

**Minutes of a meeting of the Audit and Assurance Council of the FRC
held on 24 April 2017 at the FRC, 8th Floor, 125 London Wall, London, EC2Y 5AS**

PRESENT

Ray King	Chairman
Olivier Beroud	Member
Paul Cox	Member (from Minute 1 to 8.3)
Bryan Foss	Member
Jane Fuller	Member (from Minute 1 to 9.2)
Sue Harris	Member
Scott Knight	Member
Stephen Oxley	Member
Jerry Wedge	Member

OBSERVERS

Michael Gaull (PRA)

IN ATTENDANCE

Kate Acott	Project Director
Mark Babington	Deputy Director of Audit Policy
Anu Bhartiya	Council Secretary
Keith Billing	Project Director
James Ferris	Project Director
Marek Grabowski	Director of Audit Policy
Claire Lindridge	Assistant Director AQR (for Minute 8)
Melanie McLaren	Executive Director, Audit and Actuarial Regulation (from Minute 7)
Mike Suffield	Director of Audit Quality (for minute 7)
Marian Williams	Director, Audit

1 Welcome and apologies

The Chairman welcomed everyone to the meeting. Apologies were noted from Council Members – Kari Hale and Conall O’Halloran and Observers – Lisa Campbell (IAASA) and Lee Piller (FCA). The Chairman reported that Conall’s term was coming to an end and the process to replace him was ongoing.

2 Declaration of interest

There was none to be reported.

3 Minutes and Rolling Actions

Minutes

3.1 The minutes of the Audit & Assurance Council meeting held on 21 March 2017 were approved for publication subject to a correction to the attendee list.

Rolling actions

3.2 The matters arising log was noted.

4 Chairman's update

The Chairman informed that the Board had not met since the last meeting of the Audit & Assurance Council. The Codes & Standards Committee had met on 12 April. Since the Chairman was not present at that meeting, Mark Babington (MB) reported that the Committee had considered:

- The BEIS Select Committee Report. The report was issued on 5 April which was supportive of the FRC and the proposals put forward by the FRC. The Board will be reviewing the recommendations at its next meeting on 26 April.
- The Project Stagecoach. The report included the findings of a review of the FRC's enforcement processes and activities and recommendations arising from that review. MB informed that Gareth Rees, Executive Director of Enforcement would be giving a presentation to the Council at the next meeting to give an overview of the enforcement work.
- The Sanctions Review. The Board had agreed to commission an independent review of sanctions imposed under the FRC's enforcement procedures in response to the concerns highlighted in the FRC's reputation survey.
- The PN 15 Revised – the Audit of Occupational Pensions Schemes in the UK – Draft Consultation paper. On the advice of the Council, the Committee had approved the issue of the Consultation paper.
- The revisions to the application material in ISAs (UK) 330 – The Auditor's response to Assessed Risks and 505 – External Confirmations to allow for the withdrawal of Practice Note 16 – Bank Confirmations. On the advice of the Council, the Committee had approved the revisions for recommendation to the Board.
- The Discussion paper on Preliminary Announcements. On the advice of the Council, the Committee had approved the issue of a Discussion paper.
- The Opportunities & Risks – current issues and horizon scanning. The Committee had received a presentation on this topic.

5 Report of the Director of Audit Policy

- 5.1 The Council commended the new style of papers which better highlighted information for the Council to focus on. A suggestion was made that it might be helpful for each issue to indicate possible issues for different stakeholder groups e.g. investors or professionals.
- 5.2 The Council noted the report of the Director of audit Policy which provided an overview of the ongoing engagement with the IAASB and the important issues and implications for the forward strategy. The Council discussed the following matters:

Pressure on resources

- 5.2 Marek Grabowski (MG) confirmed that resources continue to be under significant pressure in the light of the volume of work on issues such as IESBA Consultations, the reform of the governance and oversight of the standard setting boards, a number of major IAASB projects and the Developments in Audit Report 2017. However, the issue was being carefully managed and if need be the team would have to consider the impact on the timing of forthcoming projects.

CASS Standard

- 5.3 The Council noted the positive feedback received on the CASS Standard provided at a recent conference. Attendees had acknowledged that the standard supports high quality CASS audits, and was also setting higher standards in CASS entities to prepare information for audit to support the auditor's report to the FCA. MB informed that there were ongoing discussions with the FCA to review the results of the 2016

year end audits to ascertain if the standards and adequacy of information had met FCA's expectations.

IESBA Consultations

- 5.4 The Council noted that the FRC continue to urge IESBA to be more ambitious in their intentions for the applicability of the Code of Ethics and to use it to drive consistent ethical outcomes internationally, or it risks being seen as an international 'lowest' common denominator standard. MB outlined the potential benefits of having a single international standard setter covering Auditing Standards and Ethical Standards for Auditors, with ethical requirements for professional accountants covered by another body.

