

Audit and Assurance Council

**Minutes of a meeting of the Audit and Assurance Council of the FRC
held on 11 September 2013 at Aldwych House, 71-91 Aldwych, London WC2B 4HN**

PRESENT:

Nick Land (Chair)
Russell Frith
Ray King
Scott Knight
Paul Lee
Allister Wilson

OBSERVERS:

Trevor Rushe Irish Auditing and Accounting Supervisory Authority (IAASA)

IN ATTENDANCE:

Marek Grabowski	Audit Policy Director
Keith Billing	Project Director
Francesca Chittenden	Council Secretary
Jon Hooper	Project Director
Steven Leonard	Project Director
Melanie McLaren	Executive Director
Marian Williams	Codes & Standards Director

1. Apologies and introduction

1.1 Apologies were noted from Paul Ebling (PRA observer in place of Pat Sucher), Sue Harris (Council Member), John Hughes (Council Member), Aidan Lambe (CAI Observer) and Robert Talbut (Council Member).

2. Minutes of the previous meeting and rolling actions

2.1 The minutes of the AAC meeting of 17 July 2013 were approved as an accurate record of the meeting.

2.2 The Council noted that all actions were either complete or addressed on the agenda.

Reports

3. Chairman's Update

3.1 The Chairman, Nick Land (NL) reminded Council of the forthcoming away day; he advised that the agenda had not yet been finalised but that it would focus on the improving confidence in the value of audit project.

3.2 The Chairman also informed the Council that in line with the Board and Committee effectiveness review, a similar, internal review process for the Councils would commence shortly.

4. Report of the Director of Audit Policy

4.1 Mr Grabowski (MG) introduced his report which was taken as read. Particular emphasis was given to the following matters.

IAASB ED 'Reporting on Audited Financial Statements'

4.2 MG summarised the key questions which had been posed in an 'invitation to comment' to FRC stakeholders following the publication of the IAASB's proposals. He highlighted that the focus of the questions was how the proposals would relate to the audit committee and auditor reporting regime introduced by the FRC over the previous 12 months and whether it would be appropriate to adopt these ISAs for the UK and Ireland, subject to any recommendations the FRC may make for changes to the IAASB proposals. In addition, he noted, given the likelihood that the EU would adopt the ISAs, that changes may well be required to ISA (UK and Ireland) 700 on auditor reporting, to conform to the IAASB's standards (including the current proposals as finalised) in due course. These questions are therefore very pertinent for the FRC to address, whether or not we conclude that it is appropriate to align with the current IAASB proposals more immediately.

4.3 The Council noted that the FRC had arranged two events to explore the IAASB proposals on auditor reporting in more detail. One event would be held in London in October and will look at the implications of the proposals in the UK and one would be held in Brussels in November to look at the proposals in the context of the current EU audit policy proposals. Details regarding the events would be circulated to the Council.

Forthcoming IAASB Meeting 16-20 September

4.4 The Council noted the agenda for the September IAASB meeting which included:

a) *ISAE 3000 – Assurance engagements other than audits or reviews of historical financial information*

The Council noted that a proposed final revised standard was being presented to the IAASB for approval. With regard to the proposals being tabled for IAASB discussion, MG said that in his opinion it was beneficial to take out the material dealing with direct engagements because this is less well understood, was holding up the document and driving unhelpful complexity. However, MG highlighted two remaining concerns with the proposed revised standard that the FRC has previously recognised.

Firstly, despite the considerable expansion of the content draft revised ISAE from the extant version, it is still not subject matter specific and cannot be used as a stand-

alone assurance standard. This would mean in practice that subject matter standards will still generally be required and are likely to duplicate much of the material in this ISAE. It is therefore more in the nature of a framework standard than an operational standard and we are unlikely to want to adopt it in its own right.

