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Dear Ms Woods

Risk Management, Internal Control and the Going Concern Basis of Accounting

Grant Thornton UK LLP (Grant Thornton) welcomes the opportunity to comment on the Financial Reporting Council's (FRC) consultation 'Risk Management, Internal Control and the Going Concern Basis of Accounting' and the proposed revisions to International Auditing Standards.

We also welcome the new approach that the FRC has taken to the draft revised guidance compared to the earlier draft guidance issued in January 2013. We acknowledge the fact that the FRC has taken note of responses to the earlier consultation and as a result made significant changes in this latest draft guidance. Many of our own concerns that were raised in relation to the January 2013 consultation have been addressed which we see as a positive step. For example, we note that in the draft revised guidance the use of the term 'going concern' is limited to its accounting standards meaning rather than the two separate meanings that were used in the earlier document and which was a potential cause of confusion.

In principle, we believe that the proposals to integrate current guidance on going concern and risk management and internal control, as well as better linkage to the statutory requirement to explain the principal risks and uncertainties facing the business as part of the Strategic Report, is a sensible one. We agree that in, the context of reporting principal risks and uncertainties and going concern, limited revisions to the UK Corporate Governance Code in order to improve consistency are sensible.

However, it is unclear as to whether it is intended that the proposed guidance simply reflects the combination of existing guidance and requirements or whether a step change in the reporting of matters relating to risk management, internal control and going concern is expected. Clarity as to the purpose of the draft revised guidance and what would constitute a successful outcome in terms of its application would therefore be helpful at the outset. Is there an expectation that companies will 'do things differently', for example? Further, we believe that the guidance could be structured in a way that is more helpful to its key users, those being directors of companies. If the guidance is not clear, it is unlikely that an improved quality of output amongst companies will be achieved.

The findings of the 2013 Grant Thornton Corporate Governance Review (the Review) indicate that there is still room for improvement in the reporting of risks, internal control and risk management and its effectiveness. We refer to the findings of the Review in our detailed comments, but one of the key messages is that companies need to give more meaningful disclosures around risk management and control practices and the assessment of their effectiveness, rather than simply state that they exist and that they have carried out the requisite annual review.

We note that the intention is for the guidance to be separated into guidance appropriate for listed companies and that for other companies. Again this seems a sensible approach, and leaves other companies the option to follow the guidance for listed companies, if they choose to do so.

We also note that the Sharman Report recommended that the audit committee report should illustrate the robustness of the going concern assessment process and any limitations it may have had. We therefore assume that any consequential amendments to the FRC Guidance on Audit Committees will be addressed separately.

Grant Thornton supports the growth agenda and believes that the application of reason combined with instinct will allow dynamic businesses to unlock their potential for growth. We therefore fully support the production of guidance that will enable companies to release resources that can be used for growth and the contribution to economic prosperity through the creation of employment opportunities. In our response to the January 2013 consultation, we expressed concern that the proposals would hinder growth, in particular as a result of the potential increase in the number of reported material uncertainties having a negative impact on the public perception of companies in the UK. However, the change in the use of the term 'high level of confidence' and the removal of the term 'foreseeable future' from the going concern assessment period in the draft revised guidance has alleviated some of our concerns in this area. Further, we are pleased to see that the principles behind the revised draft guidance are more likely to support growth through the encouragement of more joined up disclosure and clarity in relation to key risks, the ways in which they are being managed and how they impact on going concern. Boards are therefore encouraged to explain to shareholders what the principal risks are and how they are being managed effectively and therefore give confidence to existing and potential investors.

We have included our detailed comments in Appendix A, but overall we support the direction that the FRC has taken in this latest draft revised guidance.

Our key points may be summarised as follows:

2009 Going Concern Guidance

In our response to the January 2013 consultation, we stated that we fully supported the recommendations of the Sharman Panel (Panel) and that there was a need to revisit the 2009 going concern guidance (2009 Guidance) issued by the FRC. Our view was that the 2009 Guidance was well received and has been widely used in the profession, to good effect. Consequently, we believed that any new guidance should adhere closely to the structure and content of the 2009 Guidance rather than rewrite it completely. We note that the draft revised guidance replaces the 2009 Guidance, but that some useful aspects of the 2009 Guidance have been lost.

