

**Minutes of a meeting of the Audit and Assurance Council of the FRC  
held on 11 May 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 (from minute 3)

**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 (from minute 4)
Paul George	Executive Director, Corporate Governance & Reporting
Josephine Jackson	Technical Director, Audit Policy
Michael Kavanagh	IAASA Observer
Melanie McLaren	Executive Director, Audit
Andrew Meek	Inspections Director (minute 6 only)
Oliver Rowe	YouGov (minute 5 only)
Marian Williams	Director, Audit (from minute 5)

**Apologies and welcome**

Apologies were noted from Marek Grabowski (Director – Audit Policy), Lee Piller (FCA Observer) and Stephen Oxley (Council Member).

The Chair welcomed Paul George, Executive Director - Corporate Governance & Reporting, to the meeting.

**1. Minutes of the previous meeting**

- 1.1 The minutes of the Audit & Assurance Council meeting held on 2 March 2016 were approved for publication.
- 1.2 The note of the Audit & Assurance Council conference call held on 14 March 2016 was approved.
- 1.3 The rolling action log was noted.

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

- 2.1 The Chairman provided an update on matters considered by the FRC Board at its meeting on 14 April 2016. The Council noted the Board had:
- Received a presentation on the findings of the externally led review of its effectiveness and discussed the proposed recommendations.
  - Discussed progress on the implementation of the Audit Directive & Regulation (ARD).
  - Considered feedback to the consultation on the 2016-17 FRC Plan & Budget and approved the final version for publication.
  - Considered, and approved for publication, the Feedback Statement on the Technical Actuarial Standards (TAS) Framework, TAS 100 and the specific TAS consultation documents.
  - Approved for publication the updated UK Corporate Governance Code, the revised Ethical and Auditing Standards.
- 2.2 The Chairman also provided an update on matters considered by the Codes & Standards Committee (CSC) at its meeting on 3 May. The Council noted that the CSC had received a presentation on the draft Enforcement Procedure for Audit and had discussed in detail the Audit Firm Governance Code. The executive undertook to share the final Enforcement Procedure for Audit with the Council when available.

## **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:

### *Practice Note 10 – The Audit of Financial Statements of Public Sector Bodies in the United Kingdom*

- 3.2 Mark Babington (MB) reported that the review of PN 10 is being taken forward by the Public Audit Forum (the 'Forum') following designation of the Forum as a 'SORP-Making Body' in accordance with the revised FRC policy. The Council noted that objectives of the review had been discussed with the FRC and would include comprehensive review of the outdated sections on regularity. It is the intention that a full draft of the revised PN and corresponding consultation materials will be available for Council and Codes & Standards Committee review and approval in June. MB stressed that the timetable proposed by the Forum was extremely challenging, and that they were keen to get FRC agreement for a shorter consultation period of 8 weeks. The FRC has advised that the Forum should consider how they provide users of the financial statements with appropriate opportunity to comment.

### *Public Company Accounting Oversight Board (PCAOB) consultation*

- 3.3 The Council noted that the PCAOB has issued a consultation on changes to its audit standards to strengthen existing requirements on the lead auditor's supervision of other auditors in order to have a more uniform approach. The Council highlighted the importance of seeking an alignment of the IAASB and PCAOB approaches and noted that this would be addressed through FRC representation on the ISA 600 Taskforce and our continued international influencing work.

### *General Data Protection Regulation (GDPR)*

- 3.4 The Council noted that the executive has met with a number of audit firms for initial discussions in respect of the requirements of the revised GDPR. MB reported that, whilst a number of potential issues had been identified, the specific details had not yet been developed and the discussions would reconvene once the details were available.

### *Council Strategy Day*

- 3.5 The Council considered the proposed agenda for the Council strategy day to be held on 6 July and welcomed an opportunity for a discussion on what is meant by high quality audit and on influencing behaviours. The Chair invited members to submit any comments or suggestions on the agenda to MB by email.

