



Minutes of a meeting of the Audit & Assurance Council held on Thursday, 8 November 2018 at the FRC Office, 8th Floor, 125 London Wall, London E2Y 5AS

Present:

Sue Harris	Chair of Council
Mary Cleary	Member
Paul Cox	Member
Bryan Foss	Member
Jane Fuller	Member (From Minute 4.3)
Kari Hale	Member
Fiona Kordiak	Member

Observers:

Michael Gaull	PRA
Lee Piller	FCA (From Minute 5.3)

In attendance:

David Andrews	Relationship Manager for BEIS
Mark Babington	Deputy Director of Audit Policy
Anu Bhartiya	Committee Secretary
Keith Billing	Project Director (via teleconference)
Kate Dalby	Project Director
James Ferris	Project Director
Stephen Hadrill	Chief Executive Officer (From Minute 5.5 to 5.6)
Rimit Shah	Team Inspector
Mark Shennan	Policy and Strategy Director
Mike Suffield	Acting Executive Director, Audit & Actuarial Regulation
Christos Vernardos	Team Inspector
Marian Williams	Director of Audit (From Minute 8)

1. Welcome and apologies for absence

The Chair welcomed everyone to the meeting and in particular Fiona Kordiak to her first meeting. Apologies were noted from Council Members Olivier Beroud and Scott Knight and Council Observer Aoife Warren (IAASA). The Chair informed that Jerry Wedge had stepped down from the Council due to changes in his work commitments.

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 13 September 2018 were approved for publication.

Notes on the Council Away Day

- 3.2 The Council noted the notes on the Audit & Assurance Council Away Day held on 13 September 2018.

Rolling actions

3.3 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 25 September 2018, and noted that the discussion had included:

- Consultation on the Stewardship Code
- Annual Review of Corporate Governance & Reporting
- FRC 2019 Taxonomies suite

4.2 The Chair informed that the Codes & Standards Committee had also met on 6 November and had a further discussion on the Stewardship Code consultation.

4.3 The Council noted that BEIS has asked the FRC to delay the Stewardship Code consultation to allow the department and regulators involved in the transposition of the Shareholder Rights Directive (SRD) to work together to ensure alignment. Therefore, the revised timeline for the review would be to seek Board's approval on 23 January and to publish the consultation on 30 January 2019. The Council encouraged the FRC to communicate this to the investor community.

4.4 Mr Suffield informed that at the meeting on 17 October 2018, the Board discussed the CMA market study into the UK statutory audit market. The Council noted that the FRC and CMA would work closely together, and the FRC would support the CMA in developing potential remedies.

5. Report of the Director of Audit Policy, including IAASB update and IAASB Quality Control project update and an update on Future of Audit

5.1 Mr Babington 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:

- The recruitment exercise to identify a senior audit practitioner and an audit committee member / experience practitioner has been unsuccessful. Therefore, engagement with relevant audit firms and networks is ongoing to identify suitable members to join the Council.
- BEIS have laid before the Parliament a Statutory Instrument on the EU Withdrawal Bill covering statutory audit, and the transposition of the Audit Regulation into UK law.
- In recognition of the volume of work, the FRC is looking to recruit a project director to join the Audit & Assurance Team.

Going Concern

5.2 Ms Dalby provided an update on the Going Concern project and reported that the first meeting of the working group took place on 4 October 2018. Since the meeting, work has focused on amending the requirements in ISA 570 to improve the auditor's risk assessment with respect to going concern, to enhance professional skepticism, challenge management on their going concern assumptions, including consideration of whether there is conscious or unconscious management bias, enhance procedures around the viability assessment, and increase the information that is disclosed in extended auditors report as to why auditors are satisfied with the going concern assessment. Whilst the working group acknowledged that the standard deals with the auditor's responsibilities in an audit of financial statements, it concluded that it would be beneficial to look at ways to better integrate the assessment of material contained in the viability statement into the auditor's assessment. Since the requirements in the existing

standard are designed to meet the requirements set out in Company Law, any recommendations that would require a change to the scope of audit in this respect will feed into the Future of Audit project.

