Exposure Draft

Financial Reporting Council

November 2013

Revised Auditing Standards (extracts)

ISA (UK and Ireland) 260

ISA (UK and Ireland) 570

ISA (UK and Ireland) 700

The FRC is responsible for promoting high quality corporate governance and reporting to foster investment. We set the UK Corporate Governance and Stewardship Codes as well as UK standards for accounting, auditing and actuarial work. We represent UK interests in international standard-setting. We also monitor and take action to promote the quality of corporate reporting and auditing. We operate independent disciplinary arrangements for accountants and actuaries; and oversee the regulatory activities of the accountancy and actuarial professional bodies.

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November 2013

Revised Auditing Standards (extracts)

ISA (UK and Ireland) 260

ISA (UK and Ireland) 570

Revised ISA (UK and Ireland) 700

The draft revised extracts of ISAs (UK and Ireland) 260, 570 and 700 set out in this document are issued for consultation in connection with the November 2013 Consultation Paper: *Risk Management, Internal Control and the Going Concern Basis of Accounting* – see Section 3: Implementing the recommendations of the Sharman Panel on going concern (pages 7 and 8). The extracts are shown in mark-up identifying changes from the drafts included in the January 2013 Consultation Paper *Implementing the recommendation of the Sharman Panel*: additions are shown in underline text and deletions in ~~strikethrough~~.

EXTRACT FROM INTERNATIONAL STANDARD ON AUDITING (UK AND IRELAND) 260 (REVISED [MONTH] 2013)

COMMUNICATION WITH THOSE CHARGED WITH GOVERNANCE

(Effective for audits of financial statements for periods commencing on or after [Insert date])

Contents

International Standard on Auditing (UK and Ireland) (ISA (UK and Ireland)) 260, "Communication with Those Charged with Governance" should be read in conjunction with ISA (UK and Ireland) 200, "Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with International Standards on Auditing (UK and Ireland)."

Planned Scope and Timing of the Audit

15. The auditor shall communicate with those charged with governance an overview of the planned scope and timing of the audit. (Ref: Para. A11-A15)

Significant Findings from the Audit

16. The auditor shall communicate with those charged with governance: (Ref: Para. A16)

    (a) The auditor's views about significant qualitative aspects of the entity's accounting practices, including accounting policies, accounting estimates and financial statement disclosures. When applicable, the auditor shall explain to those charged with governance why the auditor considers a significant accounting practice, that is acceptable under the applicable financial reporting framework, not to be most appropriate to the particular circumstances of the entity; (Ref: Para. A17)

    (b) Significant difficulties, if any, encountered during the audit; (Ref: Para. A18)

    (c) Unless all of those charged with governance are involved in managing the entity:

        (i) Significant matters, if any, arising from the audit that were discussed, or subject to correspondence with management; and (Ref: Para. A19)

        (ii) Written representations the auditor is requesting; and

    (d) Other matters, if any, arising from the audit that, in the auditor's professional judgment, are significant to the oversight of the financial reporting process. (Ref: Para. A20)

Entities that Report on Application of the UK Corporate Governance Code

16-1. In the case of entities that are required[1c], and those that choose voluntarily, to report on how they have applied the UK Corporate Governance Code, or to explain why they have not, the auditor shall communicate to the audit committee the information that the auditor believes will be relevant to: (Ref: Para. A20-1)

- The board (in the context of fulfilling its responsibilities under Code provisions C.1.1, ~~C.1.3 and~~ C.2.1 and C.2.2) and, where applicable, the audit committee (in the context of fulfilling its responsibilities under Code provision C.3.4); and

- The audit committee (in the context of fulfilling its responsibilities under Code provision C.3.2) in order to understand the rationale and the supporting evidence the auditor has relied on when making significant

[1c] In the UK, these include companies with a Premium listing of equity shares regardless of whether they are incorporated in the UK or elsewhere. In Ireland, these include Irish incorporated companies with a primary or secondary listing of equity shares on the Irish Stock Exchange.

professional judgments in the course of the audit and in reaching an opinion on the financial statements.

