

**Minutes of a meeting of the Audit and Assurance Council of the FRC
held on 12 June 2017 at the FRC, 8th Floor, 125 London Wall, London, EC2Y 5AS**

PRESENT

Ray King	Chairman
Olivier Beroud	Member
Bryan Foss	Member
Jane Fuller	Member
Kari Hale	Member (from Minute 1 to 6.4)
Sue Harris	Member
Scott Knight	Member

OBSERVERS

Lisa Campbell (IAASA)
Lee Piller (FCA)
Michael Gaul (PRA) (from Minute 6.2)

IN ATTENDANCE

Kate Acott	Project Director
Mark Babington	Deputy Director of Audit Policy
Anu Bhartiya	Committee Secretary
Keith Billing	Project Director (from Minute 7.7)
James Ferris	Project Director
Marek Grabowski	Director of Audit Policy (from Minute 7.7)
Josephine Jackson	Technical Director
Melanie McLaren	Executive Director of Audit

1 Welcome and apologies

The Chairman welcomed everyone to the meeting. Apologies were noted from the Council Members Paul Cox, Stephen Oxley and Jerry Wedge.

2 Declaration of conflict of interest

There were none to be reported.

3 Minutes and Rolling Actions

Minutes

- 3.1 The minutes of the Audit & Assurance Council meeting held on 15 May 2017 were approved for publication subject to minor amendments.

Rolling actions

- 3.2 The matters arising log was noted.

4 Chairman's update

- 4.1 The Chairman reported that the Codes & Standards Committee had not met since the last meeting of the Council. The Board had met on 24 May and amongst other matters had discussed the following:

- CEO Report – a discussion on the role of the FRC in a post-Brexit world including options for an IFRS endorsement process for the UK.
 - The appointment of Sue Harris as the new Chair of the Audit & Assurance Council.
 - FRC Mission – a debate on what should be the contents of the new mission.
 - FRC Classification – to note the FRC’s classification under Central Government rules and focus attention on ensuring that the FRC retains regulatory and operational independence to the greatest extent possible.
 - Audit firm supervision – the framework for the FRC’s monitoring and enforcement of the audit firms.
 - Accountancy Scheme – a discussion on its operation and co-ordination with professional bodies.
 - Risk Management Report – a review of the Principal Risks identified for inclusion in the Risk Statement in the draft Annual Report 2016/17.
- 4.2 Melanie McLaren (MM) gave further update on the Accountancy Scheme and the discussions with the bodies participating in the Scheme. It was noted that when the Scheme was first agreed in 2004, all the bodies had agreed to participate and that the Scheme would apply to all their members – this had been confirmed through public consultation as being in the public interest. Now that audit is captured by the FRC’s competent authority status, the Scheme is, for the most part, a voluntary arrangement but one that the FRC sees as being important to maintain. The FRC had discussed the issues with the bodies and the Board had considered the correspondence exchanged to date, and its implications. Work remains ongoing in this respect.

5 Report of the Director of Audit Policy

- 5.1 Mark Babington (MB) provided an update to the Council on the programme of outreach work to gather UK stakeholder views on the IAASB ED 540. The update included the following points and observations:
- FRC has been in liaison with the PCAOB which held a public Board meeting in which it set out its final rule on the implementation of extended auditor reporting in the United States. This means that auditor reporting in the USA will now be more aligned with the model pioneered by the FRC.
 - There was substantial progress made with the work to update the FRC standards and guidance material and the aim is to be able to demonstrate significant progress by the end of 2017 towards having up to date and sustainable guidance to support high quality audit.
 - Following on from meetings with UK Audit Firm chairs and with their INEs, the FRC will be holding working group meetings with the INEs. The objective of one of the groups, which Marek Grabowski (MG) will chair, will be to consider how the value of audit might be used to provide greater assurance to users and other stakeholders over information other than that included directly in the financial statements. This might also help address expectation gaps that exist between auditors and the users of their work. It was agreed that an update on the outcome of the working group meetings would be provided to the Council.
- 5.2 The Council reported that the information flowing through the format of the Report was very clear and helpful.
- 5.3 It was noted that Sue Harris, the incoming Chair of the Council, was having conversations with members of the Council on the items to be included in the agenda for the Away Day. The Members were invited to send their further suggestions to MB, if they had any.