Secondly, the draft revised ISAE continues to address both reasonable and limited assurance, concepts which can be difficult to distinguish. Limited assurance is poorly defined (being conceptually a mimic of reasonable assurance where the practitioner obtains a lower level of assurance than in a reasonable assurance engagement). This would be hard to interpret both for practitioners and users since, under the ISAE, the level of assurance to be obtained in a reasonable assurance engagement is not specified (not even – as is the case in relation to an audit – by stating that it is intended to be a high level of assurance). The level of assurance to be obtained in a limited assurance engagement also has to be at least ‘meaningful to users’ but this is also a very subjective concept.

The Council noted that the term ‘limited assurance’ is established in the Assurance Framework and is recognised in a number of IAASB standards. Whilst these concerns cannot be addressed at this time, MG noted that there may be a future project on the Assurance Framework that will provide an opportunity to challenge this further.

b) Disclosures

The Council noted the changes which are to be proposed to various ISAs to reflect how disclosures could be approached at key stages of the audit.

c) Audit Quality Framework

The Council noted that the IAASB intention is that the final version of the framework will be approved at the December 2013 IAASB meeting. The Council identified that the framework did not conflict with FRC positions and that the framework could be a useful tool for setting standards, and developing a common understanding about audit quality, at a global level.

d) ISA 720 Revised – The auditor’s responsibilities relating to other information

MG reminded the Council that the IAASB had received a lot of negative feedback in relation to the detail of the proposed revision of ISA 720 and that the IAASB task force of which he was a member would be considering its advice to the IAASB in light of that feedback and in light of the approach being taken in a parallel standard being developed by the PCAOB. The Council noted that a significant difference between the IAASB and PCAOB proposals is that the PCAOB state that the auditor should read and evaluate the other information, based on the audit evidence and the conclusions reached during the course of the audit.

The Council considered the current FRC model of reporting by exception, and now being proposed by the IAASB Task Force, is broadly appropriate. The Council also questioned whether the proposed PCAOB auditor reporting might result in the creation

of an expectation gap as users may assume that a reasonable assurance engagement has been undertaken.

4.5 EU Policy developments:

The Council noted that three issues, mandatory audit firm rotation, non-audit services and the vehicle for EU oversight, were to be considered at the next meeting of the Coreper and that the outcome of those discussions would be reported back to the Council.

UK & Ireland Auditing and Assurance Standards

Proposed advice to the FRC on the application of paragraph 19A of ISA (UK & Ireland) 700.

4.6 The Council noted the summary of the discussion held at the July Council meeting and the draft advice to the Board which had been prepared as a result of that discussion. In discussing the draft advice the following points were made:

- (a) the Council recognised that there may be important risks of material misstatement that only arise in relation to the audit of the parent company financial statements and are not addressed in the audit of the group financial statements; and that an understanding of such parent company risks may be of interest to readers of auditor's reports; however, the Council considered that the number of in scope entities where this issue would be relevant is likely to be quite small;
- (b) when drafting the standard, emphasis was placed on the group accounts and it was the intention that anything of significance in the parent company financial statements would be reported in the group financial statements;
- (c) the query was raised by two audit firms who requested clarification on the issue, the audit firms had not expressed a view or preference;
- (d) it is important not to 'spoon feed' audit firms; auditors should be able to apply judgement in considering whether or not a disclosure should be made in both the parent company financial statements and the group financial statements.

4.8 In light of the points made the Council concluded that rather than issue an amendment to the standard as previously advised it would be sufficient to issue a statement to subscribers to FRC notifications which clarifies the original policy intention. The Council also believed that this course of action could remove the requirement for consultation. The Council requested that the Council's draft advice to the FRC be revised and agreed that updated drafts of the advice and a statement for subscribers be circulated to the Council by email for agreement.

UK & Ireland Auditing and Assurance Guidance

Developing going concern guidance for non-code companies

4.9 The Council noted that revised guidance on risk and internal control, that would integrate and revise both the risk and governance aspects of the Sharman guidance and Turnbull guidance, was being developed for Code companies and had been considered by the Codes & Standards Committee in early September, it was expected that the revised guidance would be published in October.