Proposed ISA 540 - Auditing Accounting Estimates and Related Disclosures – IAASB's Consultation Document

- 5.5 The Chairman made reference to the IAASB's Consultation Document and queried if there were any matters that required Council's particular attention. MG reported that the practical challenges might be for auditors in applying the new standard in context of IFRS 9. The new concepts and approaches in the standard will need implementation guidance to assist practitioners. The proposed revisions to ISA 540 represent a significant change, and there is a challenge with the shorter consultation period the IAASB have allowed, as it will be important to receive input from a broad range of stakeholders including investors before the standard is finalised. It was reported that the FRC had already initiated a considerable outreach programme.

Professional Scepticism

- 5.6 The Council noted that this item was discussed at the March 2017 IAASB meeting and there was an update from the joint Professional Scepticism Working Group and the IAASB Professional Scepticism Subgroup. There remains a sense that some want to have a more fundamental change to the definition of professional scepticism and one of the thoughts is that professional scepticism should be considered a mind-set that has different 'levels' of intensity. MG reported that he had promoted thinking about professional scepticism in simpler terms: as a constant mind-set of an auditor that results in different levels of response to their 'professional doubts' in making professional judgments; and as a mind-set that can support appropriate levels of questioning, and where appropriate challenge, in making those judgments, based on their professional skills and experience and the nature, extent and sufficiency of the evidence they have considered.

Developments in Audit 2017

- 5.7 In response to a query relating to the timeline for publishing the report on Developments in Audit 2017, it was reported that an initial outline of the report will be presented to the Council in May and a more fully developed draft report will be presented in June for discussion. The report will be presented to the Board for approval for publication in July. The Council's Forward Planner would be amended to reflect these timelines.

Audit & Assurance Council Away Day in July 2017

- 5.8 It was reported that an outline agenda for the Away Day would be circulated at the next meeting.

6. PN11 – The Audit of Charities in the United Kingdom

- 6.1 Kate Acott (KA) outlined the purpose of the paper which was to confirm that the Exposure Draft was consistent with the proposed plan and would support high quality audit in the charity sector. She summarised the main areas of change proposed to extant PN 11 which included Legislative and Regulatory Framework, Reporting matters

of material significance to Charity Regulators, special features of charities to reflect changes in the charity accounting framework and best practice where appropriate, judgement about materiality, going concern and other information including guidance on how the revised standard applies to the trustees' report.

- 6.2 The Council discussed the reported failure on the part of trustees in relation to Kids' Company and the need for auditors to consider and robustly challenge the impact of a weak business model and financial resilience on going concern. KA confirmed that, where appropriate, additional guidance had been included in the Practice Note to address some of the concerns regarding auditors voiced by The Public Administration and Constitutional Affairs Select Committee (PACAC) in their report on Kids' Company.
- 6.3 It was suggested that the bullet points under section 183 on page 80 of the papers be reviewed to see if they are sufficiently robust; the Council agreed to send their suggestions to KA before the papers go out to the CSC on Friday 28th of April. Through discussion, it was observed that the auditor of a charity is not required by ISA (UK) or otherwise by laws or regulation to communicate key audit matters in the auditor's report. However, the auditors may communicate matters in their report if they choose to do so. Trustees that are keen to demonstrate their commitment to transparent reporting may also encourage this. It was noted that a charity's annual report must include a reserves policy which should explain why the charity is holding a particular amount of reserves and ideally reflect the risks to which the charity might be exposed.
- 6.4 Subject to the above, the Council agreed to provide its advice to the Codes & Standards Committee in respect of revised PN 11 and the Consultation Document and Impact Assessment for public consultation.

7 AQR Audit Quality Briefing

- 7.1 Mike Suffield (MS) introduced a slide presentation on the activities of AQR over the last year and the headlines of the work that was being done. He confirmed that the work underpinned the promotion of justifiable confidence in UK audit through evidence-based inspections. The presentation summarised the:
 - Ratings of the assessment of audit quality;
 - Scope of inspection, results and key findings which highlighted a gradual improvement in audit quality over time;
 - Thematic Reviews for 2016-17 included Root Cause Analysis, Data Analytics, Audit Quality Control Procedures;
 - Reflections on various challenging inspections and concerns over results;
 - Forward plan which included an expanded programme of inspections, thematic reviews and enhanced audit committee interaction.
- 7.2 The Council discussed what measures could be taken in order to achieve the target for audit quality improvement (not less than 90% at the top ratings) and enquired whether introducing 'penalties' or pressurising firms for failing to achieve this target could help support enhanced public confidence in the medium term. It was reported that firms are already demonstrating commitment through their investment in audit quality and thinking radically about audit quality improvements. The results of this investment will take time to come through in the results of inspections which are a lagging rather than leading indicator. Feedback from investors would also be key to inform the achievement of audit quality improvement targets, and MS noted that the AQR Committee now had an investor member.