6. Developments in Audit 2017

- 6.1 James Ferris (JF) informed that the draft of Developments in Audit 2016-17 report was well advanced, and would be circulated shortly to ensure Council members had the opportunity to comment on a relatively mature draft. There was still some analysis to be done on the audit tendering data collected, and to ensure that the messages were consistent throughout the report.
- 6.2 JF outlined the key messages emerging from the report, which were built on the FRC's unique evidence base and highlighted that:
- The overall standard of audit work being done in the UK continues to be high.
 - FTSE 350 audits, which were inspected by the FRC, improved for the fifth consecutive year showing continued progress towards the strategic target of 90% of audits inspected as being good or requiring limited improvements.
 - However, relatively poorer results from inspections of companies outside the FTSE 350 means that our view is of no overall improvement in audit quality in the UK since the prior year.
 - There has been significant investment in programmes of audit improvement by the audit firms, but an inconsistency in outcomes seen.
 - Accounting estimates continue to be the most common area where weaknesses are found, which include a failure by auditors to challenge assumptions made by management with a sufficient level of professional scepticism and insufficient attention to disclosures.
 - High profile accounting failures, as well as the results of the audit monitoring, continue to identify cases where auditors have not met expectations.
 - Firms report that the costs and challenges connected with tendering are high, as well as those related to taking on new clients with complex businesses.
- 6.3 MB informed the Council that following the change in the nature and format of the Audit Committee Chair survey, the FRC had received enormous number of responses which included verbatim comments in which audit committee chairs provided explanations for the assessments they had given. The results of the survey will be shared with audit committee chairs and the Audit Committee Independent forum, and will be included in Developments in Audit.
- 6.4 The Council noted that enforcement procedures have been enhanced to address cases where standards are not met on a more timely basis. Several recent cases have been concluded and the FRC has work in hand to ensure that lessons learnt are considered quickly. An independent panel had been set up to advise on the current the sanctions regime.
- 6.6 The Council noted that the draft report on the Developments in Audit 2016-17 would be circulated to the Members for comments and the Council advice would be presented to the Board in July. The report would also be shared with the Conduct Committee, Codes and Standards Committee and the Audit Quality Review Committee.

7 AAT Project Update

- 7.1 MB highlighted the purpose of the paper which was to provide its advice to the Codes & Standards Committee (i) that it recommend to the Board the approval of the revisions to ISAs (UK) 250, 330 and 505; (ii) that it withdraw PN16 (Bank Reports) and replace it with some minor new application material; and (iii) that it approve the going concern work proposal.

Draft Feedback Statement and Impact Assessment – Revisions to ISA (UK) 250 – Consideration of Laws and Regulations in an Audit of Financial Statements

- 7.2 The Council considered the responses received on the four questions raised in the Feedback Statement and Impact Assessment and agreed to provide its advice to the Codes & Standards Committee to recommend to the Board the approval of issuing a revised version of International Standard on Auditing ISA (UK) 250 – Consideration of Laws and Regulations in an Audit of Financial Statements, adopting the changes made by the IAASB to ISA 250 (Revised) and the conforming amendments to other ISAs.

Draft Feedback Statement and Impact Assessment – Withdrawal of Practice Note 16 (Bank Reports) and minor changes to ISAs (UK) 330 and 505

- 7.3 The Council considered the responses received to the Feedback Statement and Impact Assessment and agreed to provide its advice to the Codes & Standards Committee to recommend to the Board the approval of issuing a revised version of International Standard on Auditing ISA (UK) 330 – The Auditor’s Response to Assessed Risks, and conforming amendments to ISA (UK) 505 – External Confirmations as proposed in the consultation. The Council also agreed that Practice Note 16 – Bank Reports for Audit Purposes in the United Kingdom be withdrawn as it is no longer needed to support the work of auditors seeking bank confirmations to support an audit engagement now that new application material will be included in standards.

Work proposal – Going Concern

- 7.4 MB outlined the FRC’s proposal to carry out a review of Going Concern material. This is intended in part to ensure that the FRC has identified any lessons learned as a result of FRC Inspection or Enforcement work, and to make sure that the standards continue to drive high quality audit, and in part to carry out an assessment of whether the recommendations made by the Sharman Review have been appropriately addressed.
- 7.5 The Council asked for clarification on the scope of the proposal and the approach that will be taken to carry out the review. It was noted that the FRC’s response to Sharman saw a series of guidance material issued, much of which was developed in response to the financial crisis and now was a good time to see whether that remains fit for purpose, and whether the material can be consolidated more effectively within the standard itself. The project will include not just input from stakeholder via a working group, but significant stakeholder outreach. The project will explore what action is the most appropriate way to drive high quality audit and support user confidence in audited financial statements in the area of going concern.
- 7.6 The Council considered the Project Scoping form and agreed to provide its advice to the Codes and Standards Committee that it approve the going concern work proposal.