### *Council forward work programme*

- 3.6 MB invited the Council to consider a set of strategic strands that had been identified by the executive to underpin the work of the Audit Division and support the first year of the FRC's 2016-19 strategy period. MB highlighted that those strands reflect the need to support implementation and embedding of the revised Ethical and Auditing Standards and to deal with matters that had been deferred whilst work to revise the Ethical and Auditing Standards was underway. The Council supported the proposed strategic strands.
- 3.7 The Council discussed a list of projects it had previously advised the executive to commence work on. Through discussion it was highlighted that IFRS 9 is likely to give rise to a number of issues for auditors and that there may be a need to review whether the auditing standards provide appropriate support. MG, supported by Keith Billing (KB), is a member of the ISA 540 Task Force which is considering the revisions necessary to the standard to support auditors through the IFRS9 implementation

### *Revision of Practice Note 11 – The Audit of Charities in the United Kingdom.*

- 3.8 The Council supported a proposal from Kate Acott (KA) to revise PN 11 on the basis that:
- Preparers value having guidance in this area.
  - The existing guidance does not reflect recent developments in legislative and regulatory framework.
  - There is increased public interest in charities due to public response to media stories and surveys demonstrate that public trust and confidence in charities has fallen over the past year.
  - It would be in keeping with the FRC's policy to review its guidance at least every five years.

### *Practice Note 20 – The Audit of Insurers in the United Kingdom / Audit of Solvency II regulatory regimes.*

- 3.9 James Ferris (JF) provided an update on work to update PN20 and develop guidance to support the audit of Solvency II Regulatory Returns. The Council noted that the FRC's PN20 working group has concluded that auditors are likely to have difficulty in accepting engagements to audit public Solvency II reports in accordance with ISAs (UK and Ireland) on the basis that the ISAs apply only in the context of a complete set of general purpose financial statements, where Solvency II reporting is based on special purpose financial statements, and on the basis that the PRA is proposing to ask for assurance over only specific components of those reports. JF reported that the working group has identified

through detailed analysis that solvency II audit engagements could be conducted in accordance with ISA 800: *The Independent Auditor's Report on Special Purpose Considerations - Audits of Single Purpose Audit Engagements* and ISA 805: *Special considerations - Audits of Single Financial Statements and Specific Elements*. This has also been corroborated through consultation with audit practitioners, JF highlighted that, whilst ISA 800 and ISA 805 are part of the suite of International Standards issued by the IAASB they had not previously been adopted in the UK and Ireland as the Auditing Practice Board (APB) in 2007 had not considered it appropriate to give a 'true and fair view' or 'present fairly, in all material respects' audit opinion on a specific element, account or item of a financial statements, and the APB had not considered it appropriate to apply the full suite of ISAs to work on a single component.

- 3.10 The Council discussed the proposal to consult on the adoption of ISA 800 and ISA 805 to support the audit of Solvency II. Whilst the Council noted the concerns identified by the APB do not relate directly to the content of ISA 800, it was noted that there is a risk that adoption of ISA 805 could lead to a broader use of 'true and fair' opinions on components and that, as most users expect a true and fair view to be presented, this could result in an expectation gap. It was also noted that there could be unintended consequences of adopting ISA 800 and ISA 805 and that careful consideration would have to be given to how ISA 800 and ISA 805 could be used.
- 3.11 Whilst the Council supported the premise that adopting an established standard, in the form of ISA 800 and 805 would achieve the objective of providing a mechanism through which assurance could be sought, the Council considered that it would be important to understand more fully the risks associated with adoption of the standard in consulting on the merits of doing so. The Council requested that the executive explore more fully the risks that could arise. The Council suggested that, as part of its deliberations, the executive could explore whether the development of a standalone standard, akin to the Client Assets Assurance Standard, for the audit of Solvency II regulatory returns would be an appropriate alternative solution. MB agreed to reflect the Council's advice in the draft consultation by incorporating some more specific consultation questions and circulate the document to Council for comment in advance of the June meeting of CSC.