- 7.3 MS confirmed that there was a strong working relationship between the AQR and the Audit & Assurance Team within the FRC which helps the AQR team to establish how well the standards were working in practice and provide feedback.
- 7.4 From an investors' perspective, a Member queried if there was data available on the quality of audits at various stages of the audit cycle i.e. the first year of a new appointment, business as usual, and the final year of a tender period. MS confirmed that the FRC has started publishing on its website the reports on audits that were reviewed during various stages of the tender cycle.
- 7.5 The Chairman thanked MS for his informative and useful presentation.

8. AQR Materiality Thematic Scope

- 8.1 At the invitation of the Chairman, Claire Lindridge (CL) gave an overview of the materiality thematic review which would cover the eight annually inspected firms. Materiality is now disclosed in extended auditor's reports and a considerable focus is placed on materiality within an audit tender.
- 8.2 The Council discussed the nature of materiality, its significance to investors and how important it was for it to be discussed by audit committees. Through discussion the following points and observations were made:
- Investors are interested in the broader qualitative dynamics that were taken into consideration by auditors in determining materiality and not just the quantitative level of materiality.
 - Discussion on materiality at audit committees is perceived by some as generally limited. The audit firms normally have a fairly consistent view of how they set materiality unless there are particular issues of concern. It was thought to be useful if the terms of reference of audit committees included a need to review materiality, particularly given that the financial statements they approve for audit include material judgements on which the audit committee itself should have a view.
 - Some audit firms tender for audits with fees based on anticipated quantitative materiality. However, materiality is a matter of judgement and perception and there needs to be consideration of qualitative and well as quantitative measures.
 - Firms should establish strong planning processes for audit driven by materiality considerations. Performance materiality should be properly explained to audit committees and in tenders.
 - It was considered that it would be interesting to learn from the thematic review, the reasons why firms use different approaches and benchmarks on materiality.
- 8.3 It was reported that there were no plans to involve public sector audits within this review. However investors will be approached to participate in case studies.

9 TAG Update

- 9.1 MB tabled the Staff Guidance Note 01/2017 on Services Linked to Financing, Capital Structure and Allocation and Investment Strategy of the Audited Entity (Appendix 3) which was prepared following the TAG meeting in March 2017. He gave an update on the meeting which had discussed matters relating to impact of gaps in service on auditor rotation, non-audit services by the audit committee of an EU PIE at different levels, non-acceptance of engagements where a former partner or RI holds a senior position and prohibited tax services.
- 9.2 The Council discussed the contents of the guidance material which included fuller description of services which should be considered as prohibited and would help practitioners in taking a more consistent approach. It was noted that the note would be

made available through the FRC website. Through discussion, the following observations and points were made:

- The Corporate Finance-type services incorporated a wide range of services and it was questioned whether this could be made narrower. However, MB pointed out that the wording in the Regulation was deliberately very broad.
- The Financial / investment strategy related services could be supported with more explanation.
- Transfer pricing could be linked to multiple areas including taxation.
- Queries seeking guidance on ambiguous areas were still coming in as the year-end audit process using the new requirements was ongoing.
- Though efforts have been made to have consistency of approach at the EU level, other regulators were sometimes taking decisions which were hard to understand in the context of what the Regulation requires and restricts.
- The FRC follows a principle based approach in implementing the requirements of the Regulation.

9.3 MB agreed to take into consideration the observations made by the Council in finalising the guidance for publication on the FRC website. Subject to the above, the Council agreed to support the proposed guidance.

10 IAASB Update

10.1 MG outlined the purpose of this discussion which was to obtain Council members' input on the implications of an audit approach that draws significantly on the use of IT and data analytics, the challenges that auditors may have in considering the relevance and reliability of audit evidence, how auditors can use IT and data analytics to deliver high quality audits, and how might this be reflected in the updating of ISA 315.

10.2 The Council discussed the need for standards to reflect the continuous change in the capability and use of IT and agreed that it was challenging to future proof how to evaluate the relevance and reliability of audit evidence where that has greater dependence on IT controls. It was reported that, although the IAASB would not necessarily be directly discussing with system developers the implications of planned changes, it had established an advisory group to better understand some of the areas of change and challenge.

10.3 A Member noted that the findings of AQR could provide examples of where sophisticated systems give rise to risks and opportunities in audit.

10.4 The discussion also touched on artificial intelligence and automated processing, and the implications of developments in this area for the responsibility of firms to develop appropriate audit tools and the ability of the audit engagement partner to make judgments on the basis of automated decisions.

11 Draft Consultation Responses – IESBA Safeguards and Applicability EDs

11.1 Keith Billing outlined the two responses to consultations being run by the IESBA – both forming part of a larger programme of work to update the Code of Ethics. One of the consultations covered how safeguards are dealt with in the Code and the other covered the application of Part C of the Code to professional accountants in public practice.

11.2 The Council considered and supported the contents of the two draft FRC responses to the IESBA's Exposure Drafts.

12 Any other business

12.1 The Council noted the meeting dates in 2018.

13 Date of next meeting

15 May 2017