For example, the purpose of the 2009 guidance was to provide "…a framework to assist directors, audit committees and finance teams in determining whether it is appropriate to adopt the going concern basis for preparing financial statements and in making balanced, proportionate and clear disclosures." In line with this objective, the 2009 Guidance therefore included examples of factors that directors might need to assess in order to reach a conclusion. Further, the guidance contained some useful examples of disclosures that might be appropriate in different circumstances. Appendix III to the guidance also included some useful questions that boards might wish to consider in determining the appropriateness of the going concern basis of accounting. Much of this useful guidance appears not to have been carried forward to the draft revised guidance. Whilst emphasis is placed on the identification and discussion of principal risks, the way in which they are managed through the internal control and risk management systems and a link from those risks that potentially have the greatest impact on liquidity and solvency and therefore going concern, the guidance does not appear to place much emphasis on the steps necessary to consider whether or not the going concern basis of accounting is appropriate, as was the case with the 2009 Guidance.

Going concern basis of accounting

As stated above the main focus of the draft revised Guidance appears to be on the identification and discussion of principal risks, the way in which they are managed through internal control and risk management systems and providing a link from those risks that potentially have the greatest impact on liquidity and solvency to the disclosures around going concern.

However, whether the company should prepare its accounts on a going concern basis is given little prominence and only discussed in any detail in Appendix C. It is therefore outside of the main guidance, which seems contrary to the need to better link the various strands of reporting around risks and going concern. This still therefore appears to represent a fundamental shift in focus from the 2009 Guidance, as noted in our response to the January 2013 consultation. We would therefore prefer to see the discussion of the going concern basis of accounting contained in the main body of the guidance so that its linkage to other related disclosures is evident.

UK Corporate Governance Code

In principle, we agree that the proposed changes to the UK Corporate Governance Code are sensible. For example, using terms that are consistent with other areas of reporting, and encouraging disclosure in this area is a positive and helpful change. However, where there are disclosures that the FRC believes are necessary for shareholders' understanding of the board's responsibility to maintain a sound risk management and internal control system, but where such disclosures in spite of existing guidance have not generally been well made, we would encourage further enhancement to the Code. As the FRC guidance is not mandatory, there will always be differences in the degree to which it is followed by companies. This has been seen with the FRC's Guidance on Audit Committees in relation to recommended disclosures regarding the external auditor, where application of the non-mandatory guidance gave variable results and the guidance has now been brought into the comply or explain scope of the 2012 UK Corporate Governance Code.

Structure of the draft revised guidance

We observe that the current structure of the draft revised guidance is difficult to navigate and could link better the various strands of reporting. Further, more use of bold headings to identify key components of the guidance and key principles, for example, would help users to focus on key areas as distinct from underlying guidance or explanation. Boxed presentation of principles, examples or extracts from statute/regulatory requirements (eg the Companies Act requirement in relation to the Strategic Report and the Listing Rules) would also be helpful. A similar presentation was used in the 2009 Guidance, which had a positive impact on its readability. As currently drafted, it is difficult to distinguish between principles and guidance which could therefore lead to key messages being lost. A glossary would also be helpful to clarify some of the new or less familiar terms used in the guidance.

International Standards on Auditing

Overall we sense that the objective of the FRC in developing the new requirements is to enhance the auditor's role to review and challenge the adequacy and accuracy of the information prepared by the directors, and to report accordingly. We support this objective. However, we do not agree that the proposed requirements in relation to the robustness of the directors' assessment of the principal risks facing the company meet the FRC's objective.

In summary:

- ISA 260 requires the auditor to communicate their "view" on the robustness of the directors' assessment of the principal risks facing the company, including those that would threaten its solvency and liquidity and related disclosures. This implies an opinion is required to be communicated, but there is no explicit requirement regarding an evaluation of the robustness of the directors' assessment by the auditor.
- ISA 570 requires the auditor to "read and consider" the information in light of their knowledge of the entity and evaluation of management's assessment of going concern. Yet, in our view an understanding of risks that would threaten an entity's solvency and liquidity forms part of the assessment of going concern.
- ISA 570 and ISA 700 require the auditor to determine if there is anything to add to the directors' disclosures. This introduces a new type of auditor reporting not currently permissible in the auditing standards.

