



Minutes of a meeting of the Audit & Assurance Council held on Tuesday, 25 June 2019 at the FRC Office, 8th Floor, 125 London Wall, London E2Y 5AS

Present:

Sue Harris	Chair
Olivier Beroud	Member
Mary Cleary	Member
Paul Cox	Member
Bryan Foss	Member
Kari Hale	Member
Andrew Kail	Member
Scott Knight	Member
Fiona Kordiak	Member
Richard Lawrence	Member

Observers:

Simon Gibbs	PRA
Lee Piller	FCA
Aoife Warren	IAASA

In attendance:

Mark Babington	Acting Director, UK Auditing Standards and Competition
Anu Bhartiya	Committee Secretary
Keith Billing	Project Director
Kate Dalby	Project Director
Marek Grabowski	Director of Audit Policy

1. Welcome and apologies for absence

The Chair welcomed everyone to the meeting and in particular Andrew Kail, Richard Lawrence and Simon Gibbs to their first formal meeting. There were no apologies reported. The Chair informed that Jane Fuller had stepped down from the Council and thanked her for her contribution.

2. Declaration 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 25 February 2019 were approved for publication, subject to a minor amendment.

Rolling actions

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

4. Chair's Update

- 4.1 The Chair informed that the Codes & Standards Committee had met on 1 May and 12 June 2019 and the discussion had mainly focused on the development of the new Stewardship Code.

4.2 With regards to the Council Away Day on 23 September 2019, the Chair invited the Members to provide their suggestions on the topics to be included on the agenda.

5. Report of the Director of Audit Policy

5.1 The Report was taken as read.

5.2 The Council noted that this was Kate Dalby's last meeting before she went on maternity leave. The Council thanked Kate for her contribution to the development of auditing standards and wished her best for the coming months.

6. PIR: Ethical and Auditing Standards

6.1 The Acting Director, UK Auditing Standards and Competition introduced the topic and noted that:

- The main objective for reviewing the Ethical and Auditing Standards is to enhance the confidence in audit by strengthening auditor independence and ethical conduct and continuing to enhance and promote better audit quality and transparent reporting;
- The current Post Implementation Review takes into account the outcomes of the AQR thematic review on 'other information' in the annual report, addressing issues arising from the FRC's enforcement and inspection work, whilst waiting to address issues which are within the scope of the Brydon Review, until Brydon reports at the end of the year. The revisions seek to address the concerns of the BEIS Select Committee in respect of the additional application material on fraud; and
- With respect to Ethical Standards, consideration is given to the revisions to the IESBA International Code of Ethics and the legislation passed by the Parliament in support of the EU Exit. However, in finalising the standard before the end of 2019, the text will be updated as necessary to reflect the applicable legal position.

Revisions to Ethical Standards

6.2 The Council noted that more stringent measures have been proposed in a number of areas to support rebuilding confidence in audit. The Council discussed the key changes and through discussion, made a number of points and suggestions including:

- *Objective, Reasonable and Informed Third Party test:* The Council considered the definition of the 'Third Party Test' and noted that while making detailed assessment, the public interest perspective should be taken into account from the intended users' point of view. It was suggested that the auditors, in making their assessment about the third party test, could give consideration to stakeholders from the perspective of s172 of The Companies Act;
- *Part A – Overarching Principles and Supporting Ethical Provisions:* The Council noted that this section would be updated as necessary to reflect the applicable EU Exit provisions.
- *Part B – Section 1 – General Requirements and Guidance:* The Council noted that the role and function of 'Ethics Partner' is strengthened to ensure that the INEs are involved where the firm acts in a way that overrides or undermines its Ethics Partner. The other topics under this section were updated to strengthen the requirements and reflecting the revisions to the IESBA International Code of Ethics.
- *Part B – Section 2 – Financial, Business, Employment and Personal Relationships:* The Council noted that the focus has been to simplify the text and provide enhanced guidance on certain topics.
- *Part B – Section 3 – Long Association with Engagements and With Entities Relevant to Engagements:* With regards to the Key Audit Partners and Engagement Partners, it was suggested to clarify in the section that in certain circumstances the audit committee could extend the term of the engagement partner for a further period (not exceeding two years) where it is in the interest of audit quality. In respect of disclosing

this decision and the reasons for it to the audited entity's shareholders as early as practicable, it was suggested that the term 'as early as practicable' could be further explained to clarify that it should be as soon as possible through communication channels such as RNS.

