

Audit and Assurance Council

Minutes of a meeting of the Audit and Assurance Council of the FRC
held on 19 June 2013 at Aldwych House, 71-91 Aldwych, London WC2B 4HN

PRESENT:

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

IN ATTENDANCE:

Marek Grabowski	Director, Audit Policy
Keith Billing	Project Director
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 (to minute 6)

1. APOLOGIES AND INTRODUCTIONS

- 1.1 Apologies were noted from Robert Talbut (Council Member) and Aidan Lambe (Observer – Chartered Accountants Ireland).

2. MINUTES OF THE PREVIOUS MEETING AND ROLLING ACTIONS

- 2.1 The minutes of the AAC meeting of 17 May 2013 were approved as an accurate record of the meeting subject to the amendment of a typographical error.
- 2.2 The Council noted that all actions were either complete or addressed on the agenda.

REPORTS

3. Chairman's Update

- 3.1 The Chair of Council confirmed that there was nothing to report that was not covered on the agenda.

4. Report of the Director of Audit Policy

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

Forthcoming IAASB meeting (24-28 June)

- 4.2 MG drew the Council's attention to the agenda for the meeting of the IAASB scheduled for 24-28 June. He informed the Council that the IAASB would be looking to approve the Exposure Drafts on a number of ISAs in relation to Auditor reporting and that there appeared to be no obvious major issues in the IAASB proposals that would undermine the FRC's new standards in this area. MG highlighted the structure, objectives and requirements of the draft of ISA 701 "Communicating key audit matters in the independent auditor's report" being discussed by the IAASB and the flexibility that this provides where law or regulation has particular requirements in this area (as in the FRC model). He invited the Council to comment.
- 4.3 MG clarified that, while he believes that the communication requirements of ISA 701 would not be inconsistent with the FRC's new standards in this area, in the UK and Ireland it would be expected that disclosures about the entity key audit matters (KAM) required by draft ISA 701 would normally [or generally] be made under the FRC model through the Audit Committee report rather than through the Auditor's report.
- 4.4 The Council discussed the criteria specified for identifying KAM. One member questioned the extent of judgement required of an auditor in determining what matters should be identified as KAM and thought that auditors might benefit from more detailed guidance in applying them. It was also thought that auditors might benefit from an indication of the number of KAMs that were expected to be identified in the auditor's report.
- 4.5 One member also raised a number of other questions in relation to the draft standard, which included:
- 1) whether the draft standard would set market expectations of disclosure at an unrealistic level;
 - 2) whether the requirements in the draft standard would stifle discussions held between the auditor and the audit committee;
 - 3) whether the proposals would lead some auditors to be reluctant to report certain matters to the audit committee in order to avoid having to treat them as KAMs; and
 - 4) whether the end result would really provide the information that shareholders and investors want to see.
- 4.6 MG questioned whether those challenges reflected a concern that the IAASB model was seeking to have the wrong matters disclosed or whether the issue was primarily about the channel of reporting through the audit report. In respect of the latter point, MG noted that it was not practical in an international context to mandate an audit

committee reporting model but was pleased to note that the IAASB had been supportive of the UK approach in developing the flexibility that he had previously referred to. MG said that, in his view, the criteria that were being developed by the IAASB were broadly consistent with the criteria already introduced through the FRC's new standards and were no more judgmental. MG also highlighted that auditors' responsibilities to communicate with audit committees were already established in ISA 260 but that some strengthening of these requirements was also being considered by the IAASB concurrent with the proposed introduction of ISA 701.

- 4.7 In light of the concerns the Chair requested that the Council discuss the matter in more detail at the next appropriate meeting in order to form a cohesive response to the exposure draft.

Audit reform

- 4.8 MG provided an update on EU audit reform. He noted that there appeared to have been some acceleration in addressing matters in the European Council Working Group but that a lot of work was still required to reach agreement on a Council position before triologue could commence.
- 4.9 MG added that the auditor reporting requirements for Listed Company Auditors were still in the Regulation and highlighted that if the standards are delayed there could be inconsistencies with the wording used in the ISAs.

ISA (UK and Ireland) 700 (revised June 2013)

- 4.10 MG confirmed that ISA (UK and Ireland) 700 (revised June 2013) had been published and that as recommended by the Council the standard places emphasis on encouraging links to the report of the work of the Audit Committee and an avoidance of either duplication or the description of generic or abstract matters in standardised language.