We have set out in the Appendix our suggested amendments to the requirements.

Other consultations

Guidance for directors of banks

We note that a separate consultation has been issued in respect of guidance on solvency and liquidity risk management and the going concern basis of accounting for directors of banks. This guidance is of less direct relevance to us and we have therefore not responded to this consultation.

If you have any questions on our response, or wish us to amplify our comments, please contact Robert Carroll (tel: 020 7728 2210, email: robert.w.carroll@uk.gt.com) or Mary Starr (tel: 020 7728 2063, email: mary.m.starr@uk.gt.com).

Yours sincerely

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Question 1: In relation to the current guidance 'Internal Control: Guidance for Directors' the draft revised guidance seeks to address the reference to the board's other responsibilities for risk, as set out in paragraph 16 to the current guidance in more depth. Does the draft revised guidance achieve these objectives? Are there views on the structure of, and level of detail in, the draft revised guidance?

We agree that Section 2 is a useful summary of the range of responsibilities that a board might have in relation to risk. However, it would be useful to emphasise in this section that risks and the systems that are in place to control, manage or mitigate risks include those that are operational, compliance and financial in nature and those over which the board may or may not have control, ie risks are broad ranging.

As stated in our covering letter, regarding the structure of the draft revised guidance, we think that at present the document is difficult to navigate. This is in contrast to the long established guidance that it is intending to replace. In parts we believe that the key messages are obscured by unnecessary detail, whereas focus on the key principles combined with more practical examples would be more helpful to directors of companies who are likely to be the main users of the guidance.

Question 2: Sections 2 to 4 of the draft revised guidance address the board's responsibilities in relation to risk, the effective exercise of responsibilities in relation to risk, and the identification and assessment of principal risks. Sections 5 and 6 address the design and process for reviewing the risk management and internal control system which are largely unchanged from the current guidance. Do you agree or are more substantive changes to these sections required?

Section 3 looks at how the board's responsibilities in relation to risk might be exercised effectively. In principle, we agree that this section is useful. However, one might expect this section to be more closely linked to the preceding section in which board responsibilities are discussed. This is not the case and therefore at present sections 2 and 3 appear disjointed.

Section 4 appears to be addressing the identification, assessment *and* evaluation of principal risks, however the section heading only refers to 'identifying' and 'assessing'. Assessment and evaluation may be considered to be distinct processes. It would therefore be clearer if this section were sub divided into three separate processes – identification, assessment and evaluation. Whilst it is down to individual companies to identify the range of possible risks that are relevant to their business, some examples of less obvious risks could be useful here to illustrate the range of risks that could be relevant.

There is also an emphasis on solvency and liquidity risks. However, there may be other risks that would not ultimately have an impact on solvency or liquidity, in which case this could be clarified, particularly as the statutory disclosure requirement in relation to principal risks and uncertainties (as required by the Strategic Report) does not make this distinction.

In relation to sections 5 and 6, in principle we agree with the content of these sections, but as identified in our covering letter, better distinction between the key sources of guidance and 'other' would facilitate application by a user.

Given that the draft revised guidance is meant to address the going concern basis of accounting, specific reference to the going concern basis of accounting as part of the review process would ensure that there is better linkage. We note that at present a separate section dealing specifically with the assessment of the going concern basis of accounting is contained in Appendix C. However, in our view, consideration of the appropriateness of the going concern basis of accounting should be promoted to the main body of the guidance.

As noted in our covering letter, useful sections from the 2009 Guidance do not appear to have been carried forward and could usefully be used in a specific section that addresses the determination of the going concern basis of accounting, as distinct from the more general requirement to consider the principal risks that might affect liquidity and solvency.

Question 3. Section 7 proposes to amend the guidance to recommend that the board should explain what actions have been or are being taken to remedy any significant failings or weaknesses identified from the review of the effectiveness of the risk management and internal control systems. Are there views on this proposed change to the guidance?

We would encourage any measures taken by the FRC to enhance the quality of disclosure surrounding a company's risk management and internal control systems and the assessment of their effectiveness.

