

**Minutes of a meeting of the Audit and Assurance Council of the FRC  
held on 31 October 2017 at the FRC, 8<sup>th</sup> Floor, 125 London Wall, London, EC2Y 5AS**

**PRESENT**

Sue Harris	Chair
Olivier Beroud	Member
Mary Cleary	Member
Paul Cox	Member
Jane Fuller	Member
Kari Hale	Member
Scott Knight	Member
Stephen Oxley	Member

**OBSERVERS**

Lee Piller (FCA)  
Shelagh McAlpine (IAASA)

**IN ATTENDANCE**

Kate Acott	Project Director
Mark Babington	Deputy Director of Audit Policy
Anu Bhartiya	Committee Secretary
Ufuk Cengiz	Economist
James Ferris	Project Director
Marek Grabowski	Director of Audit Policy
Josephine Jackson	Technical Director
Claire Lindridge	Assistant Director AQR

**1 Welcome and apologies**

The Chairman welcomed everyone to the meeting. Apologies were noted from Council Members Bryan Foss and Jerry Wedge, PRA Observer Michael Gaull and the FRC attendees Melanie McLaren, Executive Director, Audit & Actuarial Regulation and Marian Williams, Director of Audit.

**2 Declaration of conflict of interest**

There were none reported.

**3 Minutes and Rolling Actions**

*Minutes*

- 3.1 The Council approved the minutes of the Audit & Assurance Council meeting held on 27 September 2017 for publication, subject to minor amendments.

*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 provided an update on the matters considered at the Codes & Standards Committee meeting held on 18 October 2017. Amongst other matters, the Committee had:

- Considered the Feedback Statement and Impact Assessment on the Preliminary Announcements and supported the proposal of providing an updated Bulletin to reflect the revised legal and regulatory context.
  - Approved the publication of the revised Practice Note 15: The Audit of Occupational Pension Schemes in the United Kingdom and to withdraw PN 22 – The Auditor’s Consideration of FRS 17 Benefits which is superseded by material in the revised ISAs.
  - Approved the publication of the revised Practice Note 11: The Audit of Charities in the United Kingdom.
  - Approved the withdrawal of the Practice Note 21.
- 4.2 Kate Acott (KA) informed Council that as the revision of the Corporate Governance Code and update to the Strategic Report Guidance progresses, the Audit and Assurance Team will look at relevant audit and assurance guidance that requires updating as a result. Any revised material will come to Council for advice in due course.

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

- 5.1 Marek Grabowski (MG) provided a brief update on the Audit Firm INE working group meeting. Stephen Haddrill, FRC Chief Executive had chaired the second meeting of the group, which had considered how the value of audit might be enhanced. In response to a query as to how the FRC would develop that project, it was reported that the advice of the Audit & Assurance Council would be sought as the project develops. The Council noted that in response to the INEs concerns in relation to whether IFRS are sufficiently clear about the expectations from the preparers, the FRC had provided papers on both the public interest considerations in the development of IFRS and on the current purpose of an audit.
- 5.2 The Council discussed issues raised by Client Earth which promotes greater disclosure of the impact of climate change in financial statements and corporate reports. The discussion covered:
- How to best give consideration to the need for an audit boundary that would not only focus on the audit of financial statements but also cover adequate reporting on climate change. Members asked to what extent is the engagement partner expected to have specialised subject matter knowledge to provide such assurance and how an auditor could integrate the audit assurance related skills with the specialised subject matter knowledge.
  - The procedures as set out in ISA 720 do not expect auditors to have a high level of specialised subject matter expertise, but to take into account the extent of knowledge that they have developed during the audit process and is relevant to financial reporting.
  - Client Earth are supportive of the changes to the ISA (UK) 720 in relation to auditor’s responsibilities to other information and are keen to discuss with the FRC the IAASB’s work on ISA 540 (Accounting Estimates and Disclosures) and on Emerging Forms of External Reporting.
- 5.3 A Member queried whether the way in which the Non-Financial Reporting Directive has been transposed into UK law has resulted in any concern. It was clarified that the auditor will be expected to understand the applicable reporting requirements including those set out in ISA 720 and consider whether there are any material inconsistencies in reporting. The way in which BEIS has transposed the requirement relating to the audit of the NFR appears to treat it as part of the strategic report, and therefore it has the status of statutory other information.

- 5.4 The Council acknowledged the volume of work handled by the Audit and Assurance Team and the continuing resourcing pressure requiring them to take carefully calibrated decisions in the prioritisation and timing of work. In response to a query in relation to the plans to deal with the pressure of Brexit and its implications on the UK audit market, it was reported that the FRC, through its Brexit Stakeholder Forum and its oversight responsibilities, is aware of many of the potential implications, and will respond to whatever the government's policy framework ultimately requires.