Draft Response – IESBA Strategy Consultation and Draft Response – IESBA Consultation on Professional Scepticism and Professional Judgement

- 7.7 The Council considered the drafted responses to the IESBA’s proposals with regards to their forward strategy and the proposal on professional scepticism and professional judgement. The strategy response continued to remind IESBA of the need for the Code to not just be a lowest common denominator approach to ethics rather that it should also seek to drive robust ethical behaviour in mature and sophisticated capital markets. The responses are consistent with the line taken for other IESBA consultations which have been discussed with Council on previous occasions.

- 7.8 The Council noted the concepts of 'Public Interest Entity' and 'Listed Entity' and supported the view that the IESBA definition of PIE and listed entity should be revised and clarified as a priority. Keith Billing (KB) explained the considerations given in ranking the top 6 priorities in the response paper, and on the Council's advice agreed to replace the prioritisation of a post implementation review (which would need to wait until at least a couple of years after the implementation date had elapsed), with the need to look at the ethical implications of tax advice.

8 IAASB – Responding to the IAASB's ISA 540 Consultation

Comparison of the Requirements of Proposed Revised ISA 540 (ED-540) with those of the Current Standard (ISA-540)

- 8.1 MG tabled the Exposure Draft on Proposed International Standard on Auditing 540 (Revised) – Auditing Accounting Estimates and Related Disclosures and the presentation on 'What's new in ISA 540?'
- 8.2 MG provided an overview of the drivers for the revision, main areas of change in the proposed standard, scope and risk assessment and the focus of the work effort. The Council noted the following:
- There were evolutions in financial reporting standards, leading to increasing numbers of complex accounting estimates to audit.
 - Other drivers for the revision were to address concerns in relation to the audit of accounting estimates that have been identified since it was last revised in 2008.
 - The level of change is significant, but this is evolution rather than revolution.
 - There are 18 requirements in the ED; 16 requirements are in the current standard.
 - The key changes include new and strengthened requirements for identifying and assessing the risks of material misstatements (including focus on the factors of complexity and judgement as well as estimation uncertainty); scalability whereby a relatively small number of particular procedures are identified that may be appropriate when the inherent risk of material misstatement is assessed as low; when inherent risk is not low, there are outcome based requirements for the work effort; improvements to how an 'auditor's range' is determined; developing the requirements to enhance professional scepticism; and more focus on disclosures, with the auditor needing to be satisfied that they are 'reasonable' and not just 'adequate'.
- 8.3 MG further reported the tone of the FRC's response to the Consultation is proposed to be generally supportive of the proposed revisions, agreeing that it is appropriate to ensure the standard is fit for purpose having regard to evolutions in financial reporting frameworks and to address concerns that have been identified in relation to the audit of accounting estimates since it was last revised in 2008. However, it is believed that the proposals could be further enhanced in relation to a number of matters as set out in the agenda paper.
- 8.4 The Council members were invited to have further face to face or telephone meetings with MG to share their comments in relation to the proposed matters which could be further enhanced. The responses to the Consultation are due by 1 August and therefore the FRC's draft response would be circulated to the Council by mid of July and if required, a teleconference meeting would be arranged to obtain Council's advice in the matter.
- 8.5 In response to a query in relation to assurance on the appropriateness of the internal control system in respect of expected credit loss, it was clarified that the role of auditors is focused on the audit of the financial statements rather than the Prudential Regulation Authority requiring further information beyond that.

9 Update – Reform on the Independent Standard Setting Boards

9.1 MB provided a high-level update on this topic to the Council.

10 Any other business

Topline results AAC Quality survey

10.1 MB provided an update on the FRC's annual survey of audit committee chairs to get their view on the audit quality of the audit they have received in the last audit cycle.

Amongst other matters, the Council noted the following points:

- The survey had been reformed to receive comments from audit committee chairs to understand the reasons that underpin their responses.
- 330 responses had been received which included a mixture of FTSE 350 and other companies. The responses would form a good evidence base for references that would be made within the Development in Audit 2016-17 report.
- The questions relating to satisfaction of audit approach, audit culture and professional scepticism had received high scores.
- There is a slight drop in the scores in respect of questions relating to the independence of objectivity of auditors, interaction of auditors and audit committee.
- There had been a drop in the perception of audit quality to regulatory oversights.
- There has been an improved reporting in response to the questions relating to the demonstration of innovation in data technology.

Chairman's last meeting

10.2 This was the last meeting for Ray King. On behalf of the Council, Sue Harris, the incoming Chair thanked him for his commitment and contribution to the Council and wished him well for the future. Ray thanked the Council Members and the attendees for their input to the work of the FRC.

Council Away Day - Venue

10.3 The Council noted that the Away Day on 13 July 2017 will take place at the Barbican Centre, London.

Member appointment

10.4 Sue Harris informed that the appointment of a new member to replace Conall O'Halloran was progressing.

11 Date of next meeting

11.1 Council Away Day on 13 July and next Council meeting on 27 September 2017.