

## **Audit and Assurance Council**

Minutes of a meeting of the Audit and Assurance Council of the FRC  
held on 26 November 2012 at Aldwych House, 71-91 Aldwych, London WC2B 4HN

### **PRESENT:**

|                  |   |  |
|------------------|---|--|
| <b>Members</b>   | Nick Land (by phone)<br>Russell Frith<br>Sue Harris<br>John Hughes<br>Ray King<br>Scott Knight<br>Paul Lee<br>Robert Talbut<br>Allister Wilson (acting Chair) |  |
| <b>Observers</b> | Pat Sucher<br>Helen Hall  | Financial Services Authority<br>Irish Auditing and Accounting Supervisory<br>Authority |
| <b>Staff</b>     | Melanie McLaren<br>Marek Grabowski<br>Keith Billing<br>Jon Hooper<br>Steven Leonard<br>Mark Mainwaring<br>Jon Grant   | Executive Director, Codes and Standards<br>Director, Audit Policy                      |
| <b>APOLOGIES</b> |   |  |
| <b>Observers</b> | Aidan Lambe<br>R Rottenberg   | Chartered Accountants Ireland<br>UK, Department for Business, Innovation and<br>Skills |

### **1. Introduction and minutes of the previous meeting**

- 1.1 It was explained that, as Mr Land was unable to attend the meeting physically, Mr Wilson would be the Chair. Mr Land participated by phone.
- 1.2 The minutes of the AAC meeting of 1 October 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.

### ***EU developments***

- 2.2 It was noted that support for mandatory auditor rotation was gaining momentum in various Member States, although there is still some disagreement as to the appropriate period.
- 2.3 Some Member States are suggesting that rotation should only be mandated for particular business sectors, with the financial sector given as an example. It was observed by the Council that the banking sector could face practical difficulties due to the limited number of audit firms with the capability to audit large banks. The FSA has expressed concerns in this regard to the EC, but not all financial services regulators internationally share these views.

### ***IAASB – Auditor reporting project***

- 2.4 It was noted that the IAASB had received a large number of responses from a good range of stakeholders, although with nearly half from audit firms and other representatives of the audit profession.
- 2.5 From the responses, the area giving most difficulty is the ‘auditor commentary’. There are varying views as to whether this should be limited to ‘pointing’ to other information in the annual report, or be much more discursive of particular matters.
- 2.6 Some respondents had referred in a supportive manner to the FRC approach. However, it was recognised that the IAASB, unlike the FRC, is not able to produce integrated requirements and/or guidance for directors and audit committees.
- 2.7 Mr Grabowski informed the Council that the IAASB was still aiming to approve an exposure draft in June 2013. It was noted that given this, on an optimistic basis, the earliest date for a finalised standard from the IAASB to become effective was sometime in 2015. The EC is believed to be monitoring the IAASB project to consider whether it addresses its needs.
- 2.8 It was noted that the PCAOB, although appearing to be moving more slowly than the IAASB, was also believed to be aiming to issue an exposure draft on its proposals for an expanded auditor report in June 2013. The PCAOB’s proposals may be more prescriptive in establishing criteria for auditor commentary, but also more in the nature of emphasis of matter rather than discursive.

### ***IAASB – December Meeting***

#### ***Disclosures project***

- 2.9 Mr Grabowski informed the Council that this project followed on from the IAASB consultation on audit issues related to disclosures, to which the FRC had responded in 2011. Discussions by the IAASB’s Task Force as to the way forward in addressing the issues raised on consultation were at an early stage. The Task Force will be exploring with the IAASB at its meeting in December its view that although the requirements in the ISAs may need some enhancements there may be more need for further or better guidance in a number of areas.

## *ISAE 3000*

- 2.10 Mr Grabowski informed the Council that this project was still moving forwards slowly. There was no significant new information to feed back at this time.

## ***Revision of ISA 720***

- 2.11 The Council supported the staff recommendation that a short staff paper be developed and published highlighting the main differences between the proposed revised ISA and the recently issued revised ISA (UK and Ireland) 720; and also highlighting issues and questions raised by the IAASB. This would support a proposed notification to interested stakeholders to alert them to the proposed revised ISA inviting comments for the FRC to take into consideration when developing its response to the IAASB.

## ***ICAEW guidance on assurance relating to LIBOR***

- 2.12 Mr Grabowski informed the Council that the staff were still monitoring the ICAEW project and had communicated concerns about the timing (which precludes at this stage liaising with the new LIBOR administrator which has yet to be established) and the limited diversity of the working group.

