senior preparer on the Council was progressing, but the efforts to secure a senior auditor member from audit firms have been less successful. However, the search for the latter post is still ongoing.

- 4.2 The Chair also informed that the Codes & Standards Committee had met in November and January 2019 and the discussion had mainly focused on the development of the new Stewardship Code.

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

- 5.1 The Director of Audit Policy 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:

- FRC would be making progress in implementing as many recommendations as possible arising from Sir John Kingman's independent review, although some recommendations could not be progressed without legislation and BEIS would consult on recommendations, possibly in phases.
- A number of workstreams have been agreed to address some of the immediate issues arising from the Kingman recommendations and one of the workstreams would be focusing on expanding auditor reporting requirements to require the use of 'graduated' findings.

- 5.2 Considering the volume of the ongoing projects such as the work of the CMA, the review of the Future of Audit, the project on the Future of Corporate Reporting and supporting the implementation of audit and assurance related Kingman recommendations, a Member raised a query whether the Council should meet more often to provide input on these matters. The Council discussed and reflected on the outcomes of the internal governance review of the FRC in 2018 when the Board had agreed to streamline the remit of the Councils. It was noted that ad-hoc working groups are formed from time to time to gather input of relevant stakeholders on specific projects and from the participating Council members on the associated working groups, as necessary; this had worked well in the past, most recently for the Going Concern project. It was also noted that the significance of many current projects require time between meetings to develop each phase, with no obvious value in providing operational updates in the intervening period. Sir John Kingman viewed the FRC's governance structure as overly-elaborate with a need to be further simplified and streamlined. Therefore, the FRC Executive will continue to focus on significant issues relating to audit and assurance matters with the given number of Council meetings.

## **6. Exposure Draft of ISA (UK) 570 (Revised) – Going Concern**

- 6.1 The Council considered the Exposure Draft of ISA (UK) 570 (Revised) for consultation which was drafted following significant work and discussions through a Working Group included representation from Council and the Codes and Standards Committee. The Project Director noted that the Working Group raised a number of issues which do not fall within the remit of the project to revise the auditing standard such as amendments to the UK Corporate Governance Code and changes that might be required to Corporate Reporting and Company Law. Those matters would be fed into the work on the future scope of audit led by Sir Donald Brydon and the FRC's project on the Future of Corporate Reporting.

- 6.2 It was explained that the Working Group's discussions had focused on strengthening the standard in light of the fundamental importance of going concern in the preparation of financial statements, the feedback received from the Audit Quality Review inspectors and the findings arising from the FRC's enforcement cases. It was suggested highlighting this focus in the consultation paper and clarifying that the matters requiring any changes to the financial reporting framework would be matters for consideration by other ongoing projects.

- 6.3 In response to a query whether the FRC would be required to review the standards again when the work of the Brydon review and the Future of Corporate Reporting project are completed, it was clarified that some of the outcomes of those reviews may require legislative changes which may have a long lead time, given the lack of available Parliamentary time. Considering the growing focus on going concern, it was critical to review the standards now rather than waiting for the outcome of those projects, and consistent with Sir John Kingman's recommendations, that the FRC should use existing powers to proactively respond to the needs of consumers of audited financial statements.
- 6.4 A Member raised a concern that the revision to the Standard may risk increasing the expectation gap in relation to the auditor's responsibilities. The FRC Executive disagreed and explained that there may be unrealistic expectations that the users might have in respect of auditor's assurance on the future of the entity. The auditor is not expected to predict the future but instead, to evaluate whether there are events or conditions which may impact on the financial statements and whether these have been properly disclosed. The revised Standard explains how auditors should evaluate management's assessment of going concern, how auditors should challenge management's assumptions and projections and disclose how the audit process has challenged management's assessment through enhanced reporting.
- 6.5 In response to a query in relation to the term 'management' which is used throughout the Standard, it was clarified that the term would mean the entity's board of directors who are charged with governance. The Project Director agreed to sense check the use of the terminology used throughout the Standard. A Member suggested that a probing scenario could be included to help auditors identify indicators of possible management bias. It was highlighted that provisions 10.5 and 18.1 require auditors to evaluate events, management judgements and decisions to determine if they are indicators of possible management bias.
- 6.6 A Member made reference to Sir John Kingman's recommendation of introducing a regime similar to Sarbanes-Oxley in order to establish robust internal controls in respect of work on risks and the viability statement. It was noted that introducing a different regime would be a matter of separate consultation, and would require legislation. The proposed Standard provides for a more robust risk assessment and a better basis for identifying events and conditions and assessing whether material uncertainty exists and how the auditor should consider the appropriateness of the disclosure of material information.
- 6.7 A concern was expressed that the Board's statement in respect of the going concern basis of accounting and identification of any material uncertainties to the entity's ability to continue to do so over a period of at least twelve months was not long enough. It was clarified that this was the 'minimum period' required by accounting standards and company law. It would not be appropriate to require auditors to consider a longer period as that would in effect overrule the accounting standards and legal requirements. However, the concern was noted and would be fed into the Brydon project and the project on the Future of Corporate Reporting. It was suggested and agreed that a question would be included in the Consultation Document seeking views on mechanisms that the FRC should employ to ensure there is widespread awareness of the Director's responsibilities in respect of going concern.
- 6.8 The Council felt it was important that the consultation process should seek the views of a wide range of stakeholders including preparers. It was noted that efforts are being made to engage with the 100 Group to raise more awareness of the proposed changes.

