

## Audit and Assurance Council

Minutes of a meeting of the Audit and Assurance Council of the FRC  
held on 12 September 2014 at the FRC Office, 8<sup>th</sup> Floor, 125 London Wall, EC2Y 5AS

### PRESENT:

Nick Land (Chair)  
Jane Fuller  
Sue Harris  
Robert Hingley  
John Hughes  
Ray King  
Scott Knight  
Maggie McGhee  
Conall O'Halloran  
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
Melanie McLaren	Executive Director
Lee Pillar	FCA Observer
Eileen Townsend	IAASA Observer
Pat Sucher	PRA Observer
Marian Williams	Director, Codes & Standards (agenda item 2 only)

### Apologies and introduction

The Chair welcomed Jane Fuller and Robert Hingley to their first Council meeting.

#### 1. Minutes of the previous meeting and rolling actions

- 1.1 The minutes of the Audit & Assurance Council meeting on 11 June 2014 and the formal Council discussion on 23 July were approved for publication.
- 1.2 The note of the Audit & Assurance Away Day was approved as an accurate record.
- 1.3 The Council noted the status of the actions listed on the action log.

## 2. Vision for Audit

2.1 Marek Grabowski (MG) invited the Council to provide further input in developing a vision for Audit. To set the context Melanie McLaren (MM) provided an update on the process and the interaction with the Department for Business, Innovation and Skills (BIS). The Council noted that:

- The EU Audit Directive and Regulation were issued in June and two years are given for implementation.
- The Directive and Regulation set out over 100 Member State options of varying significance, for some there is a clear direction as to which option to take, for others it is not so clear.
- The General Election falls in the two year implementation period and to meet the 2016 deadline BIS intend to have reached agreement with stakeholders as to what the high level principles that will underpin the narrative (vision) for audit will be, BIS then intend to finalise the detail alongside the election.
- The FRC is assisting BIS in developing the vision for audit, and the FRC will be holding joint public meetings with BIS on 22 September and 30 September to debate the principles that will underpin the vision.
- One of the principles the FRC will be promoting is the need to reach agreement with stakeholders as to what will put audit in the best light in terms of establishing trust and confidence in the profession.
- It is likely that BIS will delegate responsibility for implementing provisions of the Directive to the FRC through standard setting, subject to the agreement of stakeholders and ministers, as has been agreed in relation to the Accounting Directive.
- The FRC and BIS are exploring the possibility of positioning the FRC as the competent authority for oversight of the profession and with regard to the public interest, the FRC consider this would add clarity to the role of the FRC and demonstrate an independent and objective regime.

2.2 The Council noted a suite of documents that had been developed to assist the Council, and in turn the FRC, to establish a vision of where it expects 'UK Audit' to be in 3-5 years once the significant policy measures for reform already put in place or agreed have settled down and taken effect. MG reported that the documents had been informed by the discussion of the Council at its away day in July and would be used internally to support the development of a presentation to the FRC Board at its away day on 24 September and subsequently to consult stakeholders through the public meetings that will be held jointly with BIS and then in the BIS consultation. MG invited the Council to comment on the identified themes and supporting elements of the vision that had been identified and to suggest any other areas where changes in the vision, or further measures to deliver the vision would be necessary. Through discussion the following observations and suggestions were made:

- It was clarified that the document is a working document which sets out what the landscape of audit will be in 3-5 years time once the policy measures that have been put in place, or are due to be put in place have taken effect. The document should be used as a tool through which the FRC can determine whether those policy measures have done enough or whether there is more to be done.
- The Council suggested that there is a lack of clarity as to where the auditor sits in the governance structure and the suggestion that the auditor sits at the heart of governance

could be misunderstood. The Council suggested that this be revised so that auditors are positioned as an enabler of, and contributor to, effective governance.

- The Council highlighted the importance of not setting the expectation that in 3-5 years the role of the auditor will have fundamentally changed, it should be clear that the role is evolving and auditors are becoming more independent.
- It was noted that the proposed solution too many of the issues that have been identified is engagement with investors or a change in the behaviour of the investor. The Council noted that whilst the FRC can establish a dialogue with investors, direct engagement with investors to the extent required to address the issues is unlikely.
- The Council suggested that the public interest role of the auditor needs to be brought to the forefront, by positioning the public interest role at the heart of auditors work the auditor should be encouraged to think about investors in a broader sense. MG agreed that the customer (whether it be the public or investors) should always be at the heart of the role.
- The Council also highlighted the need to explore and clarify the expectations of the auditor from a public interest / societal perspective, it was suggested that once the expectations of the audit had been understood, they can be addressed. It was also suggested that it is not only the expectations of the auditor that clarity as to what the needs of society, and from the institutional investor, actually are, once the needs are identified the auditor can look to meet those needs.
- The Council importance of ensuring that the vision does not focus too narrowly on the role of auditors of entities that have external stakeholders and that there is insufficient focus on the audits of private and limited companies.
- The Council agreed that further exploration of the agency role of the auditor was necessary and that the role of the audit committee should be considered as part of this.
- The Council discussed the title of the document and agreed that 'vision for audit' is not appropriate given that it is more of a 'road map' for restoring trust in audit. MM reported that the FRC and BIS were considering alternative titles for the project and that a 'narrative for audit' was a possible choice.
- It was noted that the themes that have been identified are all matters under consideration by audit firms, and that the voice of those firms (and therefore the profession) and the role of those firms in changing the landscape should be considered.
- The Council agreed with the Chair that it would be helpful to identify the top ingredients of good, trusted audit and then consider how much emphasis needs to be placed on strengthening each of those 'ingredients'. It was suggested that accountability could be considered as one of the 'ingredients' of a good audit and that further steps to increase accountability, perhaps through greater transparency would be welcomed by investors.