- 5.3 A Council Member expressed a concern that the assessment of going concern and the viability assessment could potentially increase the user expectation gap. It was noted that the focus of the working group's efforts would be to better focus the work effort of the auditor, draw on a fuller range of available information to support the assessment, provide a basis for a more robust challenge of management's assessment and provide greater transparency over the auditor's work.
- 5.4 The Council noted that the Exposure Draft for consultation would be presented to the Council at the next meeting in February 2019. In the interim, in order to have consensus on the views of the working group and the Council, the draft requirements would be circulated to the Council via email. It was agreed that if a Council discussion is required, a teleconference meeting would be arranged.

Future of Audit

- 5.5 Mr Haddrill provided an update on the Future of Audit project and noted that the FRC Board has agreed to undertake some short and medium-term actions to respond to the FRC and stakeholder concerns in relation to the quality, relevance of audit and auditor independence. The Council noted that the Audit & Assurance Team is working closely with the Accounting and Reporting Team in respect of the FRC project on the Future of Corporate Reporting to align the thinking around changing investor and user needs for information and the extent of assurances.

Sir John Kingman Review

- 5.6 Mr Haddrill also provided an update on the ongoing review of the FRC's role and powers by Sir John Kingman. It was noted that Sir John Kingman and his secretariat team continue to meet with members of the FRC executive to develop their understanding of the work of the FRC and Sir John has confirmed his intention to report to the Secretary of State before Christmas.

Quality Management Standards ISQM1, ISQM2 and ISA 220

- 5.7 Ms Jackson tabled a presentation on 'Update - Quality Management Standards – ISQM1, ISQM2 and ISA 220' which included an update on the aspects of the proposed system of firm's quality management, components of firm's risk assessment process, quality control at the engagement level and engagement quality reviews. The presentation included an explanation on the relationship between ISQM1 (Revised) and ISA 220 (Revised) and ISQM2.
- 5.8 The Council noted that the Quality Control Task Force plans to present the three exposure drafts of the revised standards to the IAASB Board at the December 2018 meeting for approval. The exposure drafts will be issued in mid to late January for a proposed comment period of 150 days. It is anticipated that the responses would be reviewed at the September and December 2019 IAASB Board meeting and approved in March / June 2020. The effective date being proposed to the Board is 24 months after approval.
- 5.9 In response to a query about the lengthy implementation period of 24 months, it was noted that whilst some firms have already started planning for implementation, because of the complexity of the changes required to implement ISQM 1 but also because of the links between ISQM 1, ISQM 2 and ISA 220. ISQM 1 is a particular challenge for firms as it may require coordinated internal organisation changes across the individual firms in the network and, for smaller firms, there may not be as many internal resources to

implement changes. Notwithstanding it is in the public interest to make the standards effective as soon as possible to improve quality. It was suggested that the revised standards could be implemented using an incremental approach.

6. Adoption of ISA (UK) 540

- 6.1 Mr Billing introduced the paper and noted that the responses to the FRC's public consultation on the proposal to revise ISA (UK) 540 (Revised) supported the proposed revision, together with the conforming amendments to other ISAs (UK).
- 6.2 The Council considered the draft Feedback Statement on the consultation which summarises the responses received, the proposed FRC responses to those and supported the conclusion that no further revisions are needed in finalising the standard.
- 6.3 The Council agreed to advise the Executive to recommend to the Board, that the FRC adopt the revised ISA (UK) 540 (Revised December 2018) and the conforming amendments to other ISAs (UK), to be effective for audits of financial statements for accounting periods beginning on or after 15 December 2019.

7. CASS Post Implementation Review

- 7.1 Mr Babington provided a brief update on the background of the implementation of the Client Asset Assurance Standard – *Providing Assurance on Clients Assets to the Financial Conduct Authority*. At the time the Standard was issued, the FRC agreed to carry out a post implementation review within three years. Since the Standard was issued, the reaction from the profession and from CASS businesses has changed and become more supportive of the standard. It was noted that the FRC's periodic meetings with the FCA CASS unit have confirmed that the Standard has been effective in supporting their objectives, though it needs further embedding in audit firms.
- 7.2 The Council noted that as part of the review, the FRC seeks feedback on whether a proportionate monitoring regime for CASS work should be developed. The FRC's AQR work does not cover CASS audits and therefore the FRC's view of audit quality is based on feedback from firms, the FCA and from entities subject to CASS audit. In response to a query in respect of funding the monitoring regime, it was noted that the FRC will discuss this with the FCA as the regime would underpin confidence in CASS audit, which is an area of significant public interest.
- 7.3 It was queried whether the FRC is currently able to conduct a thematic review on a CASS work. It was noted that the FRC would have to put in place a mechanism to have access to audit files to carry out such a review which currently does not exist other than for enforcement cases, which can be taken under the Accountancy Scheme.
- 7.4 The Council noted that the main issues covered in the consultation had been raised through the stakeholder engagement. A Member queried the representation of the stakeholder groups; it was noted that views are sought from an umbrella group of the largest CASS holding entities. It was also noted that the FCA is supportive of the FRC's outreach.
- 7.5 The Council provided its advice to the Executive to recommend to the Board to approve the post implementation review on the *Providing Assurance on Clients Assets to the Financial Conduct Authority* – call for feedback and the questions contained therein.