In our experience, companies have tended to simply state that in accordance with (existing) Code Provision C.2.1 they have conducted a review of the effectiveness of the company's risk management and internal control systems, without further explanation as to the outcome of such reviews. This has been the case, even though the 2005 internal control guidance recommended that companies go further and "confirm that any necessary actions have been or are being taken to remedy any significant failings or weaknesses identified from [the] review".

This lack of detailed disclosure is also reflected in the results of the 2013 Grant Thornton Corporate Governance Review of the annual reports of 298 of the UK's FTSE 350 companies.

The review findings show that only 27% of companies provide a 'good' explanation of the process undertaken by the board to review the effectiveness of the internal control system, and that whilst 87% of companies provided detail on their risk management systems, only half gave useful information about how the company manages and mitigates risks. In respect of the disclosure of control weaknesses, the results of the 2013 review show that there appears to be a reluctance for companies to disclose material or significant weaknesses – only four companies disclosed significant weaknesses, 113 stated that they had none, and of the remaining 181 companies, there was either no reference to control weaknesses or the statements given were uninformative.

However, it is difficult to predict whether the proposed amendment to the guidance will have the effect that the FRC is seeking. This is because the guidance is not mandatory. If the FRC considers that this disclosure is important for a shareholder's understanding of the board's responsibility to maintain a sound risk management and internal control system, then it might be better to expand the proposed new Code Provision C.2.2 to include this disclosure. If this disclosure is only contained within the FRC guidance, then there is likely to be variability amongst companies as to the nature and extent of that disclosure, or whether disclosure is given at all. A similar situation has arisen in relation to the FRC's Guidance on Audit Committees, where, prior to the publication of the 2012 UK Corporate Governance Code, recommended disclosure regarding external auditor appointment and tendering was not always evident, but which has now been brought into the comply or explain provisions of the Code.

Usefulness of Appendices

In our view the number of appendices should be kept to a minimum. At present, the five appendices contain almost as much information as the main report. Users of the guidance may therefore be confused as to whether the main guidance can be read in isolation or whether key information is contained within the appendices. We would therefore encourage the FRC to rethink whether any of the information contained in the Appendices is in fact key information which should be included in the main body of the guidance. Further, it would be helpful if useful information such as examples or the application of guidance to specific scenarios could form part of the main guidance but be highlighted by way of a boxed presentation, for example. We have noted specific observations on each appendix below.

Appendix A

Whilst it is useful to summarise the origins of the regulatory requirements underlying the draft revised guidance, consideration should be given as to whether this information might more usefully be placed within the main sections of the guidance, so that in the context of the guidance, the origin of the requirement is clear. A similar approach was followed in the 2009 Guidance where guidance appeared to be either noted in a table or in shaded boxes within the main body of the guidance. If the source of regulation is noted within the main body of the guidance, this might make the linkage between the various strands of guidance clearer to users.

Appendix B

We agree that it is useful to include guidance on how solvency and liquidity risks might be assessed and also how stress testing might operate. However, Appendix B includes key information that would be best highlighted in earlier sections of the guidance. In particular whist the terms solvency risk and liquidity risk are used in earlier sections of the draft revised guidance, the meaning of these terms is only given in Appendix B. As these terms are key in the context of the guidance, they ought to be given more prominence earlier on in the document. As suggested in our covering letter, a glossary would be useful.

Further, we note that Appendix B continues to refer to the term 'high level of confidence' which was used in the January 2013 consultation document. Appendix B states that '… the board needs to have a high level of confidence that solvency and liquidity risk can be managed effectively during at least the twelve month period from the date of approval of the financial statements, or else it is likely to have a going concern material uncertainty to disclose.' We still believe that the term 'high level of confidence' is not sufficiently understandable. We do, however, note the removal of the term 'foreseeable future' in the context of the consideration of material uncertainties, and clarity that the period of review is the period of at least 12 months from the date of approval of the accounts. We support this change. We also note from page 7 of the draft revised guidance that a high level of confidence is intended to indicate that there is likely to be a material uncertainty unless the directors are able to judge with a high level of confidence that they would have realistic options available to them for managing the identified risks in those circumstances. This gives some clarity