- 4.10 MG informed the Council that the revised guidance moved away from using the term 'going concern' in the broader sense meant in the context of narrative disclosures about solvency and liquidity and referred instead to an assessment of, or reporting about, 'solvency and liquidity' risks. Where the term 'going concern' is used in the revised guidance it refers to the narrower meaning, as set out in the accounting standards.
- 4.11 MG informed the Council that the FRC would be issuing three other related documents as follows:
- a) a revised supplement providing guidance for Banks – to be issued as a separate document;
 - b) draft revised auditing standards; and
 - c) separate guidance for non-Code companies.

Activities since last meeting

- 4.12 The Council noted the list of activities since the last meeting.

5. Improving Confidence in the Value of Audit

- 5.1 Jon Hooper (JH) introduced the paper which provided an update on progress of the project and the YouGov final report. The Council were invited to discuss the findings of the YouGov report and consider the next steps.

YouGov Final Report

- 5.2 The Council noted that the YouGov report had been discussed by the Steering Group who had broadly welcomed the report. The Council noted the recommendation from the Group that the research report be published as an attachment to a covering paper setting out how the findings support the wider FRC project on *Improving confidence in the value of audit* and how the FRC plans to address the findings. The Council were supportive of the recommendation and highlighted the importance of making sure the plans for utilising the research are robust and clear. The Council also suggested including a statement explicitly setting out what is within the powers and remit of the FRC and what is not.
- 5.3 The Council noted the two minor concerns raised by the Steering Group in relation to the small sample size and the potential for individual quotes to be taken out of context. However, the Council were reassured that advice would be taken from YouGov and the Communications team to avoid any potential misinterpretation and that, at 36, the sample size was robust in terms of a qualitative research exercise.
- 5.4 The Council noted the importance of the Competition Commission report and highlighted that the covering paper supporting the findings should refer to the Competition Commission report and other on-going, related projects.
- 5.5 The Council discussed the findings of the YouGov report and noted that, whilst the findings did not offer any surprises, the findings provide evidence that there are issues

around confidence in audit and that the issues vary across the various stakeholder groups and the level of direct involvement they have with the audit process.

- 5.6 The Council noted that there would be a further opportunity to discuss the report and proposed cover paper at the away day in October and identified some areas for consideration / amendments prior to that discussion. The Council noted the intention of the FRC staff to submit the findings and the YouGov report to the FRC Board in October with the intention of publishing both documents shortly after.

Framework for the value of audit

- 5.7 The Council welcomed the revised Framework which had been updated following discussion at the July Council meeting and noted that the Framework would continue to evolve until views from all of those involved in audit had been captured.
- 5.8 In order to offer valuable input on the development of the Framework, the Council reminded itself of the role and the purpose of the Framework and what they hoped it would achieve. Through discussion, the Council agreed that by clearly setting out in detail the scope of audit and the auditor's role the Framework could be used as a tool for enabling debate at public policy maker level by assisting in identifying where issues and problems may arise and in educating those outside of the audit process to potentially reduce the expectation gap. The Council also suggested that the Framework would also be a useful tool for showing the supportive, cross organisational, role of the audit and demonstrate how audit feeds in to the wider FRC strategy and remit.

Standards and Guidance

6. Review of Ethical Framework for Auditors – Project Plan

- 6.1 MG and Keith Billing introduced the paper which set out the 'Review of the Ethical Framework for Auditors' project plan which had been developed following discussion at the July Council meeting. The Council noted that the project would form part of component 4 of the FRC's strategic project '*Improving Confidence in the Value of Audit*' addressing the extent to which auditors act and are seen to act in the public interest and would include a review of the 'APB Ethical Standards for Auditors' and other aspects of the auditors' ethical framework.
- 6.2 The Council noted that a briefing on the history of the Ethical Standards for Auditors would be given at the Council away day. The Council requested that the briefing cover the remit of the FRC, elements of the wider framework that fall outside that remit and the factors the FRC will have to consider in reviewing and influencing the revision of any of the ethical standards and the wider framework.
- 6.3 The Council noted that colleagues in the FRC Conduct Division would be consulted as part of the review and that public sector auditors and the public sector sub group would also be consulted.

