

**Minutes of a meeting of the Audit and Assurance Council of the FRC
held on 15 May 2017 at the FRC, 8th Floor, 125 London Wall, London, EC2Y 5AS**

PRESENT

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| Ray King | Chairman |
| Olivier Beroud | Member |
| Bryan Foss | Member |
| Jane Fuller | Member |
| Kari Hale | Member |
| Sue Harris | Member |
| Scott Knight | Member |
| Conall O'Halloran | Member |
| Stephen Oxley | Member |
| Jerry Wedge | Member (from minute 1 to 10.3) |

OBSERVERS

Michael Gaull (PRA)

IN ATTENDANCE

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| Kate Acott | Project Director |
| Mark Babington | Deputy Director of Audit Policy |
| Anu Bhartiya | Committee Secretary |
| Keith Billing | Project Director |
| James Ferris | Project Director |
| Marek Grabowski | Director of Audit Policy |
| Josephine Jackson | Technical Director |
| Melanie McLaren | Executive Director of Audit (from minute 6) |
| Gareth Rees | Executive Director of Enforcement and Executive Counsel (for minute 7) |

1 Welcome and apologies

The Chairman welcomed everyone to the meeting. Apologies were noted from the Council Member Paul Cox and Observers Lisa Campbell (IAASA) and Lee Piller (FCA). The Chairman informed that he will be stepping down from the FRC from July 2017 and considerations are being given to who should be chairing the Audit & Assurance Council. The succession arrangement would be announced once approved by the FRC Board.

2 Declaration of conflict of interest

There were none to be reported. The Chairman raised a query whether members of audit firms that are involved in audit tender which is a normal matter of practice, should declare those tenders as conflict of interest. The Chairman viewed that there was no contractual relationship involved with any of the matters discussed at the Council and the members are on advisory capacity rather than executive. The members of such firms are carefully selected in order to bring the right skills and experience on the Council and therefore those activities that are normal matter of practice of the firms do not conflict with the matters on the Council agenda. The Secretary agreed to review this understanding and report to the Council.

3 Minutes and Rolling Actions

Minutes

- 3.1 The minutes of the Audit & Assurance Council meeting held on 24 April 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

- 4.1 The Chairman reported to the Council that the Codes & Standards Committee had not met since the last meeting of the Council. The Board had met on 26 April and amongst other matters had discussed the following:

- The CEO Report including matters relating to the ethical issues in audit firms, the FRC Culture project, the Actuarial Oversight and the Monitoring proposal by the IFoA, the Accountancy Scheme.
- The FRC's monitoring of the reporting and audit of Mitie.
- The UK Corporate Governance Code and the Governance of Large Private Companies and that the FRC would be responding to the Department on the BEIS Select Committee recommendations.
- An update on the progress with the Sanctions Review.
- Approval of the Consultation on the Bank Reports – PN 16.
- Approval of the De-registration of the Third Country Auditors Procedure.
- Updates from the Chairs of the Conduct Committee and the Codes & Standards Committee.

- 4.2 In response to a query, it was agreed to include in the Council's Away Day agenda, a discussion on the FRC's relationship with the firms that it regulates.

5 Report of the Director of Audit Policy

- 5.1 Marek Grabowski (MG) reported that in view of the short time period between meetings, he had nothing to formally report to the Council. He drew Council's attention to the planned ISA 540 outreach meetings and encouraged the Members to attend and participate in some of the events.

- 5.2 The Members discussed the Forward Planner and in particular the agenda for the Council Away Day to be held on 13 July. The discussion included various reports and suggestions including:

- The SME/SMP Audits would include discussion relating to the audit approach adopted in Scandinavian countries.
- In the light of the international reforms, a suggestion for the Away Day or a future Council meeting to include discussion on the development of the framework for assessing public interest.
- Discussion and input on the role and effectiveness of the Council within the FRC's Governance structure.
- Focus on FRC's key enablers on quality, recruitment, training, culture have an impact on the audit regime.

- 5.3 The Members were invited to send their further suggestions for the Council Away Day Agenda to Mark Babington (MB), if they had any.

