Audit and Assurance Council

Minutes of a meeting of the Audit and Assurance Council of the FRC held on 3 April 2013 at Aldwych House, 71-91 Aldwych, London WC2B 4HN

PRESENT:

Members
Nick Land (Chair)
Russell Frith
Sue Harris
Ray King
Scott Knight
Paul Lee
Allister Wilson

Observers
Aidan Lambe Chartered Accountants Ireland
Trevor Rushe Irish Auditing and Accounting Supervisory Authority
Pat Sucher Financial Services Authority

Staff
Marek Grabowski Director, Audit Policy
Keith Billing
Jon Hooper
Steven Leonard
Mark Mainwaring
Jon Grant

APOLOGIES

Members
John Hughes
Robert Talbut

Observers
Helen Hall Irish Auditing and Accounting Supervisory Authority
R Rottenberg UK, Department for Business, Innovation and Skills

1. Introduction and minutes of the previous meeting
1.1 The minutes of the AAC meeting of 27 February 2012 were approved.

Auditor’s report open meeting

1.2 Members of the Council who had attended the open meeting on 28 March reported that it has been a positive event, with a good discussion of the issues, and it was noted that audit firms and investors had been generally supportive of the FRC proposals.

1.3 A record of the meeting is being produced and will be circulated to Council members.
2. Report of the Director of Audit Policy

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

IAASB April meeting

Auditor reporting

2.2 Mr Grabowski informed the Council that the auditor reporting project would be the main item to be covered at the April IAASB meeting. The IAASB is still aiming to approve an exposure draft at its June 2013 meeting.

2.3 It was noted that, compared to the FRC, the IAASB is moving towards including more information about the entity in the auditor’s report in response to calls for such information from investors. Under the FRC’s proposals such information would be given in the audit committee report but the IAASB does not have the necessary remit to follow the FRC model. Mr Grabowski informed that Council that he is seeking to obtain broad feedback from investors in the UK and US, to get a clearer view of the type of information they wish to be given, to feed in to the IAASB discussions. While the FRC model is different to that of the IAASB, it should achieve the same aims.

2.4 It was also noted that in 2012 the PCAOB adopted a standard on auditor communications with audit committees which establishes a significant number of matters that are required to be covered. It was not yet clear to what extent these matters might be required to be disclosed in an expanded auditor’s report in the US, although it was likely that it would be closer to the IAASB model rather than the FRC model.

2.5 In discussion, Council members commented that it was important to provide transparency about the communications between the auditor and the audit committee, and let individual investors decide which matters are important to them. While some investors may be interested in information about “key audit matters” of the type described by the IAASB, it was likely that the nature of them would lead to boiler plate descriptions.

Disclosures

2.6 Mr Grabowski explained that the IAASB Task Force, of which he is a member, is looking initially at considerations for the planning stages of the audit and, in particular, how to emphasise that disclosures need to be considered as an integral part of that.

2.7 The Task Force is also looking at whether the ‘management assertions’ set out in the ISAs need to be modified to better reflect the characteristics of current day disclosures. Members of the Task Force have mixed views as to the extent of modification, if any, that may be appropriate and whether the assertions should be more closely aligned with the qualitative characteristics now established in accounting frameworks – for example the characteristic of ‘relevance’ is an important element of the accounting frameworks but is not obviously covered by the ‘management assertions’ set out in the ISAs.

ISA implementation monitoring

2.8 Mr Grabowski informed the Council that the key issues highlighted in the FRC response to the IAASB were well represented in the summary of issues identified by the IAASB Task Force.

2.9 Mr Grant, who is chair of the IAASB Task Force, explained that a challenge to be addressed is that there has been a wide variety of input from a wide variety of
respondents. The main focus by the Task Force is on those particular issues which were raised by many respondents.

2.10 An issue going forwards for the IAASB will be how quickly it can respond, if necessary, to any recommendations for change given that it has relatively limited resources and other projects in progress/planned.

ISAE 3000

2.11 Mr Grabowski informed the Council that this project is moving along gradually. The IAASB would consider and give feedback on a ‘first read’ of a proposed revised standard in April. A proposed final standard will be considered at a later IAASB meeting.

EU Policy developments

2.12 The Council was informed that, with respect to the proposals directed at auditors, it was not yet clear whether final wording would be agreed by the end of the Irish presidency.

2.13 Mr Grabowski informed the Council that the Accounting Directive also has proposals that relate to the role and responsibilities of the auditors in relation to the narrative information at the front end of the annual report. The proposals are not completely clear but could be interpreted as requiring the auditor, in effect, to give an audit level of assurance on that information. This has been taken up with BIS and we are awaiting feedback from them, with advice of their legal team, as to how this might be transcribed into UK law.

Irish Liaison Committee

2.14 Mr Grabowski informed the Council that the staff had met recently with the Irish Liaison Committee to discuss the FRC proposals relating to the auditor; report and Sharman. No significant issues were raised by the Committee.

Research

2.15 The staff will circulate to the Council the paper setting out the summary findings of Professor Brenda Porter from her research into the expectation gap.

3. Practice Note 23 – auditing financial instruments

3.1 Mr Grabowski introduced the agenda item and asked for the Councils advice on the three key issues of principle that had been identified. The Council’s advice was:

- The criteria for supplementary FRC guidance set out in the consultation paper remain appropriate and the FRC should not restrict guidance solely to matters related to laws and regulations.
- The supplementary guidance reflecting the FRC view that that disclosures are not deemed less significant simply by virtue of being disclosed in a note to accounts rather than on the face of the primary statements, is appropriate to include in the PN.
- The structure of the IAPN should be retained.