## **6. IAASB Update**

### *ISA 540 – Responses to the Exposure Draft and next steps*

- 6.1 MG provided a brief update on the IAASB Board meeting that had taken place in October and outlined the high level concerns emerging from the preliminary analysis of the responses to the Exposure Draft on proposed ISA 540 (Revised). It was noted that respondents had raised concerns about the complexity of the proposed ISA and potential difficulties in understanding and applying it in practice. The Board had discussed comments on the scalability of the ISA, how risk factors could be taken into account, and how best to structure the requirements relating to the auditor's response to the assessed risks of material misstatement. It was reported that whilst there is a broad support in principle for the proposed revisions, respondents have asked for more guidance on the applicability of the proposed changes and considerable restructuring may be required. The Task Force is working towards finalising the ISA in a timely fashion, however, the timetable is challenging as there is a considerable amount of work to be done.

### *Standard Setting Reform*

- 6.2 Mark Babington (MB) provided a brief update on the proposals for reforming the Standard Setting Board and noted that the monitoring group have approved the issue of a consultation paper in November 2017 which would mainly focus on strengthening the governance and oversight of standard setting in the public interest.

## **7 AAT Project Update**

### *Going Concern*

- 7.1 MB provided a brief background to the FRC's project to review Going Concern material, including how the FRC responded to the recommendations in the Sharman Review, and whether there is additional work that still needs to be undertaken. The project will also review guidance material issued in response to the financial crisis and assessing whether that remains fit for purpose, and whether the material can be consolidated more effectively within the standard itself.
- 7.2 The Council noted that a working group would be set up to facilitate the project going forward. The Council discussed the stages and timescale of the project and enquired the frequency of meetings and the background of members required for the proposed working group. Kari Hale, Olivier Beroud and Sue Harris offered to join the working group. The first stage of the project would be to develop a discussion paper for consultation.

### *Preliminary Announcements*

- 7.3 James Ferris (JF) provided a brief update on the Draft Bulletin which provides updated guidance on auditor responsibilities with regard to preliminary announcements. It was reported that the Bulletin reflects the principle that the board should present a fair, balanced and understandable assessment of the company's position and prospects, and is being discussed with the Corporate Governance & Corporate Reporting Teams.
- 7.4 In response to a query in relation to the Corporate Reporting Users Forum (CRUF) reaction to the changes to the regime for preliminary announcements, it was reported

that the FRC had met with CRUF during the consultation period and that no formal response had been received to the consultation.

- 7.5 The Council noted that the auditor should consider whether the preliminary announcement includes statements in compliance with the Companies Act 2006 and information as required by the UK Listing Rules. It was also noted that the FRC believes that when alternative performance measures (APM) are presented in an Annual Report, compliance with Guidelines issued by the European Securities and Markets Authority will help ensure that, taken as a whole, it is fair, balanced, comprehensive and understandable. In response to a query as to why the word 'comprehensive' was included in the Bulletin, it was reported that the words were consistent with the FRC's frequently asked questions on the use of the APM. At the request of the Council, JF agreed to verify the language of the Bulletin with the Corporate Governance Code in order to ensure a consistent approach.
- 7.6 Subject to the above discussion, the Council provided its advice to the Codes and Standards Committee that it approve for publication the Revised Preliminary Announcements Bulletin.

*Money Laundering Feedback Statement and Impact Assessment and Draft ISA (UK) 250 Section A - Appendix*

- 7.7 The Council considered the Feedback Statement and Impact Assessment on the Revisions to Money Laundering and noted that the updated material will be appended to ISA (UK) 250, rather than a Practice Note which will better link that material to the standards. It was also noted that the Appendix would be linked to the recently revised CCAB Guidance on Money Laundering which contains detailed examples as approved by HM Treasury.
- 7.8 The Council provided its advice to the Codes and Standards Committee that it approves for publication the Money Laundering Feedback Statement and Impact Assessment and Draft ISA (UK) 250 Appendix.

*Themes from ACC Quality Survey*

- 7.9 In response to the request made by the Council, a paper highlighting the themes arising from the ACC annual quality survey had been prepared to facilitate discussion. The Council found the paper very useful and made various comments and suggestions including:
- Significant progress had been made in defining what High Quality Audit is and now there is a need to measure how the aspects of the definition are applied in practice. There is also a need for a more joined up approach on the view of what High Quality Audit is in context with the inspection process. With a view to gaining better understanding of the respective work of the Audit & Assurance Council and the AQR Committee, the Chairs of both bodies have agreed to attend each other's meetings at a future date;
  - The work was ongoing in relation to gathering data from inspections covering the first and the final year audit before rotation;
  - Some audit firms tend to adopt boilerplate reporting using similar text and formatting for all clients. However, audit committees are sometimes challenging auditors to get a more granular understanding of significant matters.
- 7.10 The Council discussed if there was any merit in issuing a letter to audit committee chairs, to summarise key audit issues emerging from the survey. The FRC has previously provided guidance on audit quality issues through the Audit Quality Practice Aid, and that ExCo was working on the wider strategy for engagement with audit

committee chairs and members. However, MB agreed to explore if there were any merits in including audit related matters within the letter.