6. IAASB Update – responding to the IAASB’s ISA 540 Consultation

- 6.1 MG introduced the paper by summarising the key considerations that the FRC was seeking feedback on to inform the FRC’s response to the IAASB which is due by 1 August. He also drew attention to the planned series of outreach meetings to get the views of UK stakeholders. The paper, at this stage was presented for discussion only and a further substantive discussion to inform the FRC’s response to the IAASB would be held at the June Council meeting, with a final response to be circulated by email.
- 6.2 MG tabled a slide deck on ‘What is new in the ED-540’ which included the current requirements and the changes in the scope and nature of ISA-540 proposed by the IAASB for the audit of accounting estimates and disclosures. He also tabled a supplementary paper to the proposed ISA 540 (Revised) which included chart that summarises the key aspects of paragraphs 13 – 23 of the ED-540.
- 6.3 The Council received an explanation of the proposed ‘objective based’ approach to developing responses to risks of material misstatement. This is better suited to addressing a wide range of types of estimate and has the potential to drive more appropriate responses to risks of material misstatement when complexity, judgement and uncertainty are particular factors giving rise to the underlying susceptibility to misstatement. The Council noted the approach taken to establish the requirements and application material that are intended to drive more sceptical behaviour. MG explained the considerations in relation to the application of auditing accounting estimates that have risks of material misstatement, for which inherent risk is low and for estimates that have risks of material misstatement, for which inherent risk is not low, where the requirement is for a more detailed objective based assessment.
- 6.4 A Member suggested that it would be helpful to illustrate the changes with help of an example, and to provide the supplementary paper without track changes. Following a query, MG explained the planned outreach programme and the intention to have a substantive discussion on the feedback received from the outreach programme and high level but specific suggestions for the draft response to the Consultation at the Council meeting in June.

7 Enforcement Briefing

- 7.1 At the invitation of the Chairman, Gareth Rees (GR) tabled a briefing paper on the four audit cases that had been concluded in the past year. He reminded the Council of the confidentiality of the contents of the paper.
- 7.2 The Council received an update on each of the four cases, two of which were settlements with the firms and the remaining two were taken forward to the Tribunal. The most common issue identified in the cases was relating to professional scepticism.
- 7.3 The Council discussed how the FRC identifies cases and the approach taken by firms and the FRC during the enforcement proceedings. The Council also discussed the general impact that fines have on firms and the level of responsibility that an engagement partner has within the firm in respect of a particular audit.

8. AAT Project Update

Consultation paper and Impact Assessment – Money Laundering Guidance in UK Legislation

- 8.1 MB outlined that Practice Note 12: Money Laundering – Guidance on UK Legislation was last reviewed in 2010 and is due for revision to reflect changes to UK Legislation as a result of implementation of the EU’s 4th Anti-Money Laundering Directive which is currently being transposed into UK Law. The paper proposed that the revised material be included as an appendix to ISA (UK) 250, rather than as a separate Practice Note

in order to link it more clearly to the ISA, which is being updated to make explicit references to money laundering, terrorist financing and proceeds of crime legislation. It was noted that as part of the process, the FRC has liaised with HM Treasury, HMRC and the National Crime Agency given the public interest nature of the material.

- 8.2 The Council agreed to provide its advice to the Codes & Standards Committee that it recommend to the FRC Board they approve the draft consultation document and the revised appendix to ISA (UK) 250 for a consultation period of two months.

IESBA Consultation document – The Structure of the Code of Ethics (Phase 2)

- 8.3 Keith Billing (KB) provided a brief overview of the proposed FRC response to the Exposure Draft – Improving the Structure of the Code of Ethics for Professional Accountants – Phase 2. The Council agreed the concerns raised with the IESBA that were outstanding from Phase 1 and the need for addressing those in order for IESBA to meet its aim of enhancing understanding and usability of the Code and its effective implementation, consistent application and enforcement.
- 8.4 The Council discussed the views of regulators from other countries and compared IESBA's work with that of the IAASB through the regulatory system. It was noted that there was an opportunity to raise concerns at the National Standard Setters meeting that takes place in June and discuss with the Deputy Chair of the IESBA.
- 8.5 The Council supported the views as set out in the letter and that the FRC send its response to IESBA's consultation on the structure of the International Code of Ethics, as drafted.

Withdrawal of Irish Bulletins and UK Practice Note

- 8.6 MB outlined the FRC's continuing efforts in rationalising its guidance to make it sustainable to keep up to date. Two Irish Bulletins have been identified for withdrawal (2007/02 – The Duty of Auditors in the Republic of Ireland to Report to The Director of Corporate Enforcement, and 2011/01 – Developments in Corporate Governance Affecting the Responsibilities of Auditors of Companies Incorporated in the Republic of Ireland), which now fall within IAASA's remit.
- 8.7 In addition, it was proposed to withdraw Practice Note 27 on the Audit of Credit Unions in the UK. The credit union sector in the UK is significantly smaller than in Ireland and credit unions are not included within the PIE definition. Both of these factors mean that updating the material is no longer a priority for the FRC. Michael Gaull noted that credit unions are a small sector regulated by the PRA and queried whether the auditors of such entities would also be small and therefore would benefit from guidance on how to audit credit unions. MB responded that he had undertaken outreach to establish whether the Practice Note was used and had approached a provider of audit services to credit unions in Manchester who were unaware of the Practice Note.
- 8.8 The Council agreed to provide its advice to the Codes and Standards Committee that it approve the withdrawal of: Bulletin 2007/02 – The Duty of Auditors in the Republic of Ireland to Report to The Director of Corporate Enforcement; Bulletin 2011/01 – Developments in Corporate Governance Affecting the Responsibilities of Auditors of Companies Incorporated in the Republic of Ireland; and Practice Note 27 – The Audit of Credit Unions in the United Kingdom.

