

## **Audit and Assurance Council**

Minutes of a meeting of the Audit and Assurance Council of the FRC  
held on 17 July 2013 at Aldwych House, 71-91 Aldwych, London WC2B 4HN

### **PRESENT:**

Nick Land (Chair)  
Sue Harris  
John Hughes  
Ray King  
Paul Lee  
Robert Talbut  
Allister Wilson

### **IN ATTENDANCE:**

Marek Grabowski	Director, Audit Policy
Keith Billing	Project Director (by telephone for minutes 6 and 7)
Francesca Chittenden	Council Secretary
Jon Grant	Director of International Auditing Standards
Jon Hooper	Project Director
Steven Leonard	Project Director
Mark Mainwaring	Project Director
Melanie McLaren	Executive Director
Trevor Rushe	Observer, Irish Auditing and Accounting Supervisory Authority
Pat Sucher	Observer, Prudential Regulation Authority

### **1. Apologies and introduction**

- 1.1 Apologies were noted from Russell Frith (Council Member), Aidan Lambe (Observer – Chartered Accountants Ireland) and Scott Knight (Council Member).

### **2. Minutes of the previous meeting and rolling actions**

- 2.1 The minutes of the AAC meeting of 19 June 2013 were approved as an accurate record of the meeting.
- 2.2 The Council noted that all actions were either complete or addressed on the agenda.

- 2.3 In response to a query (reference 7.4 on the action log) Melanie McLaren (MML) informed the Council that the Codes & Standards Committee had requested that a set of criteria be developed which would be used to assess whether new standards and guidance should be developed. She confirmed that the development of the criteria would not delay the development of the new section of ISA720.

## **Reports**

### **3. Chairman's Update**

- 3.1 The Chair of Council confirmed that there was nothing to report that was not covered either in the Director's report or on the agenda.

### **4. Report of the Director of Audit Policy**

- 4.1 Mr Grabowski (MG) introduced his report which was taken as read. Particular emphasis was given to the following matters.

#### **IAASB meeting (24-28 June)**

- 4.2 MG informed the Council that the IAASB had approved exposure drafts (ED) of a new suite of standards which included ISA 701 'Communicating Key Audit Matters in the Independent Auditor's Report' and revisions to ISAs 700, 705, 706, 570 and 260 as well as consequential changes to a number of other ISAs including ISA 210. MG informed the Council that the EDs had not yet been published but that they were due to be published shortly, once the explanatory memorandum was drafted and approved.
- 4.3 MG confirmed that provisions had been secured within the draft standards which would avoid the need for significant changes to be made to the approach taken over the last year introducing new auditor reporting requirements into the existing ISAs (UK & I), if the new ISA 701 ED and other proposed changes to the ISAs were to be adopted by the IAASB and these in turn were to be adopted within the ISAs (UK & I). MG highlighted that whilst ISA 701 ED does not include a requirement for reporting by the auditor on materiality, risks of material misstatement or audit scope, a provision had been secured within ED ISA 706 that identifies how an auditor should report on these matters if required to do so. Similarly, provision had been made in ED ISA 700 to specifically allow for the FRC audit committee reporting model. However, MG clarified that the FRC might still want to comment on certain aspects of the proposals in the EDs – for example, in relation to the detailed guidance around the criteria setting out what should be reported in relation to key audit matters and the extent and nature of the description of such matters.
- 4.4 The Chairman queried whether there would be any inconsistency in relation to what the audit committee considers to be a matter reported by the auditor that needs to be included in the audit committee report under the FRC code and a key audit matter under ED ISA 701. In response, MG said he believed that the expectations for a key audit matter established in the ED were similar to those established in the FRC Code for inclusion in the audit committee report; both in relation to identifying what items should be included as a KAM and how much detail should be provided in relation to

each KAM. However, the detailed criteria were not identical and would need to be considered further.

#### Development of Client Assets (CASS) Assurance Standards

- 4.5 The Council noted the update on the development of the CASS Assurance Standards and that a more detailed proposal would be brought back to the Council in September.