*Withdrawal of Practice Note 22 - The Auditors' Consideration of FRS 17 'Retirement Benefits' – Defined Benefit Schemes*

- 3.12 The Council supported a proposal to withdraw PN 22 on the basis that it has not been updated since it was issued in 2001, it is significantly out of date with regard to new accounting standards and relevant auditing standards have been substantively revised. The Council agreed to a proposal by KB that withdrawal be deferred until the project to update PN 15 had concluded.

**4. IAASB invitation to comment – Enhancing Audit Quality in the Public Interest: A focus on Professional Scepticism, Quality Control and Group Audit.**

- 4.1 Josephine Jackson (JJ) introduced a draft FRC response letter for submission to IAASB in response to its Invitation to Comment (ITC). JJ reported that the draft builds on the outline response considered by the Council at its March meeting and views expressed at a number of outreach events. The Council noted that the draft response had been considered by the Codes & Standards Committee on 3 May and that the committee had

been supportive of the proposals, noting in particular that ‘understanding the users’ perspective’ is an important area for the IAASB to explore. JJ highlighted that some minor typographical amendments had been identified since the paper had been circulated to the Council and that those amendments would be made prior to submission to the IAASB.

- 4.2 The Council discussed the draft response letter in detail. Whilst there was general support for the draft letter it was suggested that, on professional scepticism, there is too much focus on demonstrating and documenting challenge which could lead to the auditor spending time gathering unnecessary evidence. Whilst the Council noted that there is a need to gather evidence to independently corroborate management views, and that this isn’t always done in practice, the Council suggested the drafting should at least highlight the need for auditors to be objective in making judgements on management views. There was also some concern expressed that, as drafted, the references to the perception of users might amplify the ‘expectation gap’ between what users expect and what the audit delivers. Through discussion it was suggested that the letter should reflect that a high quality audit enhances the credibility of financial statements, which in turn, enhances user confidence. The Council also suggested there is a need to clarify that the term ‘users’, when referred to in the letter, means those usually referred to as the ‘intended users’ in the ISAs.
- 4.3 JJ undertook to reflect on the views expressed and update the draft response accordingly. It was noted that the updated response letter would be circulated to the Council by email when submitted to the IAASB.

## **5. Measures to support confidence in Audit - YouGov Confidence in Audit Survey**

- 5.1 The Council received a presentation from Oliver Rowe (OR) on progress with the FRC sponsored survey on Confidence in Audit, conducted by YouGov. OR reported that the survey had been designed to assess what has changed in respect of confidence in audit since the 2014 survey was undertaken. The Council noted that the approach of the 2016 survey would be consistent with the approach taken in 2014, with the exception that a number of audit committee chairs and non-practitioners, including journalists, would be interviewed. Through discussion of the sample size it was noted that the interview approach enables the FRC to gather qualitative information and that, in addition to the YouGov survey, the FRC draws on a range of other outreach activities, including undertaking an annual survey of audit committee effectiveness, to inform its thinking and evidence base.
- 5.2 OR reported that the interview process was underway and summarised the views that had been expressed by the 20 individuals who had been interviewed to date. The Council noted that initial views suggest:
- Whilst confidence in audit remains mixed, it has improved over the last two years. Some interviewees suggest the FRC has played a key role in driving this improvement.
  - Independence and transparency has improved.
  - The remit of audit is expanding, auditors are reporting to a wider group of stakeholders and providing assurance on a wider range of matters. There is a concern this could affect the quality of the core audit and also considerations in respect of auditor liability.
  - On the FRC, some interviewees called for the FRC to have a greater international role and suggested the FRC should seek to be a champion of good audit.

- Interviewees highlighted the increasing use of technology in audit.
  - Audit is higher on the agenda than it was two years ago and levels of understanding have increased.
- 5.3 The Council noted that the final report could be expected in June and would be presented to the Council in due course. The Council requested that the full report provide more information on what interviewees would like the FRC to do in respect of its international role.