8. ARD Post Implementation Review

- 8.1 Mr Babington tabled a revised call for feedback appendix on the post implementation review on the *2016 Ethical and Auditing standards changes to implement the Audit*

Regulation and Directive. It was noted that the only revision to the tabled paper was the inclusion of the four over-arching feedback questions.

- 8.2 The Council noted that the questions proposed in the Request for Feedback covered the main issues which have been raised through FRC-wide stakeholder engagement on this subject, and internally generated material based on the FRC's own assessment and research. It was noted that, subject to Council's advice, the Executive will seek Board's approval to issue the Request for Feedback before the end of November to allow FRC to start assembling the evidence to ensure that the work is aligned with CMA's market study into the UK statutory audit market.
 - 8.3 In response to a query in respect of the statement that 'In the UK, tendering has been driven by quality rather than price', Members shared a number of views and noted that, the decisions are made from quality perspective in order to shortlist audit firms and to determine the preferred auditor which is then followed by commercial discussions around price.
 - 8.4 With regards to the timelines of the project which plans to consult on changes to standards over the summer of 2019, with revised standards coming into force for the audit of periods commencing on or after 15 December 2019, it was queried whether enough time would be dedicated in assessing responses to ensure the timetable can be met. It was noted that a steering group would be set up which would include participation from the Council in order to provide deeper focus on certain areas.
 - 8.5 In respect of the engagement strategy to carry out an evidence-based review, the Council noted that the FRC will seek AQR input based on lessons learned from their inspections, and insight from the enforcement team, liaison with other regulators with an interest in this area, and use of the research that was undertaken to support the Developments in Audit report. It was also noted that the stakeholder engagement events will include roundtables with the non-auditor respondents from the ethical standard perspective, engagement through the Institute for Business Ethics and outreach with the investor community.
 - 8.6 The Council noted the proposal that changes to standards as a result of the consultation would be carried out to apply to the audit of periods commencing on or after 15 December 2019. It was queried whether the timeline was too tight and required to be reviewed. It was explained to the Council that the work needs to be delivered to align to the work with the CMA and Sir John Kingman's review, so that it can feed into the development of legislation to support the recommendations arising from both of those exercises.
 - 8.7 It was suggested that once the ARD post implementation review and the ongoing projects on audit and assurance work are over, it would be useful to publish an updated version of the audit quality practice aid for audit committees. It was reported that this work was on the plan.
 - 8.8 The Council agreed to advise the Executive to recommend to the FRC Board to approve the post implementation review on the *2016 Ethical and Auditing standards changes to implement the Audit Regulation and Directive* – call for feedback and the questions contained therein.
- 9. Standard on Investment Reporting – Project Update**
- 9.1 Mr Ferris introduced the paper and highlighted that the SIRS continue to be used widely by reporting accountants. The enhancements to SIRs 1000 and the SIR 2000 Annexure

have been made in consultation with reporting accountant practitioners from the leading UK firms. SIR 6000 has been developed with advice and input from relevant practitioners. This SIR closes a gap in the coverage of the current standards with regards to Quantified Financial Benefits Statements. It was noted that in order to manage the Council workload, the remaining SIRs which are also being updated will be presented to the Council for advice at the next meeting and the Executive would then seek Board's approval on all SIRs together for public consultation.