#### Proposed Standard for Investment Reporting (SIR) on Quantified Financial Beneficial Statements

- 4.6 The Council noted that the Codes & Standards Committee (CSC) had agreed the development of a SIR setting out Investment Reporting Standards Applicable to Public Reporting Engagements on Quantified Financial Benefit Statements, subject to an assessment against the criteria for the development of new standards.

#### The audit of Directors' Remuneration Reports

- 4.7 The Council noted that the CSC had approved its recommendation to develop a new section of ISA (UK and Ireland) 720 to address the issue of the audit of Director's remuneration reports but that the Executive were yet to assess how the proposed ISA fits against the criteria for the development of new standards.

#### PN23 and PN14

- 4.8 The Council noted that the CSC had approved the revision of PN23 and the Exposure Draft of PN14 and that both would be published before the end of July 2013.

#### Implementing the recommendations of the Sharman Panel

- 4.9 It was suggested that it would be useful to discuss the revised proposed guidance document (combining the Turnbull and Sharman guidance) with the bank respondents to the consultation, to ensure that their concerns about inconsistencies between the guidance document that had been exposed for comment and the supplementary guidance for banks had been addressed.

#### Vodafone Annual report

- 4.10 The Council noted the Annual Report which had been prepared in anticipation of the changes that were made to ISA (UK and Ireland) 700 in June and therefore, include a commentary on risk, materiality and audit scope.
- 4.11 The Council noted that the FRC's financial reporting lab were in the concluding stages of a project looking at the value of this commentary and that the team would be seeking investor feedback.

#### Loan Loss Impairment

- 4.12 The Council noted that the matter of loan loss impairment was not straightforward and that there may well be an expectation gap in terms of the public understanding of the impact of running with an expected loan loss model and the reality.

Activities since last meeting

4.13 The Council noted the list of activities since last meeting.

## **5. Improving Confidence in the Value of Audit in the UK**

5.1 Jon Hooper (JH) introduced the paper which provided an update on progress of the project.

YouGov Research

5.2 The Council noted that since the paper had been circulated YouGov had completed 80-90% of the interviews and had submitted a note of the outcomes of those interviews – the tone and content of which did not vary from those held previously.

5.3 The Council discussed the various themes identified within the report and through discussion the following points and observations were made:

- there may be a bias in the responses of those interviewed to date, until all interviews have been completed it is difficult to ascertain the full picture. The tone and views of those yet to be interviewed may be different to those put forward already.
- some respondents have identified ingrained structural problems in relation to audit; and there is a sense of their frustration and resignation coming through. However, very few solutions have been put forward and indeed respondents were not particularly encouraged to do so at this stage.
- the respondents have identified that any changes that are made must be applicable to businesses of all sizes and in all different sectors.

5.4 The Council noted that a full and detailed analysis of the completed interviews would be brought to the Council for consideration in September.

Corporate Reporting and Audit – Framework for Roles and Responsibilities

5.5 The Council received a presentation from JH which set out the Audit & Assurance team's initial thinking on how to document the framework and demonstrate the role of audit within it. The Council noted that the development of the framework would be developed by Executive staff with the input of Councils across the FRC and that this was the first of a number of iterations that the Council would be asked to consider.

5.6 The Council debated the role audit plays in the company framework and whether the overall aim of audit should be to encourage economic growth. There was debate around whether the outcome of audit is the narrow provision of signals which investors can use to inform decisions about the allocation of capital or whether the outcome is broader and leads to economic growth and sustained living standards across the whole population.

5.7 The Council identified that the framework would benefit from an introduction which set out the basic background principles, such as why companies exist, the roles of different sorts of companies and the role of audit, before consideration of what the

value of audit is. It was also suggested that to assist the identification of the value and breadth of audit, a diagram setting out that the statutory audit is a foundation / platform that underpins confidence in other reports than those directly addressed by the audit.

- 5.8 The Council highlighted the importance of ensuring the framework is applicable to small, medium and large organisations and across organisations from all sectors.
- 5.9 The Council noted that the framework would form part of a larger FRC wide strategic project in relation to fostering investment and that various points raised through discussion, including consideration of where the FRCs focus should lie in relation to various forms of investors, would be picked up as part of this wider project.
- 5.10 MG informed the Council that they would have the opportunity to discuss the framework again at both the September and October meetings. MG invited the Council to provide further comments in relation to the drafting of the document by email, if they wished to do so.

