

Audit and Assurance Council

Minutes of a meeting of the Audit and Assurance Council of the FRC
held on 1 October 2012 at Aldwych House, 71-91 Aldwych, London WC2B 4HN

PRESENT:

Members	Nick Land Russell Frith (by phone) John Hughes Ray King Scott Knight Robert Talbut Allister Wilson	Chair
Observers	Richard Thorpe Aidan Lambe	Financial Services Authority Chartered Accountants Ireland
Staff	Marek Grabowski Keith Billing Steven Leonard Jon Grant Tom Barrett Jo Goodson	Director, Audit Policy (For item 3) (For item 3)
In attendance	Jim Sutcliffe	Chair, FRC Codes & Standards Committee
APOLOGIES		
Members	Sue Harris Paul Lee	
Observers	R Rottenberg	UK, Department for Business, Innovation and Skills

1. Introduction and minutes of the previous meeting

- 1.1 The Chairman welcomed Ray King to his first meeting of the Council.
- 1.2 The minutes of the AAC meeting of 5 September were confirmed as approved.

2. Report of the Director of Audit Policy

- 2.1 Mr Grabowski introduced his report. Particular attention was given to the following matters.

PN 23 – Auditing Financial Instruments

- 2.2 Mr Grabowski informed the Council that the Codes & Standards Committee had approved the consultation paper on the proposed update of PN 23 for issuance.

Changes to ISAs (UK and Ireland) for ECS and Ireland

- 2.3 Mr Grabowski informed the Council that the FRC Board had approved the revisions to ISAs (UK and Ireland) for the ECS proposals and to enable the application of the revised reporting standards in Ireland.
- 2.4 A few changes had been made at the Board's request in ISA (UK and Ireland) 260, *Communication With Those Charged With Governance*. These did not have a substantive effect on the requirements; they primarily clarified the application material for the auditor when assessing whether there is a need to communicate with the full board regarding matters communicated by the auditor to the audit committee and how that can be achieved. Full details of the changes will be circulated to the Council members.

Request from the ICAEW Insurance Committee for the FRC to update and re-instate the guidance in Bulletin 2002/3 "Guidance for Reporting Accountants of Stakeholder Pension Schemes in the United Kingdom".

- 2.5 The request for the re-instatement of this guidance was discussed. The Council formed the view that, although the guidance is only applicable to relatively few entities and does not appear to relate to a significant public interest reporting requirement, there would be benefit re-instating the guidance to enable reporting accountants to refer to it in their reports. It was also considered more appropriate for the FRC to issue this guidance rather than the professional bodies. It was noted that the guidance would need to be updated but this was not expected to require a significant amount of work.
- 2.6 Accordingly, the Council's advice is that the guidance is updated and re-issued.

Proposed ICAEW guidance on assurance services relating to LIBOR

- 2.7 Mr Grabowski explained that there had been internal discussions at the FRC as to whether it was appropriate that an ICAEW working group alone develop this guidance or, given the apparent public interest aspect, if it was something that the FRC should have been asked to address and that the FRC was writing to the FCA to raise this. It was noted that FRC staff are attending the ICAEW's working group in an observer capacity.
- 2.8 Particular concerns were identified by the Council regarding whether this was the appropriate time to start developing guidance given that the proposed new administrator, with responsibility for LIBOR, had yet to be appointed and determine what type of assurance it may require; and whether the composition of the working group was appropriate or too limited. It was noted that the Wheatley Review had recommended that the ICAEW work with the new LIBOR administrator to ensure that their guidance informs and is consistent with the code of conduct.

Joint FRC/ICAS research project

- 2.9 Mr Wilson gave an outline of the project which will consider the skills and competencies needed by audit engagement teams in the complex business environments that exist today and will further develop in the future. The project is scheduled to take one year.

Membership of the AAC's Advisory Groups

2.10 The Council noted the progress on the membership of the three Advisory Groups.

3. Response to the IAASB ISA Implementation Survey

3.1 Mr Grabowski introduced the agenda item. The proposed structure of the response to be developed was explained, including that it would be a single FRC response setting out matters that had been identified from both the audit inspection and standard setting viewpoints. The Council considered the points that were recommended to be included.

Feedback from the Audit Quality Review Team

3.2 Mr Barrett introduced the feedback from the AQR team and informed the Council that discussions with other audit oversight bodies that belong to the International Forum of Independent Audit Regulators (IFIAR) had indicated that there was broad agreement on a number of key areas where improvements could be made to the ISAs.

