

Audit and Assurance Council

Minutes of a meeting of the Audit and Assurance Council of the FRC
held on 10 March 2014 at Aldwych House, 71-91 Aldwych, London WC2B 4HN

PRESENT:

Nick Land (Chair)
Russell Frith
Sue Harris
John Hughes
Ray King
Scott Knight
Paul Lee
Allister Wilson

IN ATTENDANCE:

Keith Billing	Project Director
Francesca Chittenden	Council Secretary
Marek Grabowski	Audit Policy Director
Jon Hooper	Project Director
Steven Leonard	Project Director
Melanie McLaren	Executive Director
David Matthews	KPMG (Minute 10 only)
Aidan Lambe	CAI Observer
Lee Pillar	FCA Observer
Eileen Townsend	IAASA Observer

Apologies and introduction

Apologies were noted from Robert Talbut (Council Member) and Pat Sucher (PRA Observer).

1. Minutes of the previous meeting and rolling actions

- 1.1 The minutes of the Audit & Assurance Council meeting of 22 January 2014 were approved as an accurate record of the meeting.
- 1.2 Marek Grabowski (MG) provided an update on the action at minute ref 4.11 and confirmed that the FRC staff had discussed the FRC's concerns in relation to the proposed ICAEW guidance for the performance of assurance work on benchmarks and indices with the FCA. MG reported that, although the FCA had acknowledged the concerns, the FCA had indicated that it may adopt similar wording to that set out in the ICAEW guidance as a short term solution and that this had been discussed with a number of the larger audit firms, including, the big four. The Council noted that the

FCA had confirmed this would not be the long term solution and that the FRC would continue to communicate its concerns to the FCA.

- 1.3 The Council noted that all other actions were either complete or addressed on the agenda.

Reports

2. Chairman's Update

- 2.1 The Chairman informed the Council Members that there was nothing to report that was not already covered on the agenda.

3. Report of the Director of Audit Policy

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

IAASB meeting 17-21 March

- 3.2 The Council noted the agenda for the IAASB March meeting and that similar papers would also be considered by the IAASB's Consultative Advisory group (CAG) on 10 & 11 March. MG informed the Council that progress was being made in relation to developing the auditor reporting project following the close of the Auditor Reporting consultation.

- 3.3 MG summarised the direction of travel that would be considered by the IAASB and CAG in relation to:

- i) ISA 700 Revised – The auditor's report
- ii) ISA 720 – Key audit matters and the auditor's responsibilities relating to other information.
- iii) ISA 570 – Going concern.

MG noted that whilst he considered the UK auditor reporting model to be reasonably well protected there remained a risk that there may be some inconsistencies, for example in relation to:

- requirements around what the auditor must report; the Council noted that the IAASB proposals for what the auditor must report are more limited than in the UK, and;
- the positioning of the standardised description of the auditors responsibilities.

- 3.4 The Council noted that despite calls for increased reporting by auditors in relation to going concern the IAASB was considering backing away from some of its previous proposals to address those demands, and the Council suggested that the IAASB should be encouraged to reconsider this position.

- 3.5 Melanie McLaren (MM) provided an update on the implementation of the Sharman recommendations in relation to 'going concern'. MM informed the Council that the FRC was continuing to try to find an appropriate way to meet investor demands for an explicit statement about the 'viability' of the company over the foreseeable future, whilst acknowledging directors' concerns that such a statement may be difficult to

make without significant caveats that could undermine its value. The FRC was exploring a possible approach requiring directors to give a statement based on their reasonable expectation that the company could continue in operation and meet its liabilities as they fall due over a period, relevant to the nature of the business, selected by the directors. This could be accompanied by a statement indicating the time period over which the statement was made and why the directors considered it appropriate. The Council noted that it was expected that a revised UK Corporate Governance Code consultation, which would incorporate the proposals on going concern, would be issued in April with an implementation date in October. The Council also noted that the FRC intends to review and clarify the accounting requirements for identifying 'going concern' material uncertainties.

Public Sector Advisory Group meeting (PSAG)

- 3.6 The Council noted that the PSAG had met on 3 March and had discussed in detail the concerns of the NAO with regards to the application of the Ethical Standards in the public sector and, in particular, the prohibition on seconding staff to long term and / or management positions in audit clients. The Council noted that whilst no consensus or solution had been reached at the meeting, some clarity on the arguments presented by the NAO had been achieved. The Council noted that the issue would be addressed in more detail at the April Council meeting as part of the review of Ethical Standard 2.

