

Audit and Assurance Council

Minutes of a meeting of the Audit and Assurance Council of the FRC
held on 13 February 2015 at the FRC Office, 8th Floor, 125 London Wall, EC2Y 5AS

PRESENT:

Nick Land (Chair)
Jane Fuller
Sue Harris
Robert Hingley
Conall O'Halloran
Maggie McGhee
Allister Wilson

IN ATTENDANCE:

Kate Acott	Project Director
Mark Babington	Incoming Deputy Director of Audit Policy
Francesca Chittenden	Council Secretary
Susan Currie	Conduct Project Director (minute 6 only)
Marek Grabowski	Director of Audit Policy
Josephine Jackson	Technical Advisor
Steven Leonard	Project Director
Melanie McLaren	Executive Director, Codes & Standards
Lee Piller	FCA Observer
Eileen Townsend	IAASA Observer
Pat Sucher	PRA Observer

Apologies and introduction

Apologies were noted from John Hughes, Ray King and Scott Knight (Council Members).

The Chair welcomed Kate Acott, who had recently joined the FRC as a Project Director and Mark Babington who would be joining the FRC as Deputy Director of Audit Policy on 2nd March.

1. Minutes of the previous meeting

- 1.1 The minutes of the meetings held on 15 December 2014 were approved for publication.
- 1.2 A member queried how many hits published minutes of Council meetings receive, Marek Grabowski (MG) undertook to investigate and present the statistics at the next meeting.
- 1.3 The Council noted the status of the actions set out on the rolling action log.
- 1.4 The Council noted an action that had been raised at the March 2014 meeting in relation to Zombie Companies and discussed whether the existing guidance on going concern in

respect of Zombie Companies is fit for purpose. Through discussion it was advised that no specific action should be taken at this stage. The Council advised that the introduction of specific requirements in respect of disclosure for Zombie Companies, and many other risks that would fall within the same class of risks, would be overly prescriptive and narrow in focus.

2. Chairman's update

- 2.1 The Chairman provided an update on membership changes within the FRC governance structure. The Chairman reported that Jim Sutcliffe had resigned as Chair of the FRC's Codes & Standards Committee and that he had taken on that role; accordingly, a recruitment exercise to identify a replacement Chair for the Audit & Assurance Council was underway. The Chairman also reported that a recruitment exercise was underway to identify replacements for two Council Members whose terms would be coming to an end later in the year.
- 2.2 It was noted that the FRC Board scheduled for 29 January had been cancelled.

3. Report of the Director of Audit Policy

- 3.1 Marek Grabowski (MG) introduced a paper that provided an update on development relating to UK and International auditing standards, FRC audit research activities and other FRC matters not covered elsewhere on the agenda.

International Auditing and Assurance Standards Board (IAASB)

- 3.2 The Council noted that the agenda for the March IAASB meeting will include Addressing Disclosures in the Audit of Financial Statements (for final approval), Group Audits and Quality Control. MG reported that the agenda and papers would be circulated with the papers for the March Council meeting.
- 3.3 The Council supported the recommendation not to respond to an exposure draft released by the IAASB in relation to amendments to ISAs 800 and 805 on the basis that the FRC has not adopted ISAs 800 & 805 as they do not apply to a 'statutory audit' and the proposed changes in the ED are limited and conforming in nature.

International Ethics Standards Board for Accountants (IESBA)

- 3.4 The Council noted that:
- Keith Billing (KB) had attended the January meeting of IESBA as an observer.
 - Richard Fleck, Chair of the FRRP and former FRC Board member had been appointed as a member of the IESBA Board.
 - Feedback on the main agenda items discussed at the January IESBA meeting.

European National Standards Setters (ENSS) meeting

- 3.5 The Council noted that MG and JJ had attended the second of two meetings held between selected ENSS on 17 December. MG reported that the group had discussed and shared initial reactions to recent developments at EU level regarding the statutory audits of financial statements including implementation issues. The Council noted that the meeting had been very useful and that the group agreed to further co-operation.