- 6.9 In response to a query whether consideration was given to including illustrative auditor's reports in the Standard, it was explained that such examples are included in the appendices to the international ISAs, but that these have never been tailored to reflect UK requirements. For UK purposes, a separate bulletin containing illustrative auditor's reports exists which will be updated in due course.
- 6.10 It was noted that the impact assessment gives regard to the FRC's 'Principles for the development of Codes, Standards and Guidance'. These require that the FRC considers whether the proposed changes are a proportionate response to the issues that need to be addressed. The impact assessment as drafted follows the approach developed under ARD. It was suggested that stakeholders' views could be sought if they believe other factors should be considered in evaluating costs and benefits as a result of the revisions proposed in the consultation.
- 6.11 Subject to the above discussion, the Council advised the FRC Executive to recommend to the Board to approve the issue of the ISA (UK) 570 (Revised) Exposure Draft for consultation for a period of three months.
- 6.12 The Chair recognised the enormous amount of work involved in this project and commended the FRC staff and the working group for their efforts and contribution.

## **7. Standards for Investment Reporting**

- 7.1 The Project Director introduced the paper and noted that SIR 1000 provides basic principles and procedures for all relevant engagements, and SIRs 2000 – 6000 provide additional principles and procedures for specific type of public reporting engagements.
- 7.2 The Council considered and discussed the draft Consultation document and the individual SIRs 1000 – 6000. Through discussion, the Council made a number of points, comments and observations, including:

### *Materiality*

- The concept of materiality is used by the preparers of information included in an investment circular, and also by reporting accountants when forming their opinion. The approach to materiality can be different for each type of engagement - for example when dealing with forward looking financial information (e.g. profit forecasts) the reporting accountant is evaluating information which is dependent on future events that may or may not happen.
- Proposed changes to the illustrative accountant's reports in the SIRs include the addition of the words 'in all material respects' in the opinion. This provides greater transparency about the nature of the work done, and the application of materiality. At the same time, the Council noted that some regulators might be concerned that this represents a 'caveat' to the opinion - even though it is not.

### *Fair, Balanced and Understandable*

- Reporting accountants are required by SIR 1000 to give their consent for their reports/names to be included in an investment circular. The previous version of SIR 1000 made the giving of this consent conditional on the reporting accountant considering the overall impression given by the investment circular as a whole. The criteria for this test was drawn from the ethical standards - whether the investment circular was misleading to the extent that the reporting accountant would not want to be associated with it.
- The proposed change is that - where the UK Corporate Governance Code applies to an entity – then the 'fair, balanced and understandable' criteria should apply, firstly because preparers are required to use them in the preparation of the circular and

secondly because they provide an enhanced set of criteria over and above the 'misleading' test.

- The Council recognised that there could be challenges in applying these criteria - for example, what would 'understandable' mean in the context of a highly technical document such as an investment circular. It was suggested and agreed to include a question in the consultation to seek stakeholder views on the proportionality and usefulness of this proposal.
- Additionally, it was suggested and agreed that during the consultation process, if opportunity allows, the staff would seek further specific feedback on the applicability of these criteria in the context of an investment circular reporting engagement.

#### *Going Concern*

- The language in respect of going concern has been aligned with that used in the separate consultation in respect of Going Concern for the audit of financial statements.
- The Council discussed the potential difficulties for reporting accountants when dealing with going concern in the context of a relevant transaction. It was queried as to how this assessment would read across to the analysis of the working capital statements which are also required; or how would they assess the impact of a transaction not completing. It was noted that close consideration would need to be given to the consultation feedback on this point.

7.3 Subject to the above discussion, the Council advised the FRC Executive to recommend to the Board to approve the issue of the SIRs consultation along with SIR 1000 – 6000 as set out in appendices 1 – 7 of the paper.

### **8. Post Implementation Review of the 2016 Auditing and Ethical Standards**

8.1 The Deputy Director of Audit Policy introduced the position paper and outlined the FRC's direction of travel in making revisions to Auditing and Ethical Standards by responding to a number of issues including the Post Implementation Review – call for feedback, the Kingman review, the CMA market study, IESBA Code of Ethics and the Brexit legislation.

8.2 The Council discussed the implications for audit if UK left the European Union without a withdrawal agreement and no transitional period. The Council noted the requirements that would apply to auditors which would mainly affect independence considerations, non-audit services provided to components of UK groups outside of the UK and the audit fee cap. As these requirements would take effect for periods commencing on or after 29 March 2019 in the event of there being no deal, audit firms and audit committees would need to act quickly to address any resulting risks of breaching applicable legal requirements. The Council confirmed that Appendix 1 of the paper which set out the impact of the changes to the requirements in standards was helpful.

8.3 The Council considered the position paper which is intended to follow with a consultation on the revised text of relevant standards from early July 2019 and noted that a consultation paper would be presented to the Council at its next meeting in June 2019. The Council agreed to give its advice to the FRC Executive to recommend to the Board to approve the issue of the Position Paper.

### **9. Future of Audit Project – Brydon Review**

9.1 The Chair introduced the Terms of Reference of the independent review into the quality and effectiveness of audit led by Sir Donald Brydon. She informed that the FRC Executive will provide an update on the progress of the Project at each Council meeting, which would be discussed and offer an opportunity for Council to provide its thinking.

9.2 A Member suggested Sir Donald Brydon be invited to one of the Council meetings to provide an insight into the project. It was noted that the FRC is not aware of the plans and approach of the project and therefore would not be able to provide any commitment to this suggestion though it would be progressed. It was noted that additionally the Council Members could provide their comments into the project when the call for evidence is published.

**10. Any other business**

There was none.

**11. Date of next meeting**

The Council noted that the next meeting would take place on 25 June 2019.