If not already covered by communications under paragraphs 15 and 16 above and paragraph 23 of ISA (UK and Ireland) 570, "Going Concern", this information shall include the auditor's views: (Ref: Para. A20-2 – A20-7)

(a) About business risks relevant to financial reporting objectives, the application of materiality and the implications of their judgments in relation to these for the overall audit strategy, the audit plan and the evaluation of misstatements identified;

(b) On the significant accounting policies (both individually and in aggregate);

(c) On management's valuations of the entity's material assets and liabilities and the related disclosures provided by management;

(d) Without expressing an opinion on the effectiveness of the entity's system of internal control as a whole, and based solely on the audit procedures performed in the audit of the financial statements, about:

  (i) The effectiveness of the entity's system of internal control relevant to risks that may affect financial reporting; and

  (ii) Other risks arising from the entity's business model and the effectiveness of related internal controls to the extent, if any, the auditor has obtained an understanding of these matters;

(e) About the robustness of the directors' ~~going concern~~ assessment of the principal risks facing the company, including those that would threaten its solvency and liquidity and its outcome, including the related disclosures in the annual report and accounts; and

(f) On any other matters identified in the course of the audit that the auditor believes will be relevant to the board or the audit committee in the context of fulfilling their responsibilities referred to above.

The auditor shall include with this communication sufficient explanation to enable the audit committee to understand the context within which the auditor's views relating to the matters in paragraph (d) above are expressed, including the extent to which the auditor has developed an understanding of these matters in the course of the audit and, if not already communicated to the audit committee, that the audit included consideration of internal control relevant to the preparation of the financial statements only in order to design audit procedures that are appropriate in the circumstances, and not for the purpose of expressing an opinion on the effectiveness of internal control.

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Application and Other Explanatory Material

Other Significant Matters Relevant to the Financial Reporting Process (Ref: Para. 16(d))

A20. Other significant matters arising from the audit that are directly relevant to those charged with governance in overseeing the financial reporting process may include such matters as material misstatements of fact or material inconsistencies in information accompanying the audited financial statements that have been corrected.

Entities that Report on Application of the UK Corporate Governance Code (Ref: Para. 16-1)

A20-1. Under the UK Corporate Governance Code, the responsibilities of the directors under Code provision C.1.1 include making a statement that they consider the annual report and accounts taken as a whole is fair, balanced and understandable and provides the information necessary for shareholders to assess the entity's performance, business model and strategy. The responsibilities of the audit committee under Code provision C.3.4 include, where requested by the board, providing advice in relation to that statement[7a]. The responsibilities of the board under Code provision C.2.1 include ~~conducting, at least annually, a review of the effectiveness of~~ carrying out a robust assessment of the principal risks facing the company, including those that would threaten its solvency and liquidity; and its responsibilities under Code provision C.2.2 include monitoring the company's risk management and internal control and at least annually, carrying out a review of their effectiveness and reporting to shareholders that they have done so[7b] ~~.systems~~[7b]. The responsibilities of the audit committee under Code provision C.3.2 include: monitoring the integrity of the financial statements of the entity and any formal announcements relating to the entity's financial performance, reviewing significant financial reporting judgments contained in them; reviewing the entity's internal financial controls and, unless expressly addressed by a separate board risk committee composed of independent directors or by the board itself, the entity's internal control and risk management systems[7c]; assessing the effectiveness of the audit process; and

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[7a] Responsibility for ensuring the annual report is fair, balanced and understandable rests with the board as a whole. The board may ask the audit committee to provide advice on this.

[7b] In addition, FC~~S~~A Rule DTR 7.2.5 R requires companies to describe the main features of the internal control and risk management systems in relation to the financial reporting process.

[7c] The FRC issues guidance for directors on their responsibilities ~~with regard to internal control~~ under the UK Corporate Governance Code ~~(generally referred to as 'The Turnbull guidance')~~ . with regard to risk management, internal control and the going concern basis of accounting. The guidance indicates that it is for the board to decide what arrangements to put in place to enable it to exercise its responsibilities. ~~takes responsibility for the disclosures on internal control and that the role of board committees in the review~~

reporting to the board on how it has discharged its responsibilities. The supporting Guidance on Audit Committees indicates that the report to the board should include, inter alia[7d]:

- The significant issues that the audit committee considered in relation to the financial statements and how these issues were addressed; and
- The basis for its advice, where requested by the board, that the annual report and accounts taken as a whole is fair, balanced and understandable and provides the information necessary for shareholders to assess the entity's performance, business model and strategy.