Other matters

- 3.7 The Council noted that the Executive had assessed against the FRC's Principles for developing Codes, Standards and Guidance whether or not the FRC should develop a standard in relation to the performance of assurance work on benchmarks and indices. The Council noted that the conclusion of the assessment was that should a standard be required, the FRC could support the development of that standard. However, it had been concluded that it would not be appropriate for the FRC to undertake the development of such a standard without being asked to do so by the FCA. The Council supported this approach.

Auditor ethics

- 3.8 MG informed the Council that the FRC had been asked to consider the ethical issues for audit firms wanting, or being invited, to tender for audits where a former partner is on the board. MG informed the Council that it has been suggested that the position is not clear-cut in the existing ethical standards.
- 3.9 The Council acknowledged the issue and noted that with the rules in relation to auditor independence and the introduction of auditor tendering requirements, the scenario would become more common and could potentially have a negative effect on market competition and choice. The Council discussed whether the existing 'threats and safeguards' approach is strong enough to sufficiently address the concern or whether there is a need for a specific rule. The Council highlighted a number of factors which would need to be considered before any conclusion could be drawn, including consideration of: the public perception; the requirements imposed by the market; and the potential effect any prohibition may have on competition. The Council noted that should a decision be taken to introduce a specific rule there could

be difficulty in reaching a view on the period for a prohibition that would gain the support of both the audit industry and the public. The Council noted that there would be an opportunity to consider the issue in more detail at subsequent Council meetings through discussion of the wider ethical standards review. The Council also noted that there would be an opportunity to review of the term 'chain of command'.

4. Horizon scanning discussion

- 4.1 MG introduced a brief paper which set out the following issues for the Council to consider as areas potentially requiring consideration by the FRC.
 - a. Zombie Companies – in the context of possible future interest rate rises.
 - b. Implications of the establishment of an independent body for banking standards.
- 4.2 The Council acknowledged the potential implications that a rise in future interest rates may have on zombie companies but highlighted that the implications would have wider implications for the economy than simply affecting Zombie Companies. The Council referred to the proposals for implementing the Sharman recommendations which would require disclosures around business model and risk and suggested that this might address this issue to some extent. Accordingly, the Council suggested that the FRC wait until the Sharman recommendations have been implemented and, at that stage, consider whether or not the existing guidance for auditors, in conjunction with the revisions to the UK Corporate governance Code, is fit for purpose.
- 4.3 The Council noted that the FRC Board had considered the proposal put forward by Sir Richard Lambert for the establishment of an independent body for banking standards and that the FRC would be responding. MG invited the Council to submit comments to assist the development of the response by email.

5. Activities since last meeting

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

Key Projects

6. Improving confidence in the value of audit

- 6.1 The Council noted that the FRC Board had discussed the objectives and governance of the project at its meeting on 5 March. MM informed the Council that the Board had agreed, in light of changes in EU legislation, the Competition Commission Report and FRC, IAASB and PCAOB initiatives, to narrow the scope of the project to focus on the development of a sound and meaningful implementation of the changes in the short term; and, in the medium term, to seek to identify and address a limited number of potential gaps not addressed through those recently introduced changes. In the longer term, the FRC would consider research and thought leadership which would look at the impact of standards on audit quality, judgement and innovation and would be used to influence the IAASB's agenda. The more focused scope was supported by the Council.
- 6.2 The Council discussed the importance of ensuring the communication that will announce the project does not suggest, or be perceived to suggest, that the FRC

considers current audit practice to be 'broken' or the key cause of events related to the financial crisis. The Council suggested that in the communication:

- Reference should be made to the multiple stakeholders of audit and the collective responsibilities of those stakeholders;
- There should be a clear recognition that it is a journey and progress has been made;
- There should be details of what outcomes from the project could be expected and when;
- There should be reference to the Corporate Governance Code consultation and Sharman recommendations;
- Consideration should be given to whether banks and other financial institutions should be specifically mentioned in the communication;
- Careful consideration should be given to the publication of the YouGov research and ensure that it is clear that YouGov found a broad range of views, and where negative views were expressed, those views weren't specifically related to a lack of confidence in banks and financial institutions. The Council noted that the YouGov research would also be published so that it can be used as a benchmark for future comparisons.

6.3 The Council noted that the communication was due to go to the FRC Board for approval in April and requested the opportunity to comment on the revised draft communication before submission to the Board.