## ***Client assets***

- 2.13 It was noted that a meeting of the working party was set for the first week of December to consider a revised version of the Bulletin.

## ***Horizon scanning***

### *Bulletin 2002/3*

- 2.14 It was noted that the Codes and Standards Committee would consider at its 30 November meeting whether guidance in withdrawn Bulletin 2002/3 should be updated and reissued. If agreed, the Council would be asked to give its advice on draft updated guidance in January.

### *Going concern guidance*

- 2.15 Mr Land asked whether, given the continuing economic slowdown, there was a need to reissue and/or emphasise the guidance on going concern that had been developed in 2008/09. The Council advised that attention to the guidance be given in the Press Notice announcing the proposed actions being taken to implement the Sharman proposals, which is planned to be issued in December.

## **3. Using the work of internal audit - Revision of ISAs (UK and Ireland) 315 and 610**

- 3.1 Mr Billing introduced the feedback on the responses received to the consultation paper. All the responses had come from audit firms, their professional bodies and public sector auditors. The main issue of principle discussed related to external auditors obtaining 'Direct Assistance' from internal audit staff (when members of the staff of the internal audit function are provided to the auditor to undertake limited detailed audit work under the auditor's direction, supervision and review). Such Direct Assistance is currently allowed in the UK and Ireland under certain circumstances

subject to significant safeguards that are set out in the supplementary application material included in the current ISA (UK and Ireland) 610.

- 3.2 Mr Billing reported that most responses had agreed that Direct Assistance was acceptable in the limited areas set out in the exposure draft of proposed revised ISA (UK and Ireland) 610 – 11 out of 13 expressed clear agreement and only one respondent had expressed outright disagreement. However, the relevant requirements and guidance are based on those proposed by the IAASB which are subject to final agreement by the IAASB, pending resolution of an issue in the International Code of Ethics (as explained in the consultation paper). There was a more balanced split of responses to the question asked in the consultation paper about whether, should the international standards ultimately not include the material on Direct Assistance, the revised ISA (UK and Ireland) should be finalised to do so (maintaining the current position under which Direct Assistance is allowed in the UK and Ireland). Three respondents indicated ‘no’ and another three indicated that the FRC should consider whether the position needs to be revisited.
- 3.3 The Council supported the proposal that the FRC should amend the equivalent UK and Ireland auditing standards to align with the revised ISA 610 as issued by the IAASB (and some related changes to ISA 315 and conforming changes to other ISAs), in conformity with the changes to the proposed ISAs (UK and Ireland) that the APB had exposed for public comment pre-Reform with the exception of that part of the revised ISAs dealing with Direct Assistance.
- 3.4 The Council was informed that the proposed revised UK and Ireland auditing standards were exposed for comment by the APB when the underlying ISAs were issued in final form by the IAASB (subject to finalisation of the position of Direct Assistance). The APB had commented on the earlier exposure drafts published for comment by the IAASB and was satisfied that the final IAASB revised standards had responded appropriately to the substance of the requested amendments that the APB had proposed to the IAASB. With respect to Direct Assistance, the APB had considered it important that the ISA should not be silent on the matter. One of the factors the APB took into consideration when agreeing the limited use of Direct Assistance included that Direct Assistance is arguably more reliable for the external auditor, than the separate work of the internal audit function, given that Direct Assistance work is directed, supervised and reviewed by the external auditor not by members of the internal audit function. The APB had also believed that the threats associated with using internal audit staff to carry out external audit procedures (such as the threat to objectivity) are similar to situations where reliance is placed on other work carried out by the internal audit function, and that such threats could be addressed by applying a ‘threats and safeguards’ approach as established in the APB’s Ethical Standards for Auditors (the APB obtained support for this in a consultation on proposed changes to the Ethical Standards).
- 3.5 The Council considered this background, and the responses to the consultation on the proposed changes to ISA (UK and Ireland) 610, and concluded that it would not be appropriate to allow the use of Direct Assistance for the following reasons:
  - Direct Assistance can be distinguished from reliance on the work of the internal audit function in that it is not a work product of the function produced for another purpose – therefore the decision to use it was not qualitatively the same as that made in using the work of the function.
  - Direct Assistance (as also with the separate work of the internal audit function), which is then used as audit evidence, is undertaken by individuals that are not independent of the audited entity under the Ethical Standards – the internal

auditors are employed by the audited entity and may have financial interests in it, a situation that would be seen to compromise the independence of other members of the audit engagement team. In order to address this, the definition of the audit engagement team had had to be amended in the Ethical Standards for Auditors (following consultation), to exclude any internal auditor providing Direct Assistance (the IESBA is currently considering, and may adopt, a similar amendment to the definition of the engagement team in the international Ethical Code applicable to auditors). The Council concluded that in principle this could not be justified and that therefore the rationale for doing so may well not be understood by a lay person.