## **6. Measures to support confidence in Audit – State of the Nation Draft Audit Report**

- 6.1 Andrew Meek (AM) introduced a preliminary draft of the first annual ‘state of the nation’ report on audit. The Council noted that the objectives of the report are to provide educational information in order to promote continuous improvement and to set out, based on the FRC’s Audit quality review work, an assessment of the UK audit market, balancing positive messages with identified development needs.
- 6.2 AM reported that there remains a lot of work to do in developing the preliminary draft and that it had been agreed that the draft presented would be split into two documents, one to be a short, standalone executive summary type report, designed to be accessible for a wider audience, and one to be a longer report that would provide more detailed information and analysis. The Council supported this approach.
- 6.3 AM invited the Council to comment on the overall feel of the preliminary draft and to identify any areas where the report appears either silent (or with insufficient emphasis) or where the report appears too strong. The following comments and suggestions were made:
- To put greater emphasis on the information currently presented in orange text and that this information should also be included in the executive summary report.
  - To include a ‘forward looking’ section explaining how the assessment will inform the FRC’s activity going forward.
  - To ensure through further review that there is an appropriate balance between emphasis on the negatives and positives.
  - To further reflect the context in which the FRC and UK audit firms operate –reference could be made to the international environment and to issues that are current in the UK.
  - To give further consideration to the presentation of cases that have been closed without formal complaint, to providing an explanation as to what ‘closed’ means, and to providing an explanation where a case has been open for a considerable length of time.
  - To further enhance / strengthen the section on pricing.
  - To refer to technological innovation and the impact this could have.
- 6.4 Through discussion it was noted that the communications team are working on the design of the report in order to improve cohesiveness and readability. It was also noted that the report would not replace the annual key facts and trends publication.
- 6.5 AM thanked the Council for their comments and undertook to reflect on their suggestions in further developing the draft report. The Council noted that the preliminary draft would be considered by the FRC Board, the Codes & Standards Committee and the Conduct

Committee in June and that a final draft would be presented to the FRC Board for approval in July.

## **7. Role and Structure of the Audit & Assurance Council - Discussion**

- 7.1 MM provided an update on considerations relating to a review of the FRC Governance structure. The Council noted that a light touch review would be undertaken in the Autumn to respond to any immediate issues arising as a result of implementation of the ARD and the FRC's role as Single Competent Authority (SCA), and that a fuller review would be undertaken in the Spring of 2017 once the changes to the executive structure had bedded in. MM emphasized the important role the Council will play once the FRC becomes the SCA, highlighting that the executive and FRC Board will look to the Council as a source of input and challenge to inform how it fulfills its new role to best effect. It was suggested that, in order to assist the Council in fulfilling this role, it would be helpful to have an education session on how the restructured audit division operates.
- 7.2 The Council reflected on the findings of the 2016 effectiveness review and noted that, in response to the review, steps were taken to improve the presentation of materials to the Council, including, through increased use of the private members area of the FRC website. Whilst it was noted that steps have been taken to improve reporting on the Council's forward agenda it was suggested there is a need to look further forward than 12 months and that there should be an increased focus on horizon scanning and risk. MB undertook to reflect on the suggestion and build an opportunity for discussion in to the agenda items proposed for the Council away day.

## **8. Technical Advisory Group – Membership and Terms of Reference**

- 8.1 MB introduced a paper seeking the advice of the Council in respect of the proposed membership of the FRC Audit Technical Advisory Group (TAG) and the proposed approach through which the TAG would deal with, and escalate issues. The Council the TAG will be a mechanism through which the ARD can be embedded and will provide a forum through which the FRC can respond to practitioner needs where areas of ambiguity have been identified in the drafting.
- 8.2 The Council supported the proposed membership of the TAG, noting that no representatives from audit firms represented on Council had been sought. The Council also supported the proposed and the approach through which the TAG would deal with and escalate issues to the Council.
- 8.3 The Council discussed a list of areas identified as requiring priority action and queried the speed at which the issues could be addressed. In response MM highlighted that the UK GAAP TAG, an equivalent group supporting the Corporate Reporting Council, has proven successful in providing a mechanism through which a consensus view / clarification can be provided with relative speed.

**9. Any other business**

9.1 There was no other business

**10. Next meeting**

10.1 The Council noted that the next meeting of the Audit & Assurance Council would be held on 8 June 2016 at 2pm.