

ACRA Audit Committee Seminar

Paul George

Executive Director Conduct Division

Financial Reporting Council

12 January 2016



Financial Reporting Council

Presentation outline

- About the FRC
- Background
- Package of changes
- Experience to date
- Audit Committee Reporting

Overview of the FRC

- FRC Mission
 - *to promote high quality corporate governance and reporting to foster investment*
- Supporting strategies of trustworthy information and trustworthy behaviour



Overview of the FRC

FRC Scope

- Corporate governance and stewardship code
- Setting accounting, auditing and actuarial standards
- Overseeing the accountancy and actuarial professions
- Monitoring corporate reporting and audit quality
- Operating an independent disciplinary scheme

The need for change

- Financial crisis highlighted
 - The need for high quality audit
 - Relevance of audit
 - Lack of transparency
 - Investors expectation that auditors, boards and regulators work together more effectively to identify, assess, mitigate and report on risk
- Based on our audit inspections a need to raise quality generally

Package of changes

- Measures to enhance the management of risk and related corporate reporting
 - Setting out the business model
 - Explaining how risk is managed
 - Fair balanced and understandable
 - Greater transparency of the work of the Audit Committee
- Measures to enhance the relevance of audit
 - Extended scope of reporting across the annual report
 - Extended auditor reports
- Measures to enhance auditor objectivity and independence
 - More stringent ethical standards
 - Retendering

Overview of changes

Audit Committee Reporting

- Significant issues they considered and how they were addressed
- How they assessed the effectiveness of the external auditor
- Their approach to ensuring auditor independence

Changes designed to increase transparency and focus of both the auditor and audit committee on audit quality

Overview of changes (2)

Auditor Reporting

- A description of the assessed risks of material misstatement
- Their impact on audit strategy, resources and audit effort
- How the auditor applied the concept of materiality
- A summary of the audit scope and how it responded to the assessed risks and application of materiality



Overview of changes (3)

Auditor Reporting (continued)

- Changes designed to enable more informed dialogue and public challenge about whether audits meet the legitimate needs of users
- Auditors were encouraged to be entity specific and joined up with audit committees



Overview of changes (4)

Auditor Reporting (continued)

- Encouraged individual audit partners to be innovative
- No specific examples within the standard
- Materiality discussion must specify the threshold used for the financial statements as a whole
- Effective for financial years from October 2012 onwards



Overview of changes (5)

We met with some resistance

- Too much responsibility on audit committees
- Calls to delay until IAASB standard issued
- Insufficient guidance
- IAASB highly supportive



Experience to date

- Benefitted from early adoption by Vodafone
- Benefitted from good dialogue and interaction between all stakeholders
- Overwhelmingly positive
- Auditors surpassed expectations
- Differences between and within firms emerged
- Investors now read audit reports

Reporting of risks

- Survey found between 1 and 10 risks reported
- Average number higher for FTSE 100 companies
- Some included standard risk of material misstatement due to fraud and error, or management override of controls
- Most risks by industry sector in Oil & Gas and Telecoms
- Granular, specific risks (61% of sample) versus generic risks (39% of sample)

Investor feedback

- Generally positive as provides a basis for dialogue
- Citi Bank research September 2015
 - Year 2 an improvement
 - A need for greater clarity on materiality
 - Focus on specific rather than generic risks
 - More 'Rolls-Royce' style reports wanted
 - Disclosure of adjusted and unadjusted audit differences
 - Further innovation sought



Audit committee reporting experience

- Looking for alignment between the report on the work of the audit committee and the auditor's report
- Average correlation – auditor's reported on 74% of the risks flagged by audit committees
- FRC concluded 90% of auditor's reports in our sample aligned well with the report of the audit committee
- Greatest challenge for Audit Committees was how they considered the effectiveness of the audit
- Reporting of audit inspection findings