A20-2. In fulfilling these responsibilities, the audit committee and the board will be assisted by an understanding of:

(a) Issues that involve significant judgment; and

(b) Other matters communicated to them by the auditor relevant to those responsibilities.

This will include an understanding of the rationale and supporting evidence for the auditor's significant professional judgments made in the course of the audit and in reaching the opinion on the financial statements, and of other matters communicated to the audit committee by the auditor in accordance with the requirements of paragraph 16-1, including relevant information communicated in accordance with the requirements of paragraphs 15 and 16. The auditor's communications include information regarding separate components of a group where relevant. In fulfilling its responsibilities set out above, the board will be assisted by the report from the audit committee on how the audit committee has discharged its responsibilities.

A20-3. The audit procedures that the auditor designs as part of the audit of the financial statements are not designed for the purpose of expressing an opinion on the effectiveness of the entity's system of internal control as a whole and accordingly the auditor does not express such an opinion on the basis of those procedures. However, communication of the auditor's views about the effectiveness of elements of the entity's system of internal control, based on the audit procedures performed in the audit of the financial statements, may help the audit committee and the board fulfil their respective responsibilities with respect to the entity's internal control and risk management systems.

~~process is for the board to decide~~. The guidance also indicates the nature of the information the board may include in its narrative statement about these matters. ~~of how the company has applied Code Principle C.2.1~~.

[7d] The Guidance on Audit Committees also sets out other matters the audit committee should consider in relation to the annual audit cycle, including in relation to the audit plan and the auditor's findings.

A20-4. The auditor's understanding of the entity includes the entity's objectives and strategies and those related business risks that may result in risks of material misstatement, obtained in compliance with ISA (UK and Ireland) 315[7e], and may also include other risks arising from the entity's business model that are relevant to an understanding of that model and the entity's strategy. To the extent that the auditor has obtained an understanding of such risks and the effectiveness of the entity's system of internal control in addressing them, communicating its views on those matters may be helpful to the audit committee and the board in their evaluation of whether the annual report is fair, balanced and understandable and provides the information necessary for users to assess the entity's performance, business model and strategy. However, the auditor is not required to design and perform audit procedures expressly for the purpose of forming views about the effectiveness of the entity's internal control in addressing such risks. Accordingly, to the extent applicable, the auditor may communicate that they have not obtained an understanding of, and therefore are not able to express views about, such risks and related aspects of the entity's internal control.

A20-5. The auditor's communication of views about the effectiveness of the entity's internal control may include, or refer to, the communication of significant deficiencies in internal control, if any, that is required by ISA (UK and Ireland) 265. However, views about effectiveness can go beyond just identifying such deficiencies. For example they may include views about such matters as the entity's strategies for identifying and responding quickly to significant new financial or operational risks; the quality of the reports that the board receives to provide them with information about risks and the operation of internal control; or how the entity's systems compare in general terms with those of other relevant entities of which the auditor has knowledge, such as the impact on internal control effectiveness that may result from different approaches to maintaining an appropriate control environment. The auditor's communications include its views relating to separate components of a group where relevant.

A20-6. ~~Provision C.1.3 of the UK Corporate Governance Code requires that a statement is made by the directors that the business is a going concern, together with supporting assumptions or qualifications as necessary. An equivalent requirement is included in the Listing Rules of the UK Listing Authority and the Listing Rules of the Irish Stock Exchange, which also specify that the statement is prepared in accordance with "[Going Concern: Guidance for Directors of UK Companies 2012]" published by the FRC. This means that listed companies that are subject to those particular rules cannot opt out of making the disclosure under the 'comply or explain model' for reporting on compliance with the UK Corporate Governance Code.~~Code provision C.2.1 requires the board to carry out a robust assessment of the principal risks facing the company, including those that would threaten its solvency ~~and~~or liquidity. In the annual report, the directors should confirm that such an assessment has been carried out-, explain how the principal risks are being

[7e] ISA (UK and Ireland) 315, paragraph 11(d)

managed or mitigated, and indicate which, if any, are material uncertainties in relation to the company's ability to adopt the going concern basis of accounting. "~~[Going Concern: Guidance for Directors of UK Companies 2012]" is intended~~"Guidance to Directors on risk management, internal control and the going concern basis of accounting – [Month] 2014" includes guidance to assist directors in applying this part of the UK Corporate Governance Code *[Note: Consider reference to LR subject to the status of the LR]* ~~and the relevant requirements of the Listing Rules~~. ~~The~~ This guidance includes ~~states~~ that ~~the annual report~~:

