

**Minutes of a meeting of the Audit and Assurance Council of the FRC  
held on 8 June 2016 at the FRC Office, 8<sup>th</sup> Floor, 125 London Wall, EC2Y 5AS**

**PRESENT:**

Ray King (Chair)  
Bryan Foss  
Jane Fuller  
Kari Hale  
Sue Harris  
Robert Hingley  
Conall O'Halloran  
Scott Knight  
Maggie McGhee

**IN ATTENDANCE:**

|                   |  |
|-------------------|--|
| Kate Acott        | Project Director, Audit Policy                         |
| Mark Babington    | Deputy Director of Audit Policy                        |
| Keith Billing     | Project Director, Audit Policy                         |
| Francesca Carter  | Council Secretary                                      |
| James Ferris      | Project Director, Audit Policy                         |
| Michael Gaull     | PRA Observer   |
| Marek Grabowski   | Director, Audit Policy                                 |
| Josephine Jackson | Technical Director, Audit Policy                       |
| Nick Land         | FRC Board Member and Codes & Standards Committee Chair |
| Melanie McLaren   | Executive Director, Audit                              |

**Apologies and welcome**

Apologies were noted from Michael Kavanagh (IAASA Observer), Lee Piller (FCA Observer) and Stephen Oxley (Council Member).

The Chair welcomed Nick Land, FRC Board Member and Codes & Standards Committee Chair to the meeting.

**1. Minutes of the previous meeting**

- 1.1 The minutes of the Audit & Assurance Council meeting held on 11 May 2016 were approved for publication subject to a correction to the attendee list.
- 1.2 The Council considered the rolling action log and noted an information gathering exercise is underway to inform a paper that will be presented to the Council in due course looking at users' needs regarding the timely provision of assurance.

## **2. Chairman's update**

2.1 The Chairman provided an update on matters considered by the FRC Board on 19 May and 8 June. It was noted that on 19 May the Board had:

- Received the Chief Executive's report on key issues, which had included an update on the FRC's Culture project and Alternative Performance Measures.
- Considered Committee Chair reports from the Codes & Standards Committee, Conduct Committee and Audit Committees.
- Considered the Board effectiveness review action plan.
- Approved amendments to FRS 103 – Insurance Contracts for Solvency II and the approach to the Triennial review of UK accounting standards.
- Discussed:
  - The consequences of Brexit for the UK and FRC.
  - the Draft report on Developments in Audit Quality
  - The Audit Firm Governance Code.

At the 8 June meeting the FRC Board agenda had been dedicated to consideration and approval of matters necessary for implementation of the Audit Regulation and Directive (ARD).

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

3.1 The Council noted a paper that provided an update on developments relating to UK and International auditing standards, FRC audit research activities and other FRC matters not covered elsewhere on the agenda. Particular attention was given to the following matters:

### ISA 800 and 805

3.2 Mark Babington (MB) provided an update on the FRC's proposals to consult publicly on the adoption of ISA 800 and 805 in the UK. The Council noted that, as set out in an email to the Council dated 26 May, the executive had undertaken a further analysis of the proposal to adopt ISA 800 and 805 in the UK and had recommended adoption on the basis that:

- the ISAs support the objective of providing reasonable assurance opinions over Solvency II regulatory returns;
- the risk identified in respect of potential to undermine the True & Fair requirement can be appropriately mitigated
- the development of a stand alone standard is not considered appropriate and would not fit within the timescale of being in place to support December 2016 year-end regulatory audit returns.

3.3 MB reported that the recommendation had been supported by the majority of Council members and that approval 'in principle' to issue the consultation would be sought from the Codes & Standards Committee (CSC) and FRC Board in June. MB reported that the approval would be sought on an 'in principle basis' pending issuance by the PRA of a further, single question consultation in the summer. The FRC's consultation would then be issued subject to the PRA confirming their final rule. The Council supported the approach.

Interpretation of Article 5 of the Audit Regulation – Non-Audit Services

- 3.4 The Council discussed in detail a request from an audit firm for clarity on the interpretation of a non-audit service prohibited in Article 5 of the Audit Regulation relating to services linked to the financing, capital structure and allocation, and investment strategy of the audited entity, incorporated in to the Ethical Standards at Paragraph 5.167R (i). Council's advice was that they considered the service, even if it comprises collecting and communicating the views of investors without elaboration or recommendation, to be instrumental to an entity successfully engaging with investors over matters of strategy. As such they advised that the services should be considered as being linked to those services prohibited under ES 5.167(i). The Council considered it highly unlikely, in view of the nature of the service and the value that the recipient would be expected to derive from it, that the provision of such services to an audited entity by its auditor would be considered appropriate by an objective, reasonable and informed third party.
- 3.5 The Council noted that, moving forward, the executive would consult the Audit Technical Advisory Group (TAG) on matters such as this and cautioned against the FRC being seen as a mechanism through which all ethical judgements can be tested.