Update on PN 11 – Audit of Charities

- 8.9 MB provided an update on the consultation paper and revised Practice Note 11 on the audit of charities which was issued recently. MB also highlighted the National Audit Office's recent investigation and report on the funding and governance of Broken

Rainbow. It was noted that there were similar findings to those of Kid's Company and highlighted the necessity of the revisions on strengthening the guidance relating to Going Concern, as supported by the Council.

9 Development in Audit 2016 - 17

- 9.1 James Ferris (JF) provided an update on the project 'Development in Audit 2016-17' which gives FRC an opportunity to set out the view of the current health of the UK audit market, the key issues facing practitioners and other stakeholders. The scope of the report would include developments in the UK audit market, the role of the FRC as Competent Authority, trends in audit quality (including inspections), FRC international engagement on audit matters (including the IAASB), emerging issues, enforcement cases, thought leadership in audit. The report will require information collected from the professional bodies based on the FRC's role as Competent Authority and will form part of evidence base along with data from audit tendering, Audit Quality survey data, key contributors from various parts of the FRC, Executive and governance oversight and publication in coordination with Key Facts and Trends. The aim is to publish the report by end of July and therefore formal approval to the report would be obtained from the Council and the Committees in June and the Board in July 2017.
- 9.2 The Council noted the Project Initiation Document and the proposed skeleton structure and content of Developments in Audit 2016-17. The Members discussed various areas of audit that could be given consideration for the Report including:
- Benefits of the rotation of auditors. It was noted that the AQR have selected some samples in this regard but it would be too early to conclude from those samples. This topic could be a consideration for the next year's report.
 - Extended Auditor's Report. It was noted that the scope of the project includes matters relating to going concern and viability statement.
 - Demonstrating stakeholder expectations. It was noted that the stakeholder survey was ongoing and it is expected that there might be some early evidences from the survey; however, the tight timelines on reporting might prove to be an issue. It was agreed that the outcome of the survey would be shared with Members at the Council Away Day in July.
 - The results of the Audit Committee Chairs Survey. It was reported that so far 330 responses had been received and there were more respondents who have provided narrative commenting.
 - The overall business model and long term viability of audit practice. This would include broader regulatory changes, practice management, tendering, rotational changes, costs, changes in technology and such variables.
- 9.3 A concern was expressed whether too many topics had been focused on and considering the constraints and tight timelines, if a quality outcome could be achieved. It was viewed that though themes were challenging, it demonstrated the wide and comprehensive audit regime of the FRC.

10 TAG Update

- 10.1 MB informed the Council that two meetings of the Technical Advisory Group had been held to discuss auditing and ethical matters related to the interpretation and application of the Standards. Since the CEAOB is yet to make progress on a mechanism to provide guidance at European level, the FRC is developing guidance covering those matters previously highlighted as having been referred to the CEAOB, using the TAG mechanism to assist where necessary.
- 10.2 Attention was drawn to the rolling log on the following matters that were considered at the TAG meetings in April and May 2017:

- Material to support a review or investigation by the Competent Authority: A group audit engagement file needs to contain documentation necessary to support a quality assurance review or investigation by the Competent Authority.
- Documenting the scope of an Engagement Quality Control Review and the audit firms to develop a policy to support EQC reviewers.
- Granularity of reporting on valuation methods. When communicating with those charged with governance, the nature of the audience should be borne in mind when considering how to present the work of the auditor and any findings emerging from the audit.
- The extent to which an audit is designed to detect irregularity, including fraud. The auditor should include an explanation in the auditor's report about how the auditor designed the audit to detect fraud or non-compliance with law or regulation for that particular public interest entity to make the auditor's report as helpful as possible to the user and not use boilerplate statements.
- Meaning of services having a direct effect on the financial statements and thus not eligible to apply the member state option derogation.
- Status of Valuation Reports required under s.593 of the Companies Act for the purposes of the non-audit services prohibition.
- Services prohibited by the 'human resources services'.
- The application of the Objective, Reasonable and Informed Third Party Test.

10.3 In response to a query relating to the guidance on the treatment of Lending Syndicates / Restructuring Syndicates, MB informed the Council that the TAG discussion was at an early stage and it has been agreed to set up a working group made up of representatives from firms that operate in these areas with a view to provide guidance in early autumn. The guidance will be presented to this Council at a future meeting.

10.4 The Council supported the proposed guidance developed following the April and May TAG meetings, and that it be made available to practitioners through the FRC website.

11 AAC Effectiveness Log

11.1 The Secretary reported that the Log sets out the actions that were identified at the Council meeting in February in response to the findings of the Effectiveness Review. It was noted that the action relating to the Observers participating in the review was a common theme from all Councils and would be considered at the next review.

12 AAC Away Day Agenda

12.1 The matter was discussed under the item 'Report of the Director of Audit Policy'.

13 Any other business

13.1 Since this was the last meeting for Conall O'Halloran, the Chairman thanked him on behalf of all Members and colleagues for his commitment and contribution to the Council.

14 Date of next meeting

12 June 2017