6.4 The Council endorsed the revised project plan and the proposals set out in it. The Council particularly welcomed the emphasis on the need to address the concerns around the increasing public interest in the ethical conduct of auditors.

7. Client Assets – the development of a new assurance standard

7.1 Steven Leonard (SL) introduced the paper which asked the Council to provide initial direction as to which approach the FRC should adopt in developing a new assurance standards with respect to the provision of assurance to the FCA, regarding whether FCA regulated firms have arranged adequate protection for client money and custody assets for which they are responsible.

7.2 SL provided the Council with the background of the Client Asset regime and the on-going changes which are being made to the regime following the financial crisis in 2007/08. The Council noted that the FCA expects to issue new CASS rules in 2014 which would come in to force in July 2014.

7.3 The Council was asked to consider whether it continues to advise the FRC that Assurance Standards on Client Assets should be developed. Through discussion of the proposals the following observations and points were made:

- a) the rules around CASS are very complex and vary significantly depending on the asset structure and permissions given to those holding client assets. Whilst the knowledge of a statutory auditor would help you understand the basic elements of the rules, a statutory auditor would not be sufficiently knowledgeable to confirm compliance with those rules;
- b) the FRC has already issued high level guidance in this area, and that guidance has been well received, however, as it is guidance it is not enforceable and therefore is not useful from a conduct perspective, an area the Council noted that the Conduct and Professional Discipline teams at the FRC have identified as requiring a Standard;
- c) due to the complexity and variability of the rules it will be difficult to write detailed standards which apply in all situations. It might be preferable to develop high level standards which give more general and principled direction to the auditor and set out the approach an auditor should take. As compared with a standard that sought to address the approach to testing for compliance with each rule in detail, this may also limit the risk of failing to address an important matter of detail that subsequently was important in a particular case – the auditor would be responsible for addressing all important aspects of compliance with the rules
- d) Standards provide certainty and clarity for the auditor;
- e) the FCA has not yet commented on the proposed structure of a Standard.

7.4 In conclusion, the Council reconfirmed its advice that the FRC should develop a Standard on Client Assets. However, the Council noted that this would be subject to testing this against the guidance being prepared for approval by the Codes & Standards Committee setting out criteria for the development of FRC standards.

7.5 In reconfirming the need for a Standard the Council considered the two approaches that had been proposed by FRC staff as a basis for developing the Standard. With regard to the points raised above the Council supported the recommendation from the staff that approach “a” be adopted and the standard be developed on the basis set out below:

Three statements of Standards:

- 1) a statement for determining whether a client assets report is required,
- 2) a statement of standards for reasonable assurance engagements, and,
- 3) a statement of standards for limited assurance engagements:

The approach would incorporate the generic requirements for an assurance engagement set out in ISAE 3000 and the requirements for planning and performing a reasonable assurance engagement would be based on the overview of a reasonable assurance process as set out in Bulletin 2011/12. The Standards would be accompanied by guidance relating to the various CASS chapters.

7.6 It was confirmed that SL would begin development of the draft Standards as proposed (pending application of the guidance being developed by the Codes & Standards Committee on the development of Standards). MG confirmed that the guidance would also be reviewed alongside the development of the Standard.

8. IAASB’s Exposure Draft: Reporting on Audited Financial Statements

8.1 MG introduced the paper which set out the IAASB’s ED: *Reporting on Audited Financial statements*, an illustrative auditor’s report showing the changes needed to apply the proposals and a comparison of the proposed requirements for the description of a ‘key audit matter’ with the information the auditor is required to communicate to the audit committee under ISA (UK and Ireland) 260.