3.3 The Council observed that some AQR concerns, in particular those related to group audits, appeared to relate to a lack of sufficient documentation that could enable evaluation of what had been done on the audit. It was generally agreed that audit documentation should be sufficient to explain the rationale for the auditor's judgements, but thought that this was already required by the ISAs. Mr Barrett stated that the AQR feedback was not calling for greater documentation requirements per se. Rather, the feedback on group audits highlighted that the application of the existing requirements in practice was often, in the view of the AQR, not resulting in sufficient evidence on the audit files of what the group auditor had actually done. Some members of the Council were concerned that there should not be a suggestion that there is a need for a plethora of individual requirements for detailed documentation on specific processes followed by the auditor – this would risk encouraging 'box ticking' approaches at the expense of due exercise of professional judgment and exacerbate the AQR concern that internal quality reviews tend to focus on compliance with policies and procedures rather than the appropriateness of audit judgments. The Council concluded that these issues were something that it would be helpful to give further attention to in future.

3.4 With regard to the AQR view that more guidance is needed on how to apply ISA 540, which addresses the audit of accounting estimates, to specific areas such as impairment it was questioned by some Council members whether it would be appropriate or practicable for the IAASB to do this. There was agreement that more guidance could be helpful in relation to some matters, but some members thought that the ISAs might not be the right location given that they need to allow for varying accounting requirements in different frameworks.

3.5 With regard to the AQR view that greater emphasis should be placed on the importance of exercising appropriate scepticism, it was agreed improvements could be made (and a significant part of the response to the IAASB will address recommendations that could enhance the references to auditor scepticism in the ISAs). In this connection it was suggested that the AQR might gain some insight into auditors' scepticism through discussion with the audit committee and Mr Barrett indicated that this was already being considered.

3.6 It was noted that the AQR had previously expressed concerns about a lack of consistency by auditors in the identification of 'significant risks' and it was suggested that this might be included in the response to the IAASB.

Scepticism

- 3.7 The Council generally supported the proposed feedback set out in the attachment to the agenda paper. Some suggestions were given as to matters that could be added, including obtaining evidence from at least two independent sources where possible; the auditor considering what an appropriate amount/range would be before looking at management's amount in relation to an item; and considering further what the role of the audit committee, where one exists, might be.

Feedback from small and medium sized audit firms

- 3.8 The summary of the feedback from small and medium sized firms, obtained using an IAASB questionnaire, was noted, including that no major unexpected issues had been identified. The Council supported submitting this information to the IAASB separately from the FRC response commenting on the implementation of the clarified ISAs.

4. Response to the IAASB invitation to comment on 'Improving the Auditor's Report'

- 4.1 Mr Grabowski introduced the item and, together with Mr Leonard, gave an overview of the main points made at the outreach meetings that had been held to date with stakeholder groups.
- 4.2 It was noted that there had been support for the FRC proposal that generally information about the entity should be given by the entity, with auditor comment focussed on audit related matters. However, there had been mixed views about whether there should be any auditor commentary on the audit – investors are generally supportive but some preparers and auditors had concerns about the merits and value of some of the information about the audit proposed to be included in the auditor's report. The Council supported a view that it would be desirable at least for there to be flexibility in providing such information in auditor commentary initially, so as to allow best practice to develop.
- 4.3 The Council supported the view that auditor commentary on audit related matters could be beneficial but suggested more outreach would help better understand what information would benefit users.
- 4.4 The Council also generally supported the recommendations given in the draft response to the IAASB, including in particular in relation to the structure of the auditor's report, the approach to commentary on going concern and the importance of maintaining the concept of Emphasis of Matter paragraphs. With respect to the alternative responses to question 7 that had been presented, the Council supported restricting mandatory application of the requirements to public interest entities.
- 4.5 With respect to the response to question 5, which included that a weakness of the IAASB examples was that they did not indicate how the identified risks were dealt with by the auditor, one Council member expressed concern that it may be impracticable for auditors to explain fully how risks were dealt with in a reasonable length of narrative. It was noted that this question is directed primarily to users and the suggested response was intended to reflect their view point
- 4.6 With regard to the illustrative auditor's report prepared to reflect the FRC's Effective Company Stewardship proposals, the Council supported a suggestion that the section on 'communication with the audit committee' be amended to just confirm that the description given by the company of significant matters discussed between the auditor and the audit committee include those matters the auditor considers most important (rather than the auditor identifying the 'most important issues').

4.7 It was suggested that the staff share the response with BIS.

5. Horizon scanning

Illegal acts

- 5.1 Mr Grabowski informed the Council that the International Ethics Standards Board for Accountants had issued an exposure draft that included a proposal that, in circumstances where there was no other appropriate authority, whistle-blowers should be able to report actual or suspected illegal acts to the auditor. This could have implications for the ISAs and ethical standards for auditors. The Council supported a recommendation that the FRC should consider and respond to the exposure draft.
- 5.1 It was also noted that the FRC Conduct Team is seeking clarification of the types of laws and regulations auditors would be expected to have a reasonable understanding of. The Audit and Assurance Team staff will discuss this with the Conduct Team and, if necessary, come back to the Council with issues to be discussed.

6. Other matters and any other business

- 6.1 None noted.

10. Next Meeting

- 10.1 The 'away-day' is on Wednesday 7 November, with dinner the evening before (venue to be confirmed). The next Council meeting is on Monday 26 November, starting at 2.00pm at the FRC's offices.