- ~~Confirms that the directors believe that a robust assessment of going concern has been undertaken~~When reporting on the principal risks and uncertainties, the board should focus on those risks it considers to be the most important to the future development, performance or position of the entity. This should include, but not be limited to, significant risks to its solvency or liquidity; ~~and~~
- ~~Illustrates the effectiveness of the assessment process by commenting on or cross referring to information on the material risks to going concern which have been considered~~The report should indicate explicitly which, if any, of the principal risks and uncertainties in the Strategic Report are material uncertainties in relation to the company's ability to continue to adopt the going concern basis of accounting; and~~.~~
- The purpose of assessing whether there are material uncertainties is to forewarn of solvency or liquidity risks of such potential magnitude and a meaningful possibility of occurrence as to threaten the entity's ability to adopt the going concern basis of accounting and which, if disclosed, would affect the economic decisions of shareholders and users of the financial statements.

Where the audit committee assists the board in relation to the assessment, these disclosures may be cross-referred to in the section of the annual report that deals with the work of the audit committee[7f]~~.~~

~~Where the going concern assessment is undertaken by the audit committee, these disclosures may be given in the section of the annual report that deals with the work of the audit committee~~[7f].

[7f] Paragraph 5.3 of the FRC's "Guidance on Audit Committees - [September 2012]" indicates that the [audit] committee will need to exercise judgement in deciding which of the issues it considered in relation to the financial statements are significant [and should be included in the description of its work], but should include at least those matters that have informed the board's assessment of whether the company is a going concern. The committee should aim to describe the significant issues in a concise and understandable form. The statement need not repeat information disclosed elsewhere in the annual report and accounts, but could provide cross-references to that information."

A20-7.~~"[Guidance on Going Concern 2013 and the related Supplement for Banks]"~~ "Guidance to Directors on risk management, internal control and the going concern basis of accounting – [Month] 2014" and the related supplementary guidance for banks provides guidance to assist directors in making their assessment of principal risks and in determining whether the going concern basis of accounting is appropriate and whether there are material uncertainties that may cast significant doubt on the company's ability to continue to do so~~and its outcome~~, including the related disclosures in the annual report and accounts. The board of directors may ask the audit committee and/or the risk committee to assist with this assessment. The directors may also be assisted in making their assessment by an understanding of the auditor's views on the robustness of the directors' ~~going concern~~ assessment and its outcome, including the related disclosures in the annual report and accounts.

INTERNATIONAL STANDARD ON AUDITING (UK AND IRELAND) 570 (REVISED [MONTH] 2014)

GOING CONCERN

(Effective for audits of financial statements for periods ending on or after [Insert date])

CONTENTS

Paragraph

International Standard on Auditing (UK and Ireland) (ISA (UK and Ireland)) 570, "Going Concern" should be read in conjunction with ISA (UK and Ireland) 200, "Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with International Standards on Auditing (UK and Ireland)."

Audit Conclusions and Reporting

17. Based on the audit evidence obtained, the auditor shall conclude whether, in the auditor’s judgment, a material uncertainty exists related to events or conditions that, individually or collectively, may cast significant doubt on the entity’s ability to continue as a going concern. A material uncertainty exists when the magnitude of its potential impact and likelihood of occurrence is such that, in the auditor’s judgment, appropriate disclosure of the nature and implications of the uncertainty is necessary for: (Ref: Para. A19 – A19-2)

    (a) In the case of a fair presentation financial reporting framework, the fair presentation of the financial statements, or

    (b) In the case of a compliance framework, the financial statements not to be misleading.