2.3 MG thanked the Council for their comments and undertook to reflect on those comments in developing materials for presentation to the FRC Board and for presentation at joint public meetings. MG also invited members to join a small group discussion to progress the development of the materials on 18 September.

2.4 The Council suggested that it would be useful to have a document setting out the various Member State options and the proposed FRC position in relation to those options would be useful.

### **3. FRC Approach to Advice on Non Audit Services**

- 3.1 Keith Billing (KB) introduced a paper setting out a range of proposals for the Council to consider in relation to the potential prohibition of non-audit services (NAS) by auditors to public interest entities (PIEs). The Council noted that the restrictions set out in the finalised EU Audit Regulation with regard to the provision of NAS to PIEs are generally tougher than the existing requirements set out in the FRC Ethical Standards and whilst the Regulations do not establish a blanket outright ban on the provision of NAS to PIEs, a number of specific NAS, including the provision of certain tax and corporate finance services, are prohibited.
- 3.2 The Council discussed in detail the arguments for and against the establishment of a prohibition on providing NAS to PIEs, other than services specifically identified as allowed. Through discussion the following observations were made:
- It was noted that the new guidance for Audit Committees has resulted in a significant drop in the use of NAS; however, there are still a number of instances where obtaining NAS from the auditor is high. It was also noted that the Regulation proposes placing a limit on allowed NAS fees of 70% of average audit fees for the preceding three year period.
  - It was noted that the FCA use auditors for a range of work specific to its regulatory remit and that the FCA would be seeking to safeguard its ability to use auditors for NAS where it relates to matters of Law.
  - It was highlighted that a review of what would fall within the scope of NAS would be required should the proposed prohibition be established. The Council highlighted that it may be difficult to create one list of allowed NAS and that it may be necessary to establish a 'soft list' setting out the boundaries of what would fall within scope in addition to a 'hard list' and that the two lists would need to be monitored and reviewed on a regular basis.
  - The Council highlighted that there would be a need to review provisions and restraints already in place should the proposed prohibition be established, for example, the FRC would have to consider whether the restraints on tendering continue to be necessary.
  - The Council suggested that the proposed prohibition would be accepted by audit firms and welcomed by stakeholders.
  - The Council discussed whether the proposed prohibition would have a negative impact on PIEs; however, it was considered that fundamentally the situation would be the same as it is now, with the benefit of increased trust.
- 3.3 The Council concluded that the benefits of establishing the ban outweighed the disadvantages, accordingly, the Council agreed to advise the FRC that it should prohibit all provision of Non-Audit Services by auditors to Public interest Entities except for specified 'audit related services'. The Council noted that the prohibitions set out in the Regulation are only applicable to entities based inside of Europe and agreed that the FRC should aim to ensure that the prohibition it would establish would apply extraterritorially in a group audit.
- 3.4 The Council also agreed to advise the FRC:
- a. Not to take up the Member State option for derogations, where provision of the NAS are not material to the financial statements, (consistent with the approach of moving to only allowing certain specified NAS) and;

b. To extend the EU definition of 'public interest entities' to include entities that are categorised as major audits for the purpose of the scope of AQR inspections.

3.5 The Council noted that the Codes & Standards Committee had considered the recommendations earlier in the week and were content with the direction of travel and that advice of the Council would be reported to the October meeting of the FRC Board. The Council also noted that the FRC intends to issue a high level consultation on the proposals set out in November alongside the BIS consultation.

#### **4. Accounting Directive Implementation – Audit Considerations**

4.1 KB introduced a paper that summarised the audit implications arising from the Accounting Directive. The Council noted that the Directive is of primary interest to the FRC's Accounting and Reporting Policy Team (ARPT) who are developing a response, but that there are a small number of audit implications. The Council was asked to note the approach BIS has taken in its consultation paper and consider the proposed FRC position to take in providing feedback to BIS.