#### Ireland

- 3.6 MB reported that the Irish Auditing and Accountancy Supervisory Authority (IAASA) had been appointed the Competent Authority for audit in Ireland. As a consequence, the FRC would no longer issue standards applicable in the UK and Ireland and references to Ireland would be removed from the revised Standards and Ethical Standards due for publication later in the month.
- 3.7 MM confirmed that seats for an IAASA observer and an Irish Council Member would be retained and that the FRC intends to work very closely with IAASA as it commences its role.

#### **4. IAASB Agenda – Forward look and issues for the Council's attention**

- 4.1 Marek Grabowski (MG) introduced a paper that summarised the issues being addressed by the IAASB in relation to its project to revise ISA 540, the international auditing standard dealing with the audit of Accounting Estimates. The Council noted that:
- The IAASB have prioritised the revisions to ISA 540 and accelerated the proposed issuance of an Exposure Draft of the revised standard by December 2016.
  - A holistic revision is expected which will address concerns raised by the FRC and future proof the standard for the changes in accounting standards relating to leases, revenue recognition and insurance contract accounting.
  - The accelerated timetable has resulted in a need to increase the intensity of the development process and has increased a number of risks to the quality of the ED, which are being managed by increased frequency of meetings and calls by the Task Force and liaison and some common membership (including MG) between the ISA 540 Task Force and the ISA 315 working group:
    - There is increased pressure on resources and due process.
    - The project will be completed prior to revision of ISA 315, a core risk assessment standard; this gives rise to the risk that ISA 540 will require significant conforming amendments soon after it is issued.
  - MG considers the most important objectives of the revisions, within the scope and boundaries of the standard, to be as follows:

- ensuring that when designing responses to identified and assessed risk, there is clear linkage back to the specific risk factors identified in the risk assessment; and
  - ensuring the risk assessment requirements are more effective in directing auditors to consider those factors that give rise to risks of material misstatement of estimates.
  - There are some divergent views about elements of the ED. However, there is general agreement about the need to make the revisions and it is not expected that the ED will on the whole be contentious.
- 4.2 While the Council welcomed the approach it was suggested that the IAASB may wish to consider, particularly in relation to IFRS 9, what the auditor could do differently. The Council also highlighted the importance of distinguishing between error and uncertainty and suggested the IAASB may wish to explore whether there is scope to strengthen the requirements relating to the audit of disclosures in respect of uncertainty.

## **5. Bulletin: Compendium of Auditor's reports**

- 5.1 Kate Acott (KA) invited the Council to consider a draft revised Compendium of Illustrative Auditor's Reports and provide its advice on the proposed focus and content therein. KA reported that the compendium had been developed in response to advice given by the Council in October to streamline the Compendium and reduce the number of examples provided.
- 5.2 The Council noted that the objective of the streamlined bulletin is to equip the profession with the modules necessary to build a broader suite of example reports, and at the same time, support high quality auditor reporting without stifling innovation or encouraging boiler plate text. On this basis, and in noting that any concerns interested parties may have in respect of the content of the compendium would be identified through broad informal stakeholder outreach, the Council supported proposals to exclude:
- Specific examples covering any entities other than companies and partnerships.
  - Examples illustrating a qualified opinion, adverse opinion or a disclaimer of opinion.
  - An illustrative example of a directors' responsibility statement.

Whilst it was noted that other professional bodies might develop illustrative reports covering examples the FRC has not, it was highlighted that it is not the FRC's role to draft auditor's reports. It was also noted that a further objective of the decision to streamline the Compendium had been to ensure the volume of examples included are manageable to maintain.

- 5.2 The Council supported the proposed focus and content of the Compendium and noted that a final draft would be presented to the Council for its advice in September.

## **6. Practice Note 10 (Revised) – The Audit of Financial Statements of Public Sector Bodies in the United Kingdom – (SORP Process) – Approval for consultation**

- 6.1 James Ferris (JF) introduced a paper seeking advice from the Council to recommend to the CSC that the Public Audit Forum consult on Practice Note 10 Audit of Financial Statements of Public Sector Bodies in the United Kingdom Revised) (PN10). JF reported that the Public Audit Forum (PAF) had been approved as a 'SORP-making body' for the purposes of making revisions to PN10 and that this is the first time a SORP like approach had been taken for the development of auditing guidance.