- *Part B – Section 4 – Fees, Remuneration and Evaluation Policies, Gifts and Hospitality, Litigation:* The Council noted that where an engagement partner agrees a fee for an engagement that does not cover the full costs of providing that engagement, they shall ensure the independence of the auditor is not compromised and the safeguards applied by the engagement partner shall be disclosed to those charged with governance. Following a query in respect of the cost of audit, it was clarified that it would include the margin that pays audit partner's drawings. It was suggested that this could be clarified in the standards. With regards to Gifts and Hospitality, the Council noted that the audit firms will need to develop policies and guidance to mitigate any risk to independence arising from the provisions of gifts or hospitality to an entity that is not audited by a firm, but subsequently becomes an entity audited by that firm.
- *Part B – Section 5 – Non-audit / Additional Services:* The Council noted the increased prohibitions to non-audit services and enhanced communication with those charged with governance required by the IESBA Code. The Council also noted that the movement from a 'black list' of prohibited services, to a shorter 'white list' of permitted non-audit / additional services for auditors of Public Interest Entities. Through discussion, the Council suggested that given the complexities in respect of banking syndicates, Section 5.40 could be reviewed to clarify whether permitted services to banking syndicates would be subject to the 70% cap. It was also suggested reviewing the paragraph in respect of competent authorities / regulators specifying the auditor as an appropriate choice for service provider to include matters relating to profits verified by auditors. It was noted that the black list of prohibited services would be moved to the appendix. The FRC Executive agreed to review the section whilst ensuring that the section supports the application of ethical principles. The Council noted that the derogation in the 2016 Ethical standard which allowed for the provision of certain non-audit services where these have no direct or inconsequential effect on the financial statements has been removed. It also noted that where prohibitions apply to services provided to a listed audit client, the reliefs which previously applied to SME listed entities are removed.
- *Section 6 – Provisions Available for Audits of Small Entities:* The section has been retained unchanged.
- In light of the learning from the experience of BHS, a question would be included in the Consultation document in respect of enhanced independence requirements and their application to certain non-PIE entities. Another question in respect of the effective date of the changes to the standard would be included.

Revisions to Auditing Standards

- 6.3 The Council noted that the proposals have been identified through responses to the call for feedback, and issues identified through the FRC's own inspection and enforcement work, including thematic reviews. In taking forward these proposals, the Council noted that the FRC is coordinating closely with the Brydon Review of audit.
- 6.4 The Council noted the key changes proposed to the standards and through discussion, made a number of points and suggestions including:
- *ISA 700 – Forming an Opinion and Reporting on Financial Statements:* The Council noted that focus has been given on audit capable of detecting irregularities, including fraud.
 - *ISA 701 – Communicating Key Audit Matters in the Independent Auditor's Report:* The Council noted the proposed additional auditor reporting requirements, including

the description of significant judgements in respect of Key Audit Matters and a requirement in respect of communicating other audit planning and scoping matters. With regards to the descriptions of individual key audit matters, it was queried whether there would be merit in reporting the details of matters that have been considered and the reasons as to why the auditor has arrived at a significant judgement. Further, a similar query was raised in respect of the reporting on the aggregate of misstatements accumulated during the audit and the aggregate of uncorrected misstatements. Through detailed discussion, the Council acknowledged that the concept of materiality is fundamental to true and fair accounting and important to investors. However, measures to address the Kingman recommendation on 'graduated findings' and any items within the scope of the Brydon review would be considered once that review has concluded and any recommendations considered by Ministers.

- *ISA 720 – The Auditor's Responsibilities Relating to Other Information*: The Council noted that the Brydon review will be considering the issue in respect to the work that auditors carry out on 'Other Information' within the annual report. The Council noted that the text of the standard is simplified by moving material relating to UK specific requirements to application guidance.
- *ISA 250A – Consideration of Laws and Regulations in an Audit of Financial Statements and ISA 250B – The Auditor's Statutory Right and Duty to Report to Regulators of Public Interest Entities and Regulators of Other Entities in the Financial Sector*: The Council noted the minor amendments made to the standards in respect of the auditor's consideration of compliance with laws and regulations.

6.5 The Acting Director, UK Auditing Standards and Competition agreed to take the above suggestions into consideration while finalising the papers before publication. Subject to the above discussion and suggestions, the Council agreed to advise the FRC Executive to recommend to the Board to issue the Feedback Statement and Impact Assessment and the revisions to the Ethical and Auditing Standards.

7. Finalisation of PN 19 (Revised)

- 7.1 The Project Director introduced the paper and noted that the draft Feedback Statement was based on the public consultation issued in December 2018 on the proposals to revise Practice Note 19 *The audit of banks and building societies in the United Kingdom*.
- 7.2 The Council noted the brief summary of the consultation responses and in particular the suggestion made in respect of Significant Increase in Credit Risk (SICR).
- 7.3 The Council suggested a small drafting amendment to the text in respect of the FRC's response in relation to auditing Expected Credit Loss and the approaches that auditors may take when auditing accounting estimates.
- 7.4 It was suggested making the SICR criteria that include quantitative assessment less specific as there are other parameters for the assessment.
- 7.5 The Project Director agreed to take the suggestions into consideration in finalising the revised PN 19. Subject to the above discussion, the Council agreed to give its advice to the FRC Executive to publish the Feedback Statement on the consultation proposing the revision of PN 19 and the revised PN 19.

8. Revision to the CASS Standards

- 8.1 The Acting Director of the UK Auditing Standards and Competition introduced the topic and outlined the high-level responses to the public consultation issued in December 2018 in respect of the Post Implementation Review of the CASS Standards. The Council noted that the stakeholder feedback agrees that the standard has been effective in

driving improvements in audit quality; however, the proposed changes could further enhance that. The Council also noted that in reviewing the standard and in proposing revisions, the FRC has liaised closely with the Financial Conduct Authority.

- 8.2 The Council agreed to advise the FRC Executive to recommend to the Board that the Feedback Statement and Impact Assessment and the revised Standard on *Providing Assurance on Client Assets to the Financial Conduct Authority* be issued.

9. Any other business

There was none.

10. Date of next meeting

The Council noted that the next meeting would take place on 23 September 2019.