EU Policy – the Accounting Directive

- 4.11 MG highlighted the matter raised in the Executive report concerning the new auditor reporting requirements in relation to Directors' Reports. The proper interpretation had not yet been clarified but discussions with BIS were continuing to seek to do so.

Implementing the Recommendations of the Sharman Panel

- 4.12 MG noted that a Press Notice had been released which set out the next steps that were being taken to implement the recommendations. MG confirmed that a further consultation was expected to follow in the Autumn and that the expectation was that the revised guidance would seek to integrate the Turnbull guidance with the Sharman guidance and would address the concerns about the dual use of the term going concern.

International Integrated Reporting Council consultation (IIRC)

- 4.13 MG noted that the FRC was developing a response to the consultation draft of the IIRC Framework document and invited Council Member comments on the draft response, especially paragraphs 19 & 20 which relate to credibility and assurance.

Council members were broadly supportive of the draft text of the FRC's response to the IIRC.

Other updates

- 4.14 MG informed the Council that the Banking Commission's report had been published overnight and Melanie McLaren (MMc) led the Council through the key recommendations which were particularly relevant to the FRC. The Council expressed mixed views in response to the report and noted the link to the FRC project addressing 'Confidence in the value of audit'.
- 4.15 MG also informed the Council that the FRC key facts and trends report had been published and that it could be found on the FRC website.

Activities since last meeting

- 4.16 The Council noted the list of activities since last meeting.

5. Response to Basel Committee consultation on guidance for the external audit of banks

- 5.1 MG introduced the draft response to the Basel Committee consultation document which had been prepared in accordance with the steer given by the Council at its April meeting. MG invited comments from the Council.
- 5.2 Pat Sucher (PS) informed the Council that the guidance would replace 2 pieces of existing Basel guidance. PS clarified the status of the guidance as 'a set of guidelines to illustrate application of the Basel principles', and in this particular instance, the principle that banks should have an external audit. The Basel Committee was seeking to explain the expectations of auditors and of audit committees from the perspective of a bank supervisor. The question for the Council was whether the expectations set out are reasonable.
- 5.3 PS noted that certain language was not consistently used throughout the document (should / would / must) and confirmed that this may be reviewed. MG suggested that Basel might consider conforming this type of language, especially when used in describing detailed recommendations for auditors, with the language used in the Clarified International standards, having regard to the likely interaction between this guidance and the ISAs.
- 5.4 PS reminded the Council that the guidance would apply across many jurisdictions and highlighted that small banks outside of the UK and US were comfortable with the increased expectations. It was suggested that the IAASB might consider developing an International Auditing Practice Note to reflect the proposed guidance relating to.
- 5.4 MG highlighted that the expectations of the Basel Committee could be considered in two parts, one: what were the expectations in terms of auditing standards and the legal and regulatory framework; and two: more detailed expectations around the focus of an auditor in applying the standards. He suggested that there is a risk that, in setting out the detailed expectations of an auditor applying the standards, the guidance could be interpreted as establishing alternative or incremental auditing standards or guidance which may be seen to compete with those issued by the IAASB.

- 5.6 Through discussion the following points and observations were made:
- the purpose of the guidelines and who they are intended for is unclear;
 - the drafting is unclear in a number of areas and there is some inconsistency in the detail; the Committee might consider setting out more principle based guidelines;
 - para 42 directs the external auditor to consider all applicable ethical codes and standards and then to identify and apply the most restrictive rules from them in relation to particular issues;
 - it would be more helpful for Basel to identify the specific ethical principles it would like to see applied – mixing elements of different ethical frameworks, which are designed to be applied holistically not piecemeal, may be problematic as they may take quite different approaches to the same issue and the application of individual elements in isolation may not be effective;
 - the guidance appears to put more emphasis on auditors communicating to supervisors than the inverse – the relationship should be a two-way relationship with open channels for communication in both directions; and
 - the impact of the guidance is likely to be greater on small banks than on large banks.
- 5.7 PS acknowledged the points raised and undertook to reflect on the points with the Basel Committee; she acknowledged that whilst the principles were generally already applied in the UK and Ireland under various guises, the guidance may have a more significant impact in some other jurisdictions.
- 5.8 MG and KB undertook to amend the response in light of the discussion and to circulate the amended response to the Council for final comments, by email.