8.2 The Council noted that whilst there are a number of differences between the IAASB proposals and the existing corresponding ISAs (UK and Ireland) the FRC has secured considerable flexibility in the way the IAASB proposals can be adopted in the UK and the proposals are conceptually compatible.

8.3 MG highlighted the importance of ensuring the Council is content with the proposed definitions and the disclosure requirements in light of the possibility that should the EU adopt the ISAs, they would also have to be adopted by the UK and could potentially constrain what the Standards currently in issue sought to achieve.

8.4 MG led the Council through the report and invited the Council to discuss how the FRC should respond. The key points raised in discussion were as follows:

- The FRC should recommend that the IAASB provide more detailed minimum reporting requirements in relation to key audit matters under ISA 701. The proposals set out by the IAASB could encourage narrow reporting and be interpreted in a way that relevant information may be missed. The Council agreed that a method through which more detailed reporting could be

achieved would be to elevate the guidance in paragraph A31 to be additional requirements.

- The Council was comfortable with the definition of the term 'significant' and indicated a preference for the IAASB's term 'key audit matters' over the term 'critical audit matters' set out in the equivalent PCAOB proposals;
- The Council considered that the response to the IAASB should suggest amending the requirement in paragraph 46(g) such that the auditor does not need to cross refer to, or list, the key audit matters and, instead, may report by exception;
- The FRC should promote the inclusion of a discussion of how the auditor applied the concept of 'materiality' in planning the audit, as user respondents to the invitation to comment have identified that they find it to be a useful concept which allows users to engage with the audit;
- The requirement for the mandated paragraphs describing the responsibilities of the auditor should be omitted in instances where the paragraphs are included in a description on a web-site which is referred to in the auditor's report in order to avoid duplication and clutter; similarly, it should be permitted to describe the responsibilities of the auditor on the website;
- The Council noted that there was a question to be addressed in interpreting the requirements of the Companies Act 2006 before concluding whether it would be permitted to make the auditor's opinion on the financial statements the first paragraph of the auditor's report;
- The Council suggested that the FRC should promote that the auditor's report should have a logical flow;
- The Council also noted that should amendments be made to ISA 720 the section in the auditor's report relating to 'other information' could be longer than shown in the illustrative example.

8.5 The Council noted that a draft response would be prepared in light of the points raised for consideration by the Council at its November meeting. The Council noted that they would be able to review the draft in the context of the responses to the FRC's consultation paper which solicited input from stakeholders with respect to the IAASB proposals.

9. Horizon scanning

Implications of the current questioning of tax avoidance

9.1 The issue was introduced by MG who informed the Council that the issue was being discussed across the FRC and that the paper presented set out the implications from an audit perspective. With regard to the broader FRC perspective, Melanie McLaren informed the Council that the Financial Reporting Lab has been asked to consider whether improved tax disclosures could be introduced in to financial reports and that the Codes & Standards Committee were also going to consider the issue at a future meeting.

9.2 Referring to the paper SL informed the Council that the staff believe there to be a risk around the expectation gap which has arisen regarding the responsibility of auditors to make sure that tax provisions and tax assets/liabilities are both fairly stated and reflect the substance rather than the form of their clients' transactions.

9.3 The Council noted the UK 'ISA plus' guidance for auditors on their responsibilities in relation to considering an audited entity's compliance with tax legislation at Paragraph A8-1 of ISA (UK & Ireland) 250 – Section A. The Council discussed updating the wording of that guidance to clarify the intention behind it but agreed that it would be appropriate to feed in to the wider FRC project and take comment from the Audit Quality Review Team before taking any action.

9.4 The Council noted that feedback on the wider project would be reported to the Council at a later stage.

10. Any other business

10.1 None.

11. Next Meeting

11.1 There will be a Council away day on 15 October starting at 9.00am.