UK & Ireland Auditing and Ethical Standards

3.6 The Council noted that:

- The FRC Consultation: Auditing & ethical standards implementation of the EU Audit Directive and Regulation had been issued on 18 December
- An open meeting to discuss the FRC's plans for the implementation of the EU Audit Directive & Regulation would be held on 11 March. Council Members were encouraged to attend.
- Detailed updates of the ethical standards, taking account of the Council's advice, has begun and a working group (formed of Council Members) has been established to give input and advice during the development stages.
- The working group had considered an inconsistency in respect of the current definition of a 'listed company' in the glossary of terms referred to in the Preface to each of the ethical standards and the glossary that is produced for the annual compendium publication of standards and guidance. The Council supported that advice of the working group that the inconsistency be addressed as part of the project to revise the ethical standards.
- BIS has confirmed changes to UK law following implementation the Accounting Directive in respect of 'abridged' accounts and that consideration will need to be given to the impact of the changes on the extant guidance Bulletin 2008/4 "The Special Auditor's Report on Abbreviated Accounts".
- The ICAEW has contacted the FRC for feedback on their proposal to publish 24 audit report templates based on the illustrative examples in Bulletin 2010/2, Bulletin 4 and Practice note 15 which would be available solely to ICAEW members. MG reported that the FRC had responded and set out that the FRC does not support the ICAEW in publishing amended versions of materials from FRC Bulletins whilst those Bulletins as this could result in confusion as to which version is most current and to ensure that access is freely available to all. However, in recognising the work that the ICAEW has undertaken the FRC has suggested that the ICAEW review the updated templates in respect of the existing examples with a view to the FRC publishing them.
- Work to update five Irish practice notes (PN 10(I), PN 15(I), PN 19(I), PN 20(I) and PN 27(I) is progressing.

Current issues and concerns

3.7 The Council discussed whether the mantra that 'an audit is an audit' is sustainable in the longer term noting that there is a sense, particularly for smaller entities, that the auditor could become involved in the preparation and presentation of the accounts. The Council noted that this preparation role could potentially fall foul of the existing ethical principles and supported the proposal that the executive explore further the potential to remodel the role of the auditor so that the auditor could undertake a general audit role but also, as a 'direct reporting engagement' be involved with the preparation and presentation of the financial statements. The Council noted that as part of the exploration consideration would have to be given to the incoming Audit Regulation and Directive, the definition of the 'public interest' and what would constitute a smaller entity. It was suggested that it might also be useful to consider whether the public sector could be brought within the scope of the re-modelled auditor role.

3.8 The Council noted that the FRC is working on a project to look the reporting of smaller entities and that a paper on the findings of that project would be presented to the Council at its next meeting.

4. Activities since last meeting

4.1 The Council noted the list of activities since the last formal meeting.

5. Assessing the effectiveness of the external audit process – guidance for audit committees

5.1 Josephine Jackson (JJ) introduced draft guidance for audit committees on assessing the effectiveness of the external audit process. JJ reported that the guidance had been updated to reflect the observations and amendments proposed by the Council at its December meeting.

5.2 The Council welcomed the updated draft and it was commented that the guidance will be a use full 'aide-memoir' and should encourage better behaviour. The Council discussed the draft in detail; the following observations and suggested amendments were made:

- The Council debated whether appendix 1 should be retained and some members suggested that the examples could be considered superficial, process driven and discourage innovative thinking. However, in acknowledging that those who participated in the round tables events had asked for practical examples, the Council concluded that the appendix should be retained on the basis that the examples are redrafted so that the terminology used encourages proactivity. It was also suggested that text should be inserted to make clear that the examples are simply illustrations and will not be applicable to all entities.
- Some members expressed concern with the increased focus on the responsibility of the auditor to stakeholders suggesting that it is unclear who could be classified as a stakeholder and that the scope is too broad. It was suggested that consideration be given to aligning the responsibilities of the auditor with the statutory duties of a Director under the Companies Act.
- It was suggested that the word 'demonstrate' should be used more frequently throughout the guidance to reinforce that a key role of the Committee is to seek evidence which will demonstrate that the auditor has done everything they purport to have done and demonstrate that the auditor has an understanding of the entity and the risks facing the entity.
- It was suggested that reference should be made to the extended auditor's report and to the Survey of 1st year experience of extended auditor's reports and aspirations for the 2nd year publication.
- It was suggested that section four 'evaluation and judgement' is too lengthy and should be cut down and that consideration be given to repositioning the section within the body of the guidance.
- It was suggested that the title is too lengthy and should simply be 'Assessing External Audit Quality'.
- The Council suggested that it would be helpful to add text in to the section on 'Concluding and reporting' to assist Committees in understanding how they conclude on the assessment and what the next steps should be.