3.2 The proposed final revised PN 23 will be presented at the May Council meeting together with a more detailed explanation of how comments from respondents have been addressed, and having regard to advice from the working party that helped develop the exposure draft.
4. **Basel Committee consultation on guidance for external audit of banks**

4.1 Mr Grabowski introduced the agenda item and invited advice on how to respond to the proposed guidance and the letter to IAASB recommending improvements to ISAs.

4.2 Matters identified by the Council in discussion included:

- The guidance sets out supervisors’ expectations and in many areas is duplicative of the ISAs;
- In some areas the guidance goes further than the ISAs and the FRC’s position on particular matters (e.g. stating that audit committees should have a policy in place that stipulates the frequency with which there should be a tender for the external audit contract, as compared to the UK Corporate Governance Code which just states that FTSE 350 companies should put the external audit contract out to tender at least every ten years);
- In other areas the guidance is not entirely consistent with the ISAs (e.g. referring to the involvement of the EQCR throughout the audit, whereas the ISAs do not explicitly require involvement at all stages of the audit);
- The intended status and authority of the guidance is not clear.
  - Is it expected to be enshrined in local regulations?
  - In a number of areas it indicates that the auditor “should” do something – the term “should” is typically associated with requirements by standard setters and the IAASB does not use it in guidance;
  - The principles set out are quite high level but the related guidance is then very granular and specific;
- The letter to the IAASB did not appear to be asking for significant changes to ISAs, mainly requesting more authoritative guidance;

5. **Response to ED ISA 720 (Revised) – the auditor’s responsibilities relating to ‘other information’**

5.1 Mr Grabowski, who is a member of the IAASB Task Force to revise ISA 720, introduced the agenda item and the proposed FRC response. He explained that the IAASB had already received over 65 responses, a large proportion of which were from auditors and professional bodies. Only three responses had been received from investors. The IAASB Task Force is looking to distinguish between conceptual issues raised and matters of detail. The proposed FRC response focuses on conceptual issues with some related matters of detail.

5.2 The Council’s advice is that the response is appropriate. A small number of drafting points of detail were identified which will be addressed by the staff before the response is finalised.
6. **Response to the ICAEW’s proposed guidance for assurance work on benchmarks and indices**

6.1 Mr Grabowski introduced the agenda item and the proposed FRC response which covered issues that had been identified at previous Council meetings.

6.2 The Council’s advice is that the response is appropriate.

6. **IAASB framework for audit quality**

6.1 Mr Grabowski and Mr Hooper introduced the agenda item and the outline responses to the four questions asked in the IAASB consultation.

6.2 Matters identified by the Council in discussion included:

- Alternatives to the ‘pyramid’ model, referred to in the introduction section of the outline response, should be identified;

- It is not clear what the primary focus is of the framework as included in consultation paper. It may be helpful to auditors and audit inspectors, but as drafted would not be very helpful to audit committees – the response should highlight that. (Mr Grant, who is chair of the IAASB Task Force, explained that the exposed framework was deliberately very broad and it was intended that more focussed material, such as for audit committees, would be produced at a later stage);

- There is some overlap with Basel guidance for bank audits (item 4 above) and it may be helpful to compare them to see if they are compatible.

6.3 The staff will present a proposed full response at the May Council meeting.

7. **Internal audit in financial services**

7.1 Mr Grabowski introduced the agenda item which covered consideration of a proposed FRC response to a consultation by the Institute of Internal Auditors (IIA) on recommendations intended to provide a benchmark for effective internal audit in financial services.

7.2 Matters identified by the Council in discussion included:

- It may be helpful for the recommendations to also address the risk function and the balance of responsibilities with internal audit;

- Care may be needed to avoid an unintended consequence of the involving the chair of the audit committee in taking on responsibilities that could be deemed to be executive in nature;

- The draft FRC response refers to giving more consideration to what independence means and how it can be safeguarded when “the internal auditor will often be a full time employee of the company”. In relation to this, it was observed that the IIA recommendations include that the audit committee should determine an appropriate interval to consider the need to change the chief internal auditor.

- In June 2012 the Basel Committee issued revised supervisory guidance for assessing the effectiveness of internal audit functions in banks. It may be interesting to compare this to the IIA recommendations.
8. Repairing confidence in the value of the audit

8.1 Mr Grabowski and Mr Hooper introduced the agenda item and asked the Council for its advice on the draft project plan. The aim was to be able to complete the survey interviews by July. Mr Grabowski informed the Council that the staff were also developing proposals for an outreach programme and would share details with them in due course.

8.2 Matters identified by the Council in discussion included:

- The possibility of undertaking some preparatory work to develop themes for testing in the survey. However, the aim of the survey at this stage is to obtain focussed information on stakeholders views and expectations of audit in a relatively short timescale;
- The focus in the survey should be on audit and not governance. However, there is a need to be clear where responsibilities reside;
- Meetings with small focus groups as well as one to one interviews could be considered. However, more full information is likely to obtained from all participants if interviewed separately;
- The questions to be asked should not be too negative or defensive of audit. Completely eliminating the ‘expectation gap’ is unlikely to be achievable as some parties may have expectations that are not reasonable and not be willing to change their views;
- Should aim to obtain views on what a future audit could do as well as views on what a current audit does;
- More widely, the project will include:
  - looking again at the Ethical Standards and auditor independence requirements;
  - exploring dialogue between auditors and investors and other stakeholders may be improved;
- Should auditor liability be considered? Liability risk is a driver of audit quality. This is likely to come up when obtaining views from auditors.
- Other matters to explore with auditors include how their views on the public interest role of auditors and how their business models support the public interest.

8.3 The staff will circulate an updated project plan to the Council.

9. Other matters and any other business

9.1 None.

10. Next Meeting

10.1 The next Council meeting is on the afternoon of Friday 17 May, starting at 2.00pm, with a light lunch available at 1.30.