4.2 The Council noted that the Directive sets mandatory thresholds for micro, small, medium and large companies and that BIS are proposing not to increase the audit exemption thresholds for small undertakings as part of the implementation of the Directive. KB clarified that this will result in a situation whereby the balance sheet and turnover thresholds for the small undertakings will differ for the purposes of the small companies regime for accounting purposes and the small companies audit exemption. The Council supported the proposal that the FRC should not object to the conditions for exemption from audit being amended.

4.3 The Council agreed that the FRC should support the proposal to early adopt the provision in Article 28 of the Audit Directive to clarify that the opinion and statement are only required to be based on the work undertaken in the course of the audit.

4.4 The Council agreed that the FRC should not support the approach taken by BIS to reduce disclosure by medium sized companies of non-audit fees paid to the auditor. The Council noted that the disclosure of non-audit fees addresses the concern about the effect of non-audit fees on the independence of auditors and should be safeguarded.

4.5 The Council supported the proposed FRC approach:

- a. that BIS should be encouraged to avoid the use of different definitions of PIEs for accounting and audit purpose and;
- b. that BIS should be encouraged to extend the EU definition of 'public interest entities' to include entities that are categorised as major audits for the purpose of the scope of AQR inspection.

#### **5. FRC Response letter – Proposed changes to the International Standards on Auditing addressing Disclosures in the Audit of Financial Statements**

5.1 Josephine Jackson (JJ) introduced the FRC's draft response letter to the IAASB's proposed changes to the International Standards on Auditing addressing the audit of financial statement disclosures. The Council noted that the response had been updated to reflect

comments made at the July meeting of the Council and responses to the FRCs invitation to comment.

5.2 JJ summarised the main points that had been raised in response to the FRCs invitation to comment and the FRC response to those points. The Council noted that:

- Although all of the respondents had expressed disappointment that the IAASB had not done more than add guidance and application material to the existing suite of standards the Executive had taken the view that the approach taken by the IAASB is appropriate. Accordingly, the response supports the proposal; but, to reflect the concern raised the response recommends that the IAASB undertake outreach to support the implementation.
- Although some respondents had suggested that the proposed changes would lead to an increase in costs to auditing firms without obvious benefit the Executive does not share this concern and takes the view that the potential benefits are substantial and are relatively minor compared to the introduction of a new standard. The Council also noted that the Executive consider there to be real issues to address in relation to disclosures and that changes in auditor behaviour through enhancement of auditor standards could make a significant positive contribution to addressing those issues. The Council noted that the Executive had highlighted the issue in the response and was content with the approach.
- The response welcomes the introduction of the Staff Publication and the IAASBs collaborative activities.
- Although the proposed changes to the assertions were not welcomed by all respondents the Executive suggest that the thorough assessment undertaken by the IAASB in developing the proposal was of sufficient quality to inform the proposal, accordingly, the response supports the proposed changes.
- That the FRC Accounting and Reporting Policy Team had suggested that reference to stewardship should be included in the response and that the letter would be updated to incorporate this suggestion.

5.3 The Council noted that the PRA had suggested that the IAASB should consider elevating certain application material proposed for ISA 700 (Forming an Opinion on the Financial Statements) as requirements. The Council agreed with the suggestion, however, the Council expressed general caution in unnecessarily increasing the requirements and suggested the Executive bear this consideration in mind.

5.4 Subject to the above the Council agreed its advice that the response be issued.

## **6 Chairman's Update**

6.2 The Chairman reported that the FRC is undertaking an effectiveness review of the Board, and the Board's Committees and Councils. The Council noted that a survey would be circulated to Council Members shortly and that following completion of the survey the Chair would contact members' individually to discuss any issues that had been raised.

6.3 The Chairman reminded Council that two conference calls had been scheduled for Council input, one on 18 September to consider the 'vision for audit' and one on 25 September to consider proposals for Reporting by Audit Committees on AQR findings.

## **7 Report of the director of Audit Policy**

- 7.1 Marek Grabowski (MG) introduced his report, which was provided an update on matters related to the work of the IAASB, matters related to UK & Ireland Auditing and Assurance Standards and Guidance and general FRC matters. The report was taken as read.
- 7.2 The Council noted a table setting out a 'snapshot' of the items on the agenda for the IAASB meeting to be held on 15-19 September. The Council welcomed the table and agreed that it is a useful tool for keeping up to date with the work of the IAASB and issues relevant to the Council.
- 7.3 The Council welcomed the forward agenda and agreed that it would be useful for the forward agenda to be circulated to the Council as part of the agenda pack for every Council meeting.

## **8 Activities since last meeting**

- 8.1 The Council noted the list of activities since the last formal meeting on 11 June 2014.

## **9 Any other business**

- 9.1 There was no other business.

## **10 Next Meeting**

- 10.1 The next formal meeting of the Audit & Assurance Council will be held on Wednesday 22 October 2014.