#### *Audit Projects Divisional Update*

- 7.11 In absence of Marian Williams, Director of Audit, MB and Jane Fuller provided a brief update on the Audit Committee Reporting Project. The objective of the project was to explore how investors' confidence in audit is enhanced by and supported through the external reporting by audit committees in the annual report, and highlighting and encouraging best practice. It was noted that the report was being drafted and would be issued in December 2017.
- 7.9 The Council considered the overall findings of the project and noted that the finding *'investors usually only contact audit committee chairs by exception. Some recognise that there is more that can / should be done. Audit committee chairs are willing to engage under normal circumstances'* was not FRC's views but the outcome derived by the FRC lab which provides a forum for stakeholders to debate and arrive at a consensus.
- 7.10 MB outlined the objective of the Audit Firm Contingency Planning project which was to review contingency planning policies and procedures at the Big Six Firms and in particular, to understand how the firm's plan is developed, updated and tested. The project would include providing feedback to firms on a confidential basis and review plans on a regular basis going forward.
- 7.11 With regards to the Audit Firm Information Security, MB informed that a detailed questionnaire has been developed and sent to firms for response. Following a query, it was reported that the FRC had received advice and support from the FCA and PRA and CESG. The project was also being supported with external advice. Council agreed that Marian Williams would be invited to attend a future meeting to provide a further update on the progress of the above matters.

#### *AQR Draft Materiality Thematic*

- 7.12 The Council considered the AQR draft thematic review on Materiality, which draws on the views of audit committee chairs, investors and the information available in extended audit reports as well as consideration, by the AQR, of the methodologies of the eight largest firms and findings from a selection of audit files. Council noted the guidance provided by firms which includes range of percentages to be applied to a variety of benchmarks in order to make the judgements on overall materiality. Whilst it was noted that not one threshold fit all entities, the table as set out in 3.2 of the paper was thought to be open to interpretation and therefore it would be useful to explain better that guidance is in existence to help audit teams come to judgments on the setting of materiality. Claire Lindridge (CL) agreed to review the text.
- 7.13 MG provided a description of the four step materiality process in the preparation of financial statements and the factors auditors should consider when making materiality judgements. He also clarified that performance materiality and component materiality are both ways to make a judgement to reduce aggregation risk. It was suggested to include these explanations in the review. It was also noted that materiality should be communicated to the audit committee and the audit committee should understand and challenge the judgements underlying the setting of materiality and how it affects the audit work performed. It was suggested to review the text relating to the guidance on performance materiality, thresholds for reporting matters to audit committees and component materiality as set out in paragraph 3.1 of the paper.

## **8 Horizon Scanning – the impact of technology on the FRC’s work**

- 8.1 Ufuk Cengiz (UC) provided a brief update on the paper that highlights four issues listed under the impact of technology on the FRC’s work which included cyber security, the use of data analytics in audit, the role of artificial intelligence in corporate reporting and the impact on education and training of accountants.
- 8.2 The Council discussed the risks and threats of artificial intelligence which automates parts of audit processes. The technology helps preparers in making its own decisions and assessing controls and capabilities. It was noted that since the technology is at its early stage and is constantly changing, there are risks associated which requires rigour in integrity and assurance over complex audit areas.
- 8.3 The Council noted that the paper presented only focused on technological issues having impact on the FRC’s work and whether the FRC’s current initiatives were adequate or not. The Council felt that it would be useful to have wider horizon scanning of risks and highlight a few top risks that might affect the working of the FRC and the actions to mitigate those risks. It was also suggested giving consideration to societal demands for broader assurances that traditional audit and financial statements do not meet. It was reported that FRC Risk Reporting / Management will be included in the agenda for the next meeting.

## **9 TAG Update**

- 9.1 The Council noted the Minutes of the TAG meeting held in October and the Rolling Record of Actions which will be updated on the FRC website.

### *Staff Guidance Note 03/2017 – Bank Lending Syndicates*

- 9.2 MB informed that the FRC had obtained legal advice to assist in the further development of the approach taken in the guidance note. MB set out the amendments that had been made to the draft and the process that would be followed to finalise it. Before finalising, the draft guidance will be discussed with audit committee chairs of banks. Following those meetings, the guidance would be finalised and presented to the Council for advice. In response to a query as to why the requirements are particularly interpreted for restructuring transactions, it was noted that the question presented to the FRC was in relation to restructuring transaction which mirrored a similar question raised over the application of the SEC independence requirements.
- 9.3 A Member queried if any response has been received from the CEAOB in respect of how materiality is applied in context of KAP requirements. MB responded that the issue was pending consideration by the Review Group.

## **10 Any other business**

- 10.1 A Member reported various recently published articles which highlights concerns around trust in audit. It was reported that a topic in relation to enhancing the value of audit would be considered at a future Council meeting.

## **11 Date of next meeting**

- 11.1 The next Council meeting will be held on 30 November 2017 at 9am.