17-1. If the period to which those charged with governance have paid particular attention in assessing going concern is less than one year from the date of approval of the financial statements, and those charged with governance have not disclosed that fact, the auditor shall do so within the auditor’s report[4b]. (Ref: Para A19-1)

17-2. In the case of entities that are required[4c], and those that choose voluntarily, to report on how they have applied the UK Corporate Governance Code, or to explain why they have not, the auditor shall read and consider in light of the knowledge the auditor has acquired during the audit, including that acquired in the evaluation of management’s[1a] assessment of the entity’s ability to continue as a going concern:

    (a) The director~~'~~s’ ~~going concern statement~~confirmation that they have carried out a robust assessment of the principal risks facing the company, including those that would threaten its solvency or liquidity; and

    (b) The disclosures,~~ in the section~~ in ~~of~~ the annual report that address how the principal risks facing the entity that would threaten its solvency or liquidity are being managed or mitigated and which, if any, are material uncertainties in relation to the company’s ability to continue to adopt the going concern basis of accounting.~~es the work of the audit committee, about the directors’ assessment of going concern.~~

    The auditor shall determine whether the auditor has anything material to add or to draw attention to in the auditor’s report on the financial statements in

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[4b] If the non-disclosure of the fact in the financial statements is a departure from the requirements of the applicable financial reporting framework, the auditor would give a qualified opinion (“except for”).

[4c] In the UK, these include companies with a Premium listing of equity shares regardless of whether they are incorporated in the UK or elsewhere. In Ireland, these include Irish incorporated companies with a primary or secondary listing of equity shares on the Irish Stock Exchange.

relation to these disclosures, and shall report in accordance with the requirements of ISA (IUK and Ireland) 700[4d].

17-3. Matters the auditor considers when determining whether there is anything to add or to emphasise in the auditor's report on the financial statements shall include, based on the knowledge the auditor has acquired during the audit, including that acquired in the evaluation of management's[1a] assessment of the entity's ability to continue as a going concern, whether:

- The auditor is aware of information that would indicate that the annual report and accounts taken as a whole are not fair balanced and understandable in relation to the ~~going concern status of the entity~~ principal risks facing the company that would threaten its solvency or liquidity; and
- Matters relating to ~~the going concern status of the entity~~ the robustness of the directors' assessment of the principal solvency and liquidity risks and its outcome, including the related disclosures in the annual report and accounts, that the auditor communicated to the audit committee[4e] and that are not appropriately addressed in the section of the annual report that describes the work of the audit committee.

[4d] ISA (UK and Ireland) 700, "The Auditor's Report on Financial Statements", paragraph 22C.

[4e] ISA (UK and Ireland) 260, "Communication with Those Charged with Governance", paragraph 16-1(e).

INTERNATIONAL STANDARD ON AUDITING (UK AND IRELAND) 700 (REVISED [MONTH] 2014)

THE AUDITOR'S REPORT ON FINANCIAL STATEMENTS

(Effective for audits of financial statements for periods commencing on or after Insert date)

CONTENTS

International Standard on Auditing (UK and Ireland) (ISA (UK and Ireland) 700, "The Auditor's Report on Financial Statements (Revised)" should be read in conjunction with ISA (UK and Ireland) 200, "Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with International Standards on Auditing (UK and Ireland)."

NOTE: The FRC has not adopted ISA 700 "Forming an Opinion and Reporting on Financial Statements". The FRC has instead issued ISA (UK and Ireland) 700 "The Auditor's Report on Financial Statements (Revised Insert Date)". The main effect of this is that the form of auditor's reports is not aligned with the format required by ISA 700 issued by the IAASB. However, ISA (UK and Ireland) 700 (Revised Insert Date) has been drafted such that compliance with it will not preclude the auditor from being able to assert compliance with the ISAs issued by the IAASB.

Statement on the Directors' ~~Going Concern~~ Assessment of the Principal Risks that would Threaten the Solvency or Liquidity of the Entity ~~Process~~

22C In the case of entities that are required[6], and those that choose voluntarily, to report on how they have applied the UK Corporate Governance Code or to explain why they have not, the auditor shall, having regard to the work performed in accordance with the requirement of paragraph 17-2 of ISA (UK and Ireland) 570, give a statement as to whether the auditor has anything material to add or to draw attention to in relation to (1) the directors' statement that ~~disclosures made by the directors about the going concern assessment and its outcome, including the related disclosures in the annual report and accounts~~they have carried out a robust assessment of the principal risks facing the company, including those that would threaten its solvency or liquidity, and (2) the disclosures in the annual report that address how those risks are being managed or mitigated and which, if any, are material uncertainties in relation to the company's ability to continue to adopt the going concern basis of accounting.

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