- The Council expressed mixed views as to whether appendix two provides valid and useful sources of information that can assist with the assessment of audit quality. Through discussion it was clarified that the list is intended to provide examples of secondary sources of information and on this basis the Council was content to retain the appendix, however, the Council suggested that greater emphasis to clarify that the list is intended to set out secondary sources was needed.
- The Council advised that the 'blue boxes' should be retained within the guidance and not moved to an appendix.
- The Council considered the language and tone of the guidance to appropriate as a guidance document which would provide practical help and raise the bar of expectation.
- It was suggested that reference to International Group Audits should be made in recognition of the fact that many entities will have branches or subsidiaries overseas.

5.4 JJ thanked the Council for their observations and suggested amendments and undertook to circulate a revised draft to the Council for review before recommendation to the Codes & Standards Committee.

6. Audit Firm Governance Code

6.1 Susan Currie introduced the latest version of the Draft Audit Firm Governance Code (the Code). SC reported that the draft had been updated to reflect comments made by the Council, the Codes & Standards Committee and the FRC Board and to reflect feedback received at a stakeholder forum held in December. The Council noted that the key changes had been to focus the report more clearly on the purpose of the Code and to ask broad questions about how the Code could be made more effective.

6.2 SC invited the Council to comment on the definition of public interest as set out in the report and to comment on the extent to which the Council considers that the audit business should have separate arrangements to the rest of the firm. Through discussion the following observations and suggestions were made:

- It was suggested that the increased focus on the public interest was unhelpful and that the definition at paragraph 14 was unclear and should be revised. The Council also suggested that paragraph 29 is contradictory to the text at paragraph 30 and should be taken out.
- The Council supported the suggestion that the governance of the audit business should have separate arrangements from the rest of the audit business on the basis that:
 - There is a distinct difference between the public interest role of the INE and the public interest role of the audit business / firm.
 - The governance of the audit business should be such that directors and INEs have specific responsibilities and INEs are held accountable.
 - Having different governance arrangements within a firm for the audit business will increase focus on the public interest role.
 - The auditors role is broader than statutory audit and the governance arrangements should reflect this.
- It was suggested that confidence in audit could be promoted if the Board of the audit business / firm was required to produce a 'Turnbull' style report on the processes and mechanisms underpinning the governance of the audit business / firm. The Council

suggested that the INEs should be responsible for the development and publication of any such report.

- It was suggested that consideration could be given to the establishment of a two tier structure within the audit business. The primary responsibility of the first tier, which would comprise directors and INEs, would be on audit quality. The primary responsibility of the second tier, which would be entirely INEs, would be the identification and assessment of threats and therefore, the prevention of failure.
- It was suggested that consideration could be given to linking the role of the INE to the performance of Directors in accordance with their statutory duties under the Companies Act.

6.3 The following additional observations were made by the Council:

- It was suggested that consideration be given to revising paragraph 32 to reflect international Regulation and Standard Setters.
- It was suggested that the FRC encourage Partners (not Senior Partners) at audit firms to respond to the consultation and to participate in any outreach events.

6.4 SC thanked the Council for their observations and suggestions and invited the Council to circulate any detailed comments on the Code by email. SC reported that the consultation document would be presented to the Board at its meeting on 4 March to be issued.

7. **Preliminary review of Exposure Drafts of new Client Assets Assurance Standard**

7.1 Steven Leonard (SL) introduced a draft Exposure Draft (ED) of a new Client Assets Assurance Standard (CASS). SL reported that considerable progress had been made by the executive, the Steering Group and the Working group in developing the draft requirements and that all who have been involved are largely content with the proposed standard. It was noted that representatives from FCA are members of both the working group and the steering group and that the FCA seems content with the ED as currently drafted.