- 6.2 JF reported that the PAF had made significant revisions to PN10, including removal of the copy-out material from the ISAs and removal of extensive references to specific reporting frameworks and frameworks of authority. JF also reported that the section on regularity had been revised on to a more principle led basis in order to be applicable to a broader range of stakeholder engagements. The Council noted that the PAF are confident the revisions meet the needs of users and that this view had been verified by members of the FRC's Public Sector Advisory Group (PSAG).
- 6.3 The Council considered a request from the PAF to reduce the consultation period from the standard three months to two months so that the revised PN10 could be published in time support the first round of audits to be conducted in accordance with the new requirements for England and Wales resulting from the abolition of the Audit Commission. While the Council was sympathetic to the request, the Council had concerns that a shortened consultation period would not allow sufficient time for respondents to comment, particularly as the consultation period would fall over the summer break and over Parliamentary recess. The Council highlighted that practitioners would still be able to refer to the ED for guidance even though it had not been published in final form.
- 6.4 Through discussion of the draft ED the Council highlighted that the PAF perspective of relevant user groups is inconsistent with the FRC perspective; the Council suggested that the FRC explore this with the PAF and work closely with the PAF to develop a stakeholder engagement plan. The Council also highlighted a number of instances where, in attempting to streamline the documentation, some over-simplified examples had been introduced to the PN that could lead to confusion, error and potentially broaden the expectation gap.
- 6.5 Subject to amendments to address the issues set out at 6.4 the Council confirmed its advice to the CSC that the PAF issue the ED of PN10 (revised) for a full public consultation. The Council advised that the ED should be issued for the standard three month consultation period.

## **7i. Revised Scope and Authority of Audit and Assurance Pronouncements**

- 7i.1 MB reported that the FRC publishes, along with its auditing and ethical standards, a Scope and Authority document that sets out the audit and assurance pronouncements that are issued by the FRC and an explanation as to how auditors are required to use them in carrying out their work.
- 7i.2 The Council noted that it is necessary to update the current Scope and Authority document to reflect:
- Major changes to the FRC's auditing and ethical standards, both as a result of changes necessary to implement ARD and to reflect the changes stemming from the FRC's own review of its ethical standards.
  - The introduction of the SORP-making approach to the development of guidance materials.
  - Withdrawal of the Auditors' Code.
  - IAASA's role as competent authority and standard-setter for audit in Ireland.

7i.3 The Council considered a proposed revised Scope and Authority document, updated to reflect the points raised at 7i.2. Subject to amendments to remove reference to the Audit Commission and to include reference to the FRC at paragraph 19, supported the updated document for publication.

## **7ii. Revised Auditor's Responsibilities for the Audit of Financial Statements webpage**

7ii.1 KA reported that the FRC maintained a webpage that sets out the auditor's responsibilities in respect of an audit of financial statements which requires updating to incorporate the new requirements in the IAASB's ISA 700 (Revised) which are currently being incorporated in to UK auditing standards.

7ii.2 The Council noted that the proposed revised wording is based on the IAASB's wording as set out in Illustration 2 Auditor's report on Consolidated Financial Statements of a Listed Entity Prepared in Accordance with a Fair Presentation Framework supplemented with the following additional statements, taken from the current FRC webpage on:

- areas the auditor is required to consider when forming a conclusion on the financial statements;
- unmodified vs modified opinions;
- emphasis of matter and communicating other matters;
- other information; and
- other legal and regulatory requirements.

7ii.3 The Council supported the proposed wording subject to minor drafting amendments. The Council supported inclusion of the text set out in the grey box on the basis that it would be useful to some users.

## **8. YouGov Confidence in Audit Survey – oral update**

8.1 MB circulated a table that summarised, at a high level, the findings of the YouGov Confidence in Audit survey. MB reported that the field work had concluded and that a draft report was expected shortly.

8.2 The Council noted that the findings of the survey are generally positive and show an improvement in levels of confidence in audit. While respondents have a positive view of the FRC and suggest the FRC should increase its international influencing activities, some questioned whether it the FRC is sufficiently resourced.

8.3 MB reported that an analysis of the findings would be undertaken over the summer to identify areas that warrant further review, it can be expected that the FRC will seek to explore what users' expectations of auditors are and whether they are reasonable.

8.4 The Council noted that the full report is expected to be published towards the end of the summer and that, subject to Board approval, the key findings would be included in the summary of the FRC's State of the Nation report on Audit.

## **9. Audit Technical Advisory Group – oral update**

9.1 MB reported that terms of reference for the Audit Technical Advisory Group, as noted at the Council meeting in May, had been approved by the CSC and the first meeting would be held on 15 June. The Council was reminded that the Group will act as a filtering mechanism to provide the FRC with a way of identifying practical implementation issues experienced by practitioners. The FRC can then respond to these where it is appropriate to do so, taking Council's advice where necessary. A report on matters discussed by the Group would be presented to the Council routinely.

9.2 The Council noted an updated membership list and that, under the terms of reference, Members of the Council could attend TAG meetings if they wish to do so.

## **10. Any other business**

10.1 The Council noted that the meeting would be Maggie McGhee's last. The Council thanked Maggie for her contribution to the work of the Council and wished her well in her new role at the ACCA.

## **11. Next meeting**

11.1 It was noted that the next meeting would be the Council Away Day and would be held on 6 July.

