

Audit and Assurance Council

Minutes of a meeting of the Audit and Assurance Council of the FRC
held on 14 September 2015 at the FRC Office, 8th Floor, 125 London Wall, EC2Y 5AS

PRESENT:

Ray King (Chair)
Jane Fuller
Kari Hale
Sue Harris
Robert Hingley
Scott Knight
Maggie McGhee
Conall O'Halloran

IN ATTENDANCE:

Kate Acott	Project Director, Audit Policy
Mark Babington	Deputy Director of Audit Policy
Keith Billing	Project Director, Audit Policy
Susan Currie	Conduct Project Director (Minute 7 only)
Francesca Carter	Council Secretary
James Ferris	Project Director, Audit Policy
Marek Grabowski	Director of Audit Policy
Melanie McLaren	Executive Director, Codes & Standards
Dan Rouse	Case Manager, Professional Discipline Team (Minutes 5 & 6 only)

Apologies and introduction

Apologies were noted from Allister Wilson (Council Member), Lee Piller (FCA Observer), Pat Sucher (PRA Observer) and Eileen Townsend (IAASA Observer).

1. Minutes of the previous meeting

- 1.1 The minutes of the meetings held on 6 July 2015 were approved for publication.
- 1.2 The note of the Away Day held on 24 July was approved subject to the addition of reference to the Council's request that the FRC place increased focus on SMEs.
- 1.3 The Council noted the status of the actions set out on the rolling action log.

2. Chairman's update

- 2.1 The Chairman placed on record his thanks to Allister Wilson for his contributions to the work of the Council. The Council noted that Stephen Oxley had been appointed to fill the vacancy arising from Allister's departure and that Stephen Oxley would take post on 1

October. The Council also noted that a recruitment exercise to fill the vacancy arising from Nick Land's departure was underway.

2.2 Melanie McLaren (MM) provided an update on the work of the FRC Board and the Codes & Standards Committee.

It was noted that on 1 July the Board had:

- Approved various amendments to Accounting Standards FRS 100 and FRS 101, and approved a new accounting FRS 105 applicable to micro-entities. This completes the transformation of the suite of UK GAAP Accounting Standards.
- Approved the direction of travel in respect of the development of a new Framework for Technical Actuarial Standards.
- Considered a paper on Corporate Governance in Banks and Financial Institutions and agreed that the FRC should monitor developments in this area.

It was noted that on 8 September the CSC had:

- Considered a paper on FRC strategy ahead of the Board's Strategy Away Day which would be held in September and concluded that the FRC should conclude projects that are in train and allow changes that are to be made / have recently been introduced to embed.
- Considered a paper on Stewardship agreed how monitoring of reporting against the Code should be carried out.
- Considered the final proposed revisions to the Ethical Standards and Auditing Standards, and, subject to the advice of the Council, supported the direction of travel.

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.

3.2 The Council noted an update on the work of the Financial Stability Board (FSB) and the outcome of a meeting between the FSB, IFIAR and the GPPC to discuss the IFIAR survey of GSIFI (Financial Institutions) audits. MG reported that there is a lack of agreement as to what is an acceptable outcome in terms of quality. He also noted that IFIAR member inspection timetables are such that there is often little time for audit firms to respond to the findings from one year in time for the following year's inspections. The Council supported the proposal that the executive, along with other stakeholders in the UK, encourage IFIAR to consider the findings of the survey and encourage IFIAR to move to a position where greater focus is placed on encouraging high quality outcomes.

3.3 The Council discussed a draft response to the ICAEW's discussion paper '*Reporting on regulatory capital: choices for assurance*' (the 'DP'). The Council noted that the proposals are in the very early stages of development and that Mark Babington (MB) had participated in the ICAEW's working group responsible for developing the DP. The Council discussed the proposals of the DP in some detail. Whilst the Council acknowledged this is an area that requires consideration, some concern was expressed that the consequences of the proposals have not been sufficiently thought through and it was queried whether firms would currently have the capability and resources to implement the proposals. The Council agreed that the response should identify the need, in developing detailed proposals, for clarity as to what the regulator wants to achieve. The Council also suggested that the

response should highlight that, should the regulator want assurance to be provided over the models and the outputs of those models, there would be a number of complex factors to consider. The Council also suggested that the response might highlight a need to have regard to the broader context and the implications of other initiatives such as Solvency II and Pillar III.

4. Feedback Statement on Consultation on Client Assets Assurance Standard

4.1 MB introduced a paper summarising responses to the FRC Consultation on the new Client Assets Assurance Standard, a draft feedback statement and a revised standard, reflecting the actions set out in the feedback statement. The Council noted that 17 written responses had been received to the consultation and that, despite a conscious effort to engage with smaller practices, only one of the 200 smaller practices that had been contacted by the FRC submitted a written response.

4.2 The Council discussed matters raised by respondents to the consultation and noted noting that the client Assets Assurance Standard steering group had been reconvened to assist with how best to respond to the concerns raised. The following observations were made:

The overall proportionality of the standard.

The Council noted that there appears to be a lack of understanding of the difference between a principles based Standard and detailed non-mandatory guidance. MB reported that the status of the contextual information did not always appear to have been fully understood. It had been developed to provide guidance on the implementation of the standard. Some respondents suggested that the Standard is too prescriptive and detailed, whereas other respondents requested the inclusion of additional, detailed guidance within the Standard itself. The Council supported the proposed approach to the contextual material, by: broadening it to support auditors in making professional judgements; clarifying its status (both within the Standard and via the feedback statement); and using cross-referencing between the Standard and the contextual material.

The Engagement Quality Control Review (EQCR).

The Council noted that some respondents had challenged the proposal to require EQCRs for all reasonable assurance client asset engagements, suggesting that engagement quality control reviews should only be required for high risk client asset audits. The Council supported the executive proposal that the Standard should retain the requirement on the basis that there has in the past been significant failures in respect of CASS.

Ethical Requirements

The Council noted that some respondents had challenged the proposal to mandate the use of Ethical Standards, suggesting that compliance with the Ethical Codes of the relevant accountants' professional bodies would be sufficient. The Council disagreed with the concerns raised and supported the executive proposal to retain the requirement to mandate the use of the FRC Ethical Standard (being proposed to replace the APB Ethical Standards for Auditors).

4.3 The Council discussed the timetable for issuing the Standard. Whilst the Council noted that CASS auditors will have been subject to the changes set out in the revised FCA Handbook earlier in 2015 and that further changes to the Ethical Standards, of which CASS auditors will also be subject too, will be introduced in 2016, the Council supported the issue of the Standard to be available for use on engagements from 1 January 2016.

4.4 The Council noted that the revised Standard has been shared with the FCA who are content with the changes proposed as a result of the consultation. The Council also noted that an impact assessment would be included within the feedback statement, when it and the Standard are published. The Council confirmed its advice to the Codes & Standards Committee supporting the publication of the feedback statement and Standard and that the FRC's existing guidance in the form of Bulletins 2011/2 and 2013/3 should then be withdrawn.

5. Implementation of Audit Regulation and Directive: FRC Consultation Document and Exposure Drafts – Ethical and Auditing Standards for UK and Ireland, UK Corporate Governance Code and Guidance on Audit Committees

5.1 MG introduced a paper setting out the FRC approach to implementation of the EU Audit Regulation and Directive (ARD), other reforms to the Ethical Standards arising from the wider FRC review and recent revisions made to International Standards on Auditing (ISAs) by the IAASB. The Council noted that implementation of the ARD will have an impact on many areas of the FRC's remit and that the FRC intends to issue a single consultation document addressing changes to the Ethical and Auditing standards, the Corporate Governance Code and associated Guidance for Audit Committees.

5.2 The Council was requested to provide its advice on the proposed revisions to the Auditing and Ethical Standards and on the parts of the consultation document and impact assessment that refer to the auditing and Ethical Standards. MG confirmed that the proposed revisions had been informed by the consultation completed earlier in the year and the advice given by the Council at its previous three meetings.

5.2 Kate Acott (KA) referred the Council to a document tabled at the meeting setting out at a high level the main changes that had been made to the auditing and quality control standards. The Council discussed the table and the changes set out in the table in detail. The following observations, suggestions and advice were given:

ISQC1 (UK and Ireland) 1 – Paragraph 58R-1

5.3 The Council discussed the proposal to require the retention of audit working papers for a period of ten years, for statutory audits of public interest entities (PIEs), and for seven years for any other statutory audits of financial statements. The Council noted that the retention periods proposed are more stringent than the requirements of the ARD (five years from date of creation of the document) and extend beyond the statute of limitation period in the UK of six years. Whilst the Council acknowledged that some respondents to the earlier consultation had suggested the retention periods should be as proposed, the Council did not consider this to be sufficient justification to extend the retention period beyond the requirements of the ARD and the limitation period. Accordingly the Council advised that the retention period should be limited to six years and the retention period apply from the date the auditor report is signed.

ISA (UK and Ireland) 210 – Paragraphs A15.1 and A36.1

5.4 The Council supported the proposed additional application material to assist auditors in dealing with their responsibilities arising from implementation of the Accounting Directive:

- The auditor of an entity subject to the small companies regime to conclude whether the financial statements give a true and fair view and, for the auditor to carefully consider whether additional disclosures will be necessary in the financial

statements when compliance with an accounting standard is insufficient to give a true and fair view.

- The auditor of an entity that has prepared its financial statements in accordance with the micro-entities regime to give an opinion on whether the financial statements of that entity are deemed to give a true and fair view.

ISA (UK and Ireland) 250B – The Auditor’s right and duty to report to regulators in the financial sector

5.5 The Council noted that the ARD introduces three new requirements on reporting to competent authorities responsible for the oversight of PIEs and discussed the integration of these requirements in to the standard. Through discussion it was noted that changing the definition of a regulated entity within ISA (UK and Ireland) 250B in the manner suggested to include all regulated entities would bring in to the scope of the standard not only ‘EU listed’ PIEs (financial services entities, whether PIEs or otherwise under the ARD, were already included in the definition and scope of the standard) but also many other non-listed entities that are regulated (for example Charities or Utilities). Whilst the Council considered the suggestion to broaden the scope of the standard in this way to all entities that are regulated, rather than simply to financial service institutions and ‘EU Listed’ PIEs, the Council concluded that it would not be appropriate to do so at this stage. Accordingly the Council advised that, in order to address the requirements of the ARD the widening of the scope should be restricted to PIEs and that the definition be revised to state that the requirements of ISA 250B are applicable to entities in the financial services sector and any other entities that are PIEs under the EU definition.

5.6 The Council also advised that a question should be included in the consultation document to ask whether the requirements in ISA 250B should also be extended to other listed entities.

ISA (UK & Ireland) 570 – Going Concern

5.7 The Council supported the proposal to:

- introduce a requirement at paragraph 22-1 to encourage the auditor to consider whether a Key Audit Matter (KAM) relating to going concern exists that should be communicated in the auditor report, and; should be reported
- introduce a requirement at paragraph 22-2(c) to require the auditor to report by exception on whether the management’s use of the going concern basis of accounting in the preparation of the entity’s financial statements is not appropriate, or, management has not disclosed in the entity’s financial statements any identified material uncertainties.

The Council noted that, although this was not a requirement of the ARD, the proposal would not be burdensome to auditors as they are required to perform the underlying work already by the auditing standards and the proposals would bring together the requirements of ISA 701 – Key Audit Matters and the new requirements of ISA 570 – Going Concern, by encouraging the auditor to think carefully about the reporting of going concern matters, including ‘near misses’.

ISA (UK and Ireland) 700 – Forming an opinion and reporting on financial statements

5.8 The Council supported the proposal to insert paragraph 30R(1) requiring that for statutory audits of financial statement of PIEs, and for audits of complete sets of general purpose financial statement for entities that are required, and those that chose voluntarily to report on how they have applied the UK Corporate Governance Code, the auditor shall

communicate in the auditors reporting in accordance with ISA (UK and Ireland) 701. The Council noted that this requirement extends the scope of entities who are required to apply ISA 701 from all listed entities to also include PIEs and those entities who are required to or voluntarily apply the UK Corporate Governance Code (and are not already within scope as a listed entity).

ISA (UK and Ireland) 701 – Communicating KAM in the independent auditor’s report

5.9 The Council noted that the requirements to communicate other planning and scoping matters has been widened to include all audits where the auditor is required to or voluntarily apply ISA 701. This has the effect of extending the extant requirements which currently only apply to Code Companies to PIEs and all other listed entities (ie AIM companies). The Council highlighted that, whilst the proposed requirements will require increased effort for PIEs who were not previously required to undertake extended auditor reporting, the requirements are primarily established by the ARD which is not optional. Accordingly the Council supported the proposed amendments to 701.

ISA (UK and Ireland) 720 – Auditor’s responsibility for Other Information

5.10 The Council supported the proposal to define the umbrella term ‘statutory other information’, to include for example in the UK at least the Strategic Report, the Director’s Report and a separate Corporate Governance Statement.

5.11 The Council noted that, as requested at a previous meeting, its advice to insert a requirement for the auditor to obtain an understanding of the other information reporting framework and for the auditor to apply that understanding in fulfilling its responsibilities under ISA (UK&I) 720, has been inserted at paragraphs 12D-1 and 14D-1. KA confirmed that these requirements do not extend to all documents issued by the entity for stakeholders.

5.12 The Council noted that paragraphs 22D-1 and 22D-2 have been taken directly from the UK Companies Act requirements enacting the requirements of the Accounting Directive (and subsequently the ARD).

Concluding remarks and advice

5.13 Subject to the advice given, the Council confirmed its advice to the FRC Board that the Board should approve:

- a) The sections of the consultation document covering the Auditing Standards:
- b) The revised Auditing Standards
- c) The sections of the Impact Assessment covering the Auditing Standards.

6. Ethical Standards – final proposed revisions

6.1 Keith Billing (KB) referred the Council to a document summarising significant changes that had been made to the revised Ethical Standard since the July Council meeting. The Council discussed the changes in detail; the following observations were made and advice was given.

Incorporating the Ethical Standard for Reporting Accountants (ESRA)

6.2 The Council supported the proposal to withdraw the ESRA and incorporate the requirements of the ESRA in to the revised Ethical Standard on the basis that there is

significant overlap between the ESRA and the Ethical Standard and, one of the objectives of widening the scope of the Ethical Standards had been to include other public interest assurance engagements, including investment circular reporting arrangements, to enable withdrawal of the ESRA. The Council noted that, in order to enable withdrawal of the ESRA, supporting guidance from the ESRA has been introduced to the revised Ethical Standard and the introduction to the revised Ethical Standard identifies (as did the ESRA) that for investment circular reporting engagements, the requirements of the revised Ethical Standard applies only to those persons with actual knowledge of the engagement.

Section 1.

- 6.3 The Council noted that the introduction has been significantly amended to include new material explaining the background to the Ethical Standard and how it supports third party trust and confidence. The Council also noted that to improve clarity and assist auditors in understanding their responsibilities in the context not only of audits but also of other public interest assurance engagements, some of the definitions have been amended and new definitions have been added. MG highlighted that the introduction of new definitions has enabled the length of the revised standard to be reduced significantly by removing the need to repeat long phrases.
- 6.4 The Council supported the opening three introductory paragraphs subject to:
- The insertion of the words “or prospective stake” into introductory paragraph 2 to clarify that users interest in an entity can also be because they propose to invest in it. The Council noted, and supported, the removal of the term ‘principal agent dilemma’ from the text.
 - The redrafting of the second sentence of introductory paragraph 3 to simplify and reduce the length of the sentence.
- 6.5 The Council:
- Supported the proposed amendment to the definition of independence to explain that independence would be compromised if it is probable (more likely than not) that an objective, reasonable and informed third party would conclude that the threats, arising from any conditions or relationships that exist would impair integrity or objectivity to such an extent that it would be inappropriate for the firm to accept or continue to perform the audit or any other public interest assurance engagement unless the threats were eliminated or further reduced, or more effective safeguards were implemented.
 - Supported the proposed clarification to the definition of a listed entity to the effect that the definition does not include entities with quoted or listed shares, stock or debt that are in substance not freely transferrable or cannot be traded freely.
 - Supported the proposed new definitions for ‘entity relevant to the engagement’; ‘subject matter information’, ‘subject matter’ and ‘person in a position to influence the conduct or outcome of the engagement’.
 - Advised that, in the case of an investment circular reporting engagement, the simpler definition of a ‘person in a position to influence the conduct or outcome of the engagement’ should be adopted subject to the addition of words to clarify that to be in a position to influence the person must have actual knowledge of the engagement.
- 6.6 The Council discussed supporting provision 2.4, addressing the scope for group engagements noting that the draft presented differs from the advice given by the Council

in July as it maintains the current position with respect to network firms not involved in the audit and third party firms involved in the audit complying with the IESBA Code rather than the relevant FRC Ethical Standard. On the basis that the current position is proportionate, could not be considered as 'gold plating' and continues to allow network firms to be held to account, the Council agreed with the proposal that independence should, for network firms involved in the audit, be assessed by reference to the FRC Ethical Standard and, for third party firms involved in the audit and network firms not involved in the audit, should continue to be assessed by reference to the IESBA Code.

Section 2 – Financial, business, employment and personal relationships

6.7 The Council noted and supported the amendments that had been made to section 2 in order to enhance clarity.

Section 3 – Long association with an entity

6.8 The Council agreed with the amendments made to section 3 to maintain the current requirements for rotation of engagement partners, engagement quality reviewers and other key partners. The Council noted that the amendments go beyond the requirements of the EU Audit Regulation for PIEs, and advised that it is an appropriate position to adopt subject to consultation.

Section 4 - Fees, remuneration and evaluation policies, litigation and gifts and hospitality.

6.9 The Council noted that other than amendments to reflect the incorporation of the ESRA this section had not been substantially amended from the previous draft.

Section 5 – Non-audit services and additional services

6.10 The Council discussed the proposal for providing reliefs to other (predominantly AIM) listed entities with a market capitalisation of £100 million or less. Whilst noting that the £100 million cap is aligned with the criteria adopted by the FRC's Conduct Division, the Council suggested there is a need to explain this rationale in the consultation document and ask whether respondents consider this to be the most suitable measure. The Council also advised that:

- There is a need to be specific on how the measurement applies (for example, whether there is a snapshot assessment of when £100 million is exceeded) and that
- Consideration should be given to establishing a requirement that once a company exceeds the £100 million threshold, it cannot access the reliefs again, even if its market capitalisation falls below £100 million in future periods.

6.11 The Council noted that the revised Ethical Standard had been updated not to extend the scope of services prohibited under the EU Audit Regulation to other listed entities (that are not 'EU Listed' PIEs), in light of government policy against unnecessarily increasing regulatory burdens. The Council supported the update and supported the inclusion of the condition of 'clearly inconsequential' with reference to the derogation of non-audit services.

6.12 The Council noted that the current more stringent FRC requirements that apply to listed entities have been retained in the revised Ethical Standard, subject to the proposed relief for smaller listed companies. The Council also noted that it would be necessary to specify the size limit for the relief and how it would be calculated in light of the advice set out at paragraph 6.10. The Council also suggested that the consultation paper should include an

acknowledgement that respondents to the initial consultation had requested relief and that this was considered to be proportionate. The Council also noted that the consultation paper will flag that these requirements are more stringent in some regards than the EU requirements.

Issues raised by the FRC's Professional Discipline and Audit Quality Review Team (AQRT)

6.13 The Council discussed a request from the Monitoring Sub-Committee to address differences in view about the nature of the uncertainty referred to in ES 5, paragraph 95 *Tax services provided on a contingent fee basis* and to clarify that it includes uncertainty in the application of tax law not merely uncertainty as to what the law itself is intended to mean. The Council agreed that this was the appropriate interpretation and considered proposed amendments to the paragraph and supporting guidance to provide the clarification requested. However, the Council concluded that, in order to improve clarity, support the objective of confidence in audit and avoid a situation whereby the interests of an auditor may be, or be perceived to be, compromised, all tax services provided on a contingent fee basis should be prohibited. Accordingly, the Council advised that the Standard should be amended to reflect this prohibition, and that a specific question on the prohibition should be included in the consultation document and the impact assessment be updated.

6.14 The Council also noted that some questions had been raised in relation to the provision of non-audit services to connected parties in the context of the audit of investment funds but that it was too early, based on the information available, to determine whether amendments might be needed to the Ethical Standard to address this. The Council also noted that the FRC would continue to monitor this issue and could seek to influence the debate at the international level with IESBA. The Council also noted some concerns identified by the AQRT about the interpretation of the term materiality by some practitioners in the different contexts in which it is used in the Ethical Standards. The Council concluded that it is also too early to consider whether amendments may be required to the draft Ethical Standard, to clarify this.

Concluding remarks and advice

6.15 Subject to the advice given and final review by the Steering Group, the Council confirmed its advice to the FRC Board that the Board should approve:

- a) The sections of the consultation document covering the Ethical Standards;
- b) The revised Ethical Standards
- c) The sections of the Impact Assessment covering the Ethical Standards.

7. ACC Chairs Quality Survey

7.1 Mark Babington (MB) introduced a paper that set out the findings of the ACC Chairs Quality Survey. The Council noted that the survey had been conducted by YouGov on behalf of the FRC and that although the response rate had improved from the previous year there had been some changes in the companies that had responded.

7.2 The Council discussed the findings and was pleased to note that Audit Committee Chairs consider that the quality of audit is high and appears to be improving. The Council suggested that it would be helpful for the FRC, and its AQR function, to consider in more

detail what Audit Committee Chairs consider to be high quality, and what information Audit Committee Chairs look for to inform their judgement of quality. The Council noted that the FRC is seeking to develop a 'score card' approach to developing an overall assessment of audit quality from various inputs, such as this survey, AQR reports and others, in order to allow the FRC to achieve a holistic view as to whether audit quality is improving.

- 7.3 The Council noted that the FRC has sent a summary of the findings to all firms who took part and that the summary sets out where each individual firm sits in relation to the median. The Council suggested that moving forward it might also be helpful to let firms know where they sit in relation to the top and bottom scores.

8. Any Other Business

- 8.1 The issue of interpretation relating to Ethical Standard ES5.95 was considered under agenda item 6.

- 8.2 There was no other business.

9. Next Meeting

- 9.1 The Council noted that the next formal meeting of the Audit & Assurance Council would be held on 14 October 2015.