7.2 SL invited the Council to discuss and, where appropriate advise, on the issues that had been identified in developing the draft. Through discussion the following observations were made and advice was given:

Defining the nature and extent of the work effort for a reasonable assurance engagement

- The Council supported the approach taken in defining the nature and extent of the work effort for a reasonable assurance engagement, noting that the guidance had been drafted to rebut the notion that the requirements are seeking to impose a concept of absolute assurance rather than reasonable assurance.
- It was suggested that the drafting be reviewed to consistently use the expression “the systems and controls ‘enable’ compliance”.
- The Council noted that some members of the working group seek more specific guidance as to the nature and extent of assurance work that should be performed by the auditor and considered whether the balance of ‘principles versus rules’ in the draft is appropriate. Through discussion the Council highlighted the importance of an auditor exercising high quality judgement and the importance of not undermining that judgement by providing a check list of procedures; Accordingly the Council supported the approach set out.

Level of detail

- The Council noted that the document is drafted at a high level and whilst it provides a sufficient level of detail to capture what a CASS auditor should be responsible for and captures all circumstances where the FCA requires a report, there are a range of specific circumstances which are not covered. The Council supported this approach and the inclusion of a question in the ED to determine whether there are any further circumstances which should be included in the Standard.

The need for an Engagement Quality Control Review

- The Council noted that there is some resistance amongst members of the Working Group to requiring engagement quality control reviews for all reasonable assurance engagements on the basis that such reviews are not customary within auditing firms and the review can be costly. The Council supported the view of the Steering Group that Engagement Quality Review should be required in order to provide further protection to the public interest, particularly for medium and larger firms, and advised that a question on the matter should be included in the ED.

The Ethical Standards that should apply to CASS auditors

- SL reported that the FRC and the FCA executives are due to discuss the possibility of requiring CASS auditors to comply with the FRC's Ethical Standards (at present the FCA's Rules do not contemplate this possibility). However, until that discussion has been held the draft proposes that CASS auditors should comply with the IFAC's IESBA Code on the basis that the FCA's SUP rules (which were written before the FRC's Ethical Standards existed) requires auditing firms to comply with the independence rules of their Recognised Supervisory Body.
- The Council supported this approach and commented that it would be useful for CASS auditors to be able to know and comply with a single set of Ethical Standards.

Communicating deficiencies in internal control to those charged with governance and management

- The Council discussed the request of the FCA for the insertion of requirements for CASS auditors to communicate deficiencies in internal control, which do not constitute breaches, to both management and those charged with governance.
- It was noted that the nature of CASS engagement is such that a breaches schedule is normally maintained, however, it was suggested that the requirement for 'near misses' to be included on this schedule is problematic as there is no clear definition of what a 'near-miss' is and as a management letter is not an official there may be confusion as to what the letter should set out. It was also noted that some stakeholders have expressed the view that the requirement should be established by Regulation, not through a standard.
- The Council supported the proposal that questions on the FCA proposal be included in the ED.

Other points

- The Council noted that legal advice is to be sought to clarify whether a Client Asset Report is required under the SUP rules.
- The Council noted that, in response to concerns raised by the Working Group, the text that had been developed as a 'background paper' which would put the requirements in to context would be rebadged as 'Explanatory notes' and appended to the guidance.

7.3 The Council noted a final Exposure Draft would be presented to the Council at its March meeting and that the Council would be invited to recommend the ED to the Codes & Standards Committee to be issued.

8. Survey of 1st year experience of extended auditor's reports and aspirations for the 2nd year

- 8.1 The Council noted that the report on the survey of 1st year experience of extended auditor's reports and aspirations for the 2nd year had been approved for publication by the Codes & Standards Committee at its meeting on 3 February 2015 and would be published on the FRC website in February and published in print in March.

9. FRC / ICAS Skills research project

- 9.1 The Council noted the executive summaries of draft reports prepared by two groups of academics who had been appointed by the FRC and ICAS to research the capability and competence requirements of auditors in today's complex business environment. The Council noted that the reports would be published alongside a report of the FRC / ICAS Joint Audit Skills Project Steering Group and would be presented at an academic event in April.

- 9.2 Allister Wilson (AW) reported that the report of the FRC / ICAS Joint Audit Skills Project Steering Group would draw out challenging and pejorative aspects of the research. The Council noted that an update on the content of the Steering Group report would be presented at the next meeting.

10. Horizon scanning

- 10.1 The discussion on Horizon Scanning was deferred to the March meeting.

11. Any other business

- 11.1 The Chairman placed on record his thanks to Steven Leonard who would be leaving the FRC in March 2015.

12. Next Meeting

- 12.1 It was confirmed that the next formal meeting of the Audit & Assurance Council would be held on 25 March 2015.