## **Standards and Guidance**

### **6. Review of Ethical Framework for Auditors**

- 6.1 MG introduced the paper setting out a project proposal to review the 'APB Ethical Standards for Auditors'. The Council noted that the project would form part of component 4 of the FRC's strategic project '*Improving confidence in the Value of Audit*' addressing the extent to which auditors act and are seen to act in the public interest.
- 6.2 The Council noted that the FRC Board had previously identified concern in relation to non-audit services and the impact of non-audit services on the perception of the independence of auditors and that the issue featured regularly in the media.
- 6.3 MG reminded the Council that although Ethical Standards are not all set by the FRC (some are established by the professional bodies and some in the law), it is appropriate to consider whether the FRC should increase its focus on the ethical standards, especially in light of proposed changes in the legal framework in Europe.
- 6.4 The Council suggested the order of the project proposal be reviewed to increase the emphasis on questioning of the structure and governance of audit firms and to avoid an apparent over-emphasis on non-audit services. In order to strengthen the proposal the Council suggested including a brief context setting statement and a brief statement clarifying the importance of identifying not just what auditors do but identifying how they do it.
- 6.5 MG reiterated that changes to the Ethical Framework would not necessarily result from the review, but that the review would assess whether the current framework is effective and fit for purpose. MG confirmed that the review would be informed by consultation with conduct colleagues, by reference to the ethical frameworks set by other countries and legislative changes being developed in Europe.

6.6 The Council approved the project plan, subject to the amendments set out, for advice to the Codes & Standards Committee and requested that the revised plan and an outline timetable be brought to the Council in September.

**7. ISA 700 (UK and Ireland) Para 19A – Entities that Report on Application of the UK Corporate Governance Code**

7.1 Steven Leonard (SL) introduced the background to the paper; he informed the Council that clarification had been requested from two of the large audit firms as to whether the provisions within paragraph 19A of ISA (UK and Ireland) 700 are intended to apply to the auditor's report of both the parent company and the group financial statements when the audited entity is a group.

7.2 SL informed the Council that a strict reading of the provisions, and therefore the interpretation of the Audit & Assurance Policy team, would be that paragraph 19A would apply to the auditors' reports on both the parent company and the group financial statements. It was therefore, a matter for the Council to consider whether the FRC's illustrative example of a UK auditor's reporting reflecting the requirements of ISA (UK and Ireland) 700 (Revised June 2013) should be amended to clarify this point or whether this interpretation was not in fact intended and that the standard itself should be amended to remove the requirement in relation to parent companies.

7.3 In considering the interpretation and options available there was significant debate on the relevance of providing the required disclosures about the parent company and how useful this information would be, and on how onerous and costly the requirement for parent company disclosures would be on preparers.

7.4 Through the discussion the following points were noted:

- the FRC supports the cutting of clutter from corporate reporting - requiring disclosure on the parent company audit report would go against this principle;
- there is a risk of encouraging 'boilerplate' statements in the accounts should the requirement apply to both parent and group accounts;
- materiality in the parent company financial statements would not be addressed in the audit report on the audit of the group financial statements, as the approach to materiality required to be discussed in that report would only be that applied to the group as a whole.

7.5 There general view was that it would be rare for a risk of material misstatement of significant importance to arise in the parent company audit that did not also arise in the group audit. If such a matter arose there was however support for it to be included in the audit report. Some thought it would be appropriate for it to be included in the group audit report so that there would be no need to require separate reporting in the parent company audit report. Others were unsure whether this would be required if paragraph 19A were to be amended to disapply it in relation to the parent company audit.

7.6 In conclusion, the majority of the Council members were minded to advise the Board that the standard should be amended to take out reference to the parent company. However, Council members asked to see a draft of the advice to the Board on this before finalising their views.

## **8. Horizon scanning**

Implications of the current questioning of tax avoidance

8.1 Due to time constraints the Council agreed to defer a discussion on the implications of the current questioning of the role of auditors in relation to tax planning to the September meeting.

## **9. Any other business**

9.1 None.

## **10. Next Meeting**

10.1 The next Council meeting is on Wednesday 11 September starting at 9.30am.