The Council considered that the prohibition should be extended in a group audit to any component auditor whose work is relied upon by the group auditor.

- 3.6 Auditor members of the Council considered from their experience that prohibiting the use of Direct Assistance would not be a significant practical problem for auditors other than in a limited number of cases where more significant use is made of Direct Assistance. For these, there could be a cost impact.
- 3.7 It was noted that a prohibition in the UK and Ireland would not be inconsistent with the revised ISA, as it is currently expected to be finalised by the IAASB, because the revised ISA as currently drafted recognises that Direct Assistance is prohibited under laws and regulations in a number of countries and, therefore, would only be permitted under the ISA if also permitted under applicable laws and regulations.
- 3.8 The Council unanimously concluded that auditors should be prohibited from using Direct Assistance on an audit conducted in accordance with ISAs (UK Ireland). It was felt that if the Board accepted the Council's conclusion a limited further consultation should be undertaken in view of the support for Direct Assistance from those who had responded to the APB's consultations.
- 3.9 The staff will prepare the necessary briefing paper for the FRC Board, which will be circulated to the members of the Council for comment before being finalised.

#### *Process for consulting on the adoption of future new/revised ISAs*

- 3.11 Mr Billing reported that responses to the consultation paper had generally supported the proposed process for seeking views from stakeholders on proposed new/revised ISAs issued by the IAASB to help inform the FRC's considerations about them in developing its response to the IAASB. The Council's advice to the FRC Board is to agree the proposed process.

## **4. The Auditor's report**

- 4.1 Mr Grabowski introduced the discussion of how to take forward proposals to revise the auditing standards to require disclosure in the auditor's report of key audit planning judgements.
- 4.2 The Council considered that there were three options:
  - (i) To move in parallel with the IAASB (recognising that, as discussed earlier, this would mean revised standards not being likely to be in place until 2014, and effective in 2015, at the earliest);
  - (ii) To move in parallel with the IAASB but seek one or more companies to go ahead with FRC proposals on a voluntary basis (the current standards do not preclude adding more information in the auditor's report);

- (iii) To move ahead of the IAASB and revise the ISAs (UK and Ireland) at the same time as for Sharman, with an aim to introduce new requirements effective for December 2013 period ends.
- 4.3 The Council unanimously supported the FRC leading by example and advised that option (iii) should be recommended to the FRC Board.
- 4.4 The Council also advised that important considerations for the consultation include:
- Getting views from stakeholders, including views on the value of this information to investors; and
  - The consistency between corporate and auditor reporting in identifying and describing risks (possible issues could arise if the directors and auditors are perceived to have different views about the risks the entity faces).
- 4.5 The staff will circulate proposed revisions to the auditor reporting standard to the Council for comment before it is finalised for presentation to the FRC Board.

## **5. Away-day feedback**

- 5.1 Mr Grabowski introduced the discussion of the feedback from the Council away-day on the Board's strategic priority to "Repair Confidence in the Value of Audit". The Council observed that a number of issues relate to the 'expectation gap' and that consideration of actions to address these should involve other parts of the FRC with an interest in, corporate reporting and audit. It was recognised that possible solutions to reduce the expectation gap may include more than just further educating users and there was support for the proposed cross FRC initiative involve testing with all stakeholders, but importantly with policy makers, especially in relation whether there is a need to further develop the role of the auditor.
- 5.2 There was also discussion of whether some of the issues that contribute to reduced confidence in the value of audit could be related to actual or perceived flaws in accounting requirements. It was agreed that it would be helpful to have a joint meeting with the Accounting Council at an appropriate time in the future to discuss such issues.
- 5.2 The summary of the away-day discussion and proposed way forward were agreed in principle. The staff will now develop a more detailed action plan and paper for further discussion by the Council, the Codes and Standards Committee and the Board (as its second reading) in January.

## **6. Horizon scanning**

- 6.1 It was noted that the Autonomy situation may have implications for the work of the FRC.

## **7. Other matters and any other business**

- 7.1 None noted.

## **10. Next Meeting**

- 10.1 The next Council meeting is on Friday 11 January, starting at 9.30am at the FRC's offices.