Standards and Guidance

6. First read of an exposure draft of PN14 – Housing Associations

- 6.1 MG introduced the paper and invited comments from the Council. He informed the Council that although the agenda described this item as a first read he hoped and suggested that the Council might be in a position to provide its advice to the Codes & Standards Committee recommending the Committee's approval of PN14 for issuance as an exposure draft at its meeting in July.
- 6.2 The Council noted that since the publication of the last version of PN 14 there had been significant changes in the regulation of Housing Associations and that, as a devolved activity, the regulatory regimes differ quite significantly throughout the UK.
- 6.3 Ray King (Chair of the Working group) informed the Council that he felt an effective process had been followed in putting together the exposure draft of PN14 and that a broad range of stakeholder input had been received. RK advised that the working group had attempted to tightly focus the content so as to set out only what is important and specifically relevant to Housing Association audits and not repeating guidance already in the ISAs (UK and Ireland) – accordingly, the proposed revised draft of PN14 was significantly shorter than the previous PN 14.
- 6.4 The Council discussed the references to 'business risk' and 'audit risk' throughout the document. Steven Leonard (SL) advised that this had been deliberate with a view to

encouraging users of the PN to recognise the inter-relationship between certain audit and business risks. These relationships had been emphasised by cross-referencing them to each other where relevant in the guidance.

- 6.5 The Council welcomed the approach to reducing the length of the guidance in this PN and advised that this approach should be considered when next reviewing other existing PNs and when developing new PNs.
- 6.6 The Council welcomed the Exposure Draft of the PN and subject to final drafting changes (to be reviewed by the Chairs of the Council and Working Group), the Council gave its advice that the PN be recommended for approval by the Codes & Standards Committee at its meeting in July 2013.

7. ISA (UK and Ireland) 720 – Directors’ Remuneration

- 7.1 SL introduced the background to the paper. MG highlighted that, although this may be considered to be a relatively straightforward area there is a high degree of sensitivity in relation to the topic.
- 7.2 The Council recognised that, in light of this sensitivity and the importance of addressing the risks to the quality of audit work in this area, specific auditing standards should be included in the ISAs (UK and Ireland) to clarify expectations of auditors in providing the required opinions on these matters.
- 7.3 The Council noted that provisions in relation to the audited part of the Director’ report were included in ISA (UK and Ireland) 720 Section B and advised that it would be logical to include information on the Directors’ remuneration report as a new separate section within ISA (UK and Ireland) 720 rather than developing a new section in ISA (UK and Ireland) 700.
- 7.4 The Council agreed that it would advise the Codes & Standards Committee that a new section of ISA (UK and Ireland) 720 should be developed to address the audit of the Directors’ Remuneration report.

Influencing

8. ICAS / FRC Audit skills project update

- 8.1 Allister Wilson (AW), Chairman of the ICAS research working group introduced the paper and provided an update on progress of the project. He confirmed that two teams were in place and had begun undertaking two complementary research projects, one based in the Europe and one outside of Europe looking at the composition of the audit team and the skills required in an audit team. He confirmed that both teams would be reporting on progress in September.
- 8.2 In response to a query AW confirmed that the outcome of the research projects would be fed in to the FRC project ‘*Improving confidence in the value of audit*’.

8.3 The Council highlighted the importance of ensuring that the other professional bodies in England and Wales and Ireland are aware of the project and its outcomes, particularly in relation to research around audit training and the qualifying process.

8.3 The Chair thanked AW for his update.

Research

9. Repairing confidence in the value of the audit

9.1 MG introduced the paper and asked the Council to consider reviewing the title of the project. The Council's advice was that the project should be retitled 'Improving confidence in the value of audit'.

9.2 JH provided an update on progress of the project and informed the Council that YouGov had begun recruiting candidates to participate in the research exercise. The Council noted that participants would be categorised into tiers and that participants would be asked to comment primarily on what they believe are the requirements of audit today and the extent to which that meets their expectations rather than being asked to comment, at this stage, on how they would like things to be changed.

9.3 The Council noted that dates of meetings of the steering group had been reorganised so that feedback from the meetings of the steering group could be reported to Council. The Council also noted that the project would be a standing item on the Council agenda whilst the project continued.

10. Horizon scanning

10.1 The Council identified the need to monitor progress of the Banking Commission report.

11. Any other business

11.1 None.

12. Next Meeting

12.1 The next Council meeting is on Wednesday 17 July starting at 9.30am.