- 9.2 Mr Ferris explained that there were still some external factors outside the control of the project, including details of how the new EU prospectus rules would be implemented in the UK post Brexit, and also the finalization of technical guidance by ESMA. Nevertheless, all other aspects of the revision of the SIRs could be completed if Council was content with the outline drafts presented at this meeting.
- 9.3 The Council considered the SIRs 1000, 2000 and 6000 and made a number of comments including:
- The SIRs are well written and very helpful.
 - The project is important because it supports the assessment of reporting on transactions which are key to capital markets.
- 9.4 A Member agreed to communicate with Mr Ferris offline on some drafting amendments. The Council agreed to advise the Executive to recommend to the Board to consult on SIR 1000, the SIR 2000 Annexure and SIR 6000 together with other SIRs which would be presented to the Council for advice at a future meeting.

10. Consultation on revision of Practice Note 19

- 10.1 Mr Billing introduced the paper and explained the proposed consultation on the revised Practice Note 19 which provides guidance to assist applying the requirements of the ISAs (UK) in 'The Audit of Banks and Building Societies in the United Kingdom'. Consideration has been given to changes in applicable laws and regulation, the establishment of the PRA and FCA in place of the FSA, ISAs (UK) that have been updated / revised since the last update of PN 19 and also to ISA (UK) 540 (Revised December 2018), in particular to assist the audit of complex accounting estimates such as expected credit losses (ECL).
- 10.2 Mr Billing emphasised that in respect of the revised section on ISA (UK) 540, that section of the PN has been expanded and appendix 8 has been added that illustrates a high-level approach for forward looking information. The PN does not describe all the detailed procedures that may be appropriate in an audit of an ECL estimate. This is consistent with the FRC's approach for the development of principles-based guidance.
- 10.3 The Observer present expressed a concern that the revised PN does not provide sufficient guidance to auditors to audit an ECL estimate. He noted that ECL will challenge auditors in areas that have been highlighted as quality issues in the most recent FRC audit quality report including skepticism and audit of judgements, particularly as the requirements for ECLs contain new terms and concepts. The PN should help auditors to understand how ISA 540 works in the context of the audit of ECLs and to apply it well. He did not believe that the PN as drafted would assist sufficiently in this regard. The FRC's Working Group and the Executive believe that the exposure draft will support high quality work, but will continue to test this as the FRC carries out outreach work throughout the consultation period.
- 10.4 The Council and the Executive had a thorough discussion on the concern raised and how this might be addressed within the context of developing principles-based guidance

in accordance with the FRC policy for the development of Codes, Statements of Practice and Guidance. Through discussion, a number of points and suggestions were made including:

- The Executive were willing to expand Appendix 8 to include more detail and examples on how to apply ISA (UK) 540 to the audit of forward-looking information in ECL estimates in banks, if the PRA provided specific content.
- There is already significantly expanded material in ISA (UK) 540 itself on the audit of complex accounting estimates such as ECL.
- One of the suggestions was to consult on the PN and develop further material during the consultation period.
- It would be challenging to delay the consultation on the PN whilst spending more time on expanding the ECL specifics. This would not be compatible with the FRC's work on the 2016 Ethical and Auditing Standards.
- PRA are key stakeholders in respect of PN 19. However, there are other stakeholders such as preparers and auditors who need guidance on standards and factor requirements into their planning process and given that the FRC has allowed for early adoption of ISA (UK) 540, largely in response to prudential regulators, it is only right to provide material to support its application. Therefore, the consultation on PN 19 should not be delayed and appropriate post-consultation actions should be taken as necessary.
- The Executive also proposed to include an additional question in the consultation about the need for more specific guidance on ECL and if there is an appetite, this could be included in the final version of the PN.
- The PN should not be prescriptive and should stand the test of time.

10.5 It was noted that the PN 19 will be issued for consultation after the FRC Board's approval of the publication of the ISA (UK) 540 in December 2018. Therefore, there was some time in the interim to liaise with the PRA and address the concerns.

10.6 The Council gave due consideration to the Observer's concern and felt it appropriate that the FRC should consider expanding further the material in appendix 8 before it is published in December 2018, based on specific suggestions from the Observer. The Council also felt appropriate to include a question in the consultation about whether further guidance on ECL was required with a view to incorporating that in the final PN. The Observer confirmed that he was supportive of this approach. Subject to additional consultation questions and broader material in Appendix 8, the Council agreed to advise the Executive to consult on revising PN 19, as set out in the paper. It was agreed that the precise revised questions and enhanced Appendix 8 for consultation would be circulated by email to all Council members and Observers for comment and agreement.

11. TAG Guidance Updates

SGN 02/17 Explaining to what extent the audit was considered capable of detecting irregularities, including fraud

11.1 Mr Babington introduced the SGN 02/17 which has been updated to encourage more granularity and tailoring in the disclosure in the auditor's report on how their audit was designed to identify irregularity, including fraud.

11.2 The Council considered the SGN and agreed to provide its advice to the Executive to publish the SGN 02/17.

SGN 02/18 Group audits: Determining whether components are significant and/or material, and what that means for key audit partners and engagement quality control reviewers

11.3 Mr Babington introduced the SGN 02/18 which has been developed to address potential weaknesses in the documentation and review of group audits, including the engagement

quality control review. He noted that this should also drive greater consistency of approach.

11.4 The Council noted that in respect of group audit, the Audit Directive and Regulation requires that the group engagement quality control reviewer (EQCR) should discuss the components and results of the review with each of the key audit partners (KAP) at subsidiary level. A Member pointed out that a discussion could also be held between the group EQCR and the EQCR at the subsidiary level. Since the Audit Directive and Regulation is clear with respect to the requirement, the Executive proposed not to add additional material. However, the Executive agreed to include this in guidance for AQR Teams.

11.5 Subject to above, the Council agreed to provide its advice to the Executive to publish the SGN 02/18.

12. Audit Quality Thematic Review: Other Information in the Annual Report

12.1 Mr Shennan introduced the paper highlighting that the review focused on those aspects of 'Other Information' where auditors have specific reporting responsibilities. He outlined the key messages as set out in the paper and noted that the auditors are not generally performing sufficient work on Other Information to meet the requirements of Auditing Standards, or expectations of investors.

12.2 The Council was complimentary about the work undertaken in respect of the Thematic Review and viewed that the report was well presented and helpful. The Council made a number of comments and suggestions including:

- Besides addressing the failures with the audit firms, the report should also be shared with clients, the CFOs and the audit committee chairs. It was noted that particular points arising from the Review will be included in the FRC letters to companies in order to improve the overall processes and procedures.
- In respect of whether there is any correlation between quality, accuracy and consistency in the nature of information in front end of the reports and how well the audit is completed, it was noted that the review showed that there were some examples of good practice in larger entities but there were issues across the scale of entities.
- The Thematic Review has been a useful evidence base to assess whether the ISA (UK) 720 *The Auditor's responsibilities relating to Other Information* needs revision to better support the objectives for that standard.
- Some inconsistencies in paragraph 3.6 were highlighted in respect of key performance indicators / alternative performance measures. Mr Shennan agreed to review the section.

12.3 The Chair thanked Mr Shennan and his Team for the work undertaken in respect of the Review and discussing the outcomes with the Council.

13. Any other business

Developing the 2019/2020 FRC Plan

13.1 Mr Andrews introduced the paper and emphasised that in developing the draft plan, it is intended that the Plan should demonstrate how the FRC's regulatory tasks and projects including high quality audit and assurance work support and drive the FRC's mission forward. Whilst doing so, consideration is required to be given in respect of the potential costs of implementing Sir John Kingman's recommendations, work related to EU exit and the post-EU exit regime for accounting and auditing.

- 13.2 The Council gave due consideration to the outline plan for 2019/2020 in respect of the work relating to audit and assurance and made a number of comments including:
- In light of the current economic conditions and market failures, whether the FRC had plans to promulgate successes to drive confidence in capital markets. It was highlighted that FRC communications do include success stories; however, it is mindful of balancing its reporting and not ignoring issues at the same time.
 - Besides the pieces of work listed in the draft Plan, it was queried if there were plans in place to address the aspirations of broader stakeholders. It was noted that the Plan would be discussed with the Corporate Reporting Council on 15 November 2018 which will stimulate discussion around reporting in public interest.
 - The draft Plan include a number of themes described as 'long-term' projects. It was noted that some projects may have short, medium- and long-term objectives which may require liaison with other regulators for regulatory changes.
 - With regards to work in relation to effective enforcement, Carillion was the key project in the draft Plan.

13.3 The Chair thanked Mr Andrews for sharing the draft Plan with the Council and seeking its views on the development of the FRC's Annual Plan for 2019/2020.

14. Date of next meeting

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