Standards and Guidance

7. Bulletin: Recent developments in Company Law, the Listing Rules and Auditing Standards that affect UK auditor's reports

7.1 Steven Leonard (SL) introduced a paper which set out a Bulletin entitled 'Bulletin 4 - Recent developments in Company Law, The Listing Rules and Auditing Standards that affect UK auditor's reports', for approval. The Council noted that the Bulletin would be an interim measure pending finalisation of the IAASB's ISA 720 and would provide brief guidance on:

- Reporting on the Strategic Report
- Implications of the option to provide a stand-alone Strategic Report
- Reporting on the Directors' Remuneration Report
- Changes in Listing Rules with respect to director's remuneration
- Recent changes in ISA (UK and Ireland) 700.

7.2 The Council agreed that guidance as set out in paragraph 43 of the draft Bulletin, which recommends that the auditor should provide the particulars of directors remuneration that have been audited within the auditor's report when the extent of the Directors' Remuneration Report that has been audited is not clearly described should be retained. The Council also agreed that the guidance set out in the draft Bulletin in relation to prima facie inconsistencies between the disclosures in the financial statements and in the Directors Remuneration Report should be retained.

7.3 The Council approved the draft Bulletin for recommendation to the Codes & Standards Committee (CSC) and also agreed to advise the CSC to withdraw Bulletin 2008/3 'The

Auditor's Statement on the Summary Financial statement in the United Kingdom' on the basis that it has become obsolete.

8. Standards: The case for developing Client Asset Assurance Standards

- 8.1 SL introduced the paper which set out the findings of an assessment testing the case for the development of Client Asset Assurance Standards against the FRC's principles for the development of Codes, Standards and Guidance. The Council noted that the assessment indicated that there is a clearly defined issue relevant to the FRCs mission and responsibilities and that the development of standards would be the most appropriate way to address the issue. Accordingly, the Council agreed based on the assessment to advise the Codes & Standards Committee that the proposed Standards be developed. The key factor in the Council's assessment is that a strong client assets regime is both in the public interest and would underpin the effectiveness of the FRC's enforcement and disciplinary activities.

Influencing

9. IAASB Future Strategy 2015-19

- 9.1 The Council discussed the proposed response to the IAASB's proposed work strategy for 2015-19 and proposed work program or 2015-16.
- 9.2 The Council noted that the response reflected the advice given by the Council at the January meeting but, on the basis that the IAASB is an international auditing and assurance standard setter, the response does not include a subsequent recommendation that the IAASB should commit to:
- provide leadership in reforming financial statements to better meet the requirements of the principal users; or,
 - investigate whether serving the interests of all users of accounts is compatible with transparency.
- 9.3 The Council also noted that the response did not address the need for a review of the IAASB's funding mechanism as it would not be appropriate to address such matters in the response to a consultation on the work strategy and plan, however, the FRC should be advised to further consider whether more radical ways to enhance the IAASB's resources would be needed to enable it to address more of the issues that it has identified.
- 9.4 The Council approved the draft response for submission to the IAASB.

Research

10. PRG Audit Quality Questionnaire

- 10.1 David Matthews (DM) introduced a questionnaire which had been developed by the Professional Reputation Group (PRG) to assess audit quality and assist in the promotion of audit quality. DM informed the Council that the PRG was considering enlisting a third party organisation to co-ordinate the publication of the questionnaire and that the intended publication date would be mid-year. The Council noted that the PRG does intend to publish the results of the questionnaire, and, depending on the

success of the questionnaire, the PRG intends to reissue the questionnaire on an annual basis.

10.2 The Council welcomed the approach to keep the questionnaire short and on one page but made the following suggestions for the PRG to consider before finalising the questionnaire:

- Whether to ask respondents to indicate how easy the user found it to form a view on the questions asked.
- Whether the PRG should ask respondents who provide a score lower than 5 to comment on why they gave that score.
- Whether the PRG should include a question on whether materiality reported by auditors reflected stakeholder expectations.
- Whether the PRG should include a question on views of the extended auditor report and how well the auditor has responded to the extended auditor report requirements.
- Whether or not the questionnaire should be designed in a way that allows the results to be comparable to the results of the research questionnaire developed by the Center for Audit Quality in the US.
- Whether or not it would increase the usefulness of the results if they were to be published by aggregate / sector.

10.3 The Council noted the questionnaire and considered the objective of the questionnaire to be consistent with the objectives of the FRC.

11. Any other business

11.1 None.

12. Next Meeting

12.1 The next meeting of the Audit & Assurance Council will be held on Friday 11 April 2014.