

Minute of the formal business discussion of the Audit Assurance Away Day on 23rd July 2014 held at the Hilton Tower Bridge, 5 More Place, London, SE1 2BY

PRESENT:

Nick Land (Chair)
Sue Harris
John Hughes
Ray King
Maggie McGhee
Scott Knight
Allister Wilson

IN ATTENDANCE:

Keith Billing	Project Director
Francesca Chittenden	Council Secretary
Marek Grabowski	Director of Audit Policy
Josephine Jackson	Technical Advisor to the Director of Audit Policy
Steven Leonard	Project Director
Lina Nalubega	Intern, FRC
Dan Rouse	Case Manager, Professional Discipline Team
Rebecca Smart	Intern, FRC
Pat Sucher	PRA Observer
Marian Williams	Codes & Standards Director

Apologies

Apologies were noted from Conall O'Halloran (Council member), Melanie McLaren (Executive Director, Codes & Standards), Eileen Townsend (IAASA Observer) and Lee Pillar (FCA Observer).

The Chairman welcomed Maggie McGhee to her first Council meeting.

1. Ethical Standards framework review

- 1.1 KB introduced a paper summarising a review of issues specific to the Ethical Standards for Auditors (ES) 3, *Long association with the audit engagement*, and 4, *Fees, remuneration and evaluation policies, litigation, gifts and hospitality*, as part of the wider project to review the ethical framework. The Council were invited to discuss and provide advice in relation to the course of action that should be taken in response to those issues.

Ethical Standard 3 – Long association with the audit engagement

- 1.2 The Council noted a comparison of ES3 to the forthcoming EU Audit Regulation. Through discussion the following observations were made and advice was given:
- It is unnecessary for FRC guidance to be produced as to how [audit] firms will establish ‘an appropriate gradual rotation mechanism with regard to the most senior personnel involved’, the Council considered the direction provided in the Regulation to be sufficient.
 - The Council agreed that where requirements of the EU Audit Directive and Regulation are less stringent than the requirements of ES3, the more stringent requirements of ES3 should be retained, unless a strong argument for relaxing the requirements of ES3 is subsequently identified. It was noted that, in the event that the FRC does consider the requirements of ES3 should be relaxed, a consultation process would be necessary.
 - KB reported that the term ‘key audit partner’ as set out in the EU Regulation covers partners with ‘primary responsibility’ (in essence the audit engagement partners), whereas, in the ESs, the term excludes audit engagement partners, who are considered separately. The Council advised that the definition in the ESs should be revised to conform to the definition set out in EU Regulation if practical to do so, given that the latter term will be established in Law, and suggested that the Executive consider the impact of such a change in the ESs.
- 1.3 The Council discussed in detail whether the partner rotation requirements of ES3 should be simplified so that they are similar for all AEPs, EQCRs and KAPs and set at a maximum of five years on the engagement, with no return for five years and no involvement with the entity during that “off” period. Whilst it was noted that there are arguments against mandatory rotation, including issues with continuity, the Council concluded that it is simpler to have the same requirements for all and that there is limited justification for distinguishing between AEPs, EQCRs and KAPs.

Ethical Standards 4 – Fees, remuneration and evaluation policies, litigation, gifts and hospitality

- 1.4 The Council noted a summary of the general provisions of ES4 and issues that had been identified in relation to the standard. Through discussion, the following observations were made and advice was given:
- The remuneration and evaluation policies set out in ES4 should be broadened to include a requirement for the objectives and performance evaluation and remuneration of those involved in the audit to be driven primarily by audit quality considerations.
 - The requirement in relation to ‘threatened and actual litigation’ should apply to all partners in the firm and any member of the engagement team (members of the engagement team, internal experts and specialists, those involved in oversight or quality control of the audit and other person in a position to influence the audit).
 - The requirements in relation to gifts and hospitality offered or provided to audit clients should be treated in the same way as gifts and hospitality accepted from audit clients is treated.

- The FRC should maintain the requirements set out in ES4 with respect to the limits on the proportion of fees that can be earned from a single audited entity even though the requirements of the EU Audit Regulation are less stringent. It was noted that this is a Member State option and should also be discussed with BIS.
 - The Council noted that the restrictions of the EU Directive with respect to gifts and hospitality are more stringent than the restrictions set out in ES4. The Council advised that, given the EU Directive requirements will become law, ES4 should be conformed with the position set out in the Directive. The Council highlighted the importance of communicating that the change to more stringent requirements would be to reflect the change in the law.
- 1.5 The Council noted that the FRC is working with BIS on its consultation which is due to be issued in the autumn and that the Council would have the opportunity to comment on FRC input to the development of that BIS consultation.

2 Proposed changes to the International Standards on Auditing addressing disclosures in the audit of financial statements – developing the FRC response letter

- 2.1 Josephine Jackson (JJ) introduced a paper summarising the risk-based approach taken by the IAASB in relation to auditing disclosures. JJ reported that the IAASB began work on the audit of disclosures in an audit of financial statements in 2010 and that a long and thoughtful journey had been undertaken by the IAASB in developing the proposals set out. The Council noted that, whilst the decision taken by the IAASB to enhance application material rather than introduce a new standard or new requirements, is likely to disappoint some stakeholders the Executive support the decision as it considers that the introduction of a new standard may exacerbate concerns or repetition within the ISAs.
- 2.2 The Council considered matters the Executive proposed to include in the FRC response to the IAASB. Through discussion the following observations and advice was given:
- The IAASB should be encouraged to undertake outreach to national standard setters and firms about their intentions in implementing the proposed amendments.
 - The IAASB should be encouraged to dedicate resource in 2014-15 to developing guidance, which will have the appropriate level of authority and will clarify the objectives for given disclosures, in relation to risk assessment processes and forward looking assessments.
 - The FRC should express regret that the IAASB did not decide to propose a new requirement in relation to a preliminary determination of materiality for non-quantitative disclosures in ISA 320; the Council considered that the insertion of the requirement as a footnote to ISA 315 is illogical.
 - The Council agreed that the proposed changes to the assertions will help appropriately integrate the work on disclosures with the audit work on the underlying amounts, thereby promoting an earlier and more effective audit of discourses.
 - The IAASB should be encouraged to provide additional enhancements in relation to ISA 700 to promote the effective auditing of disclosures as part of a financial statement audit.

- The IAASB should be encouraged to emphasise the importance of disclosures.

2.3 The Council noted that a draft response, incorporating the views expressed, would be presented to the Council for consideration in September.

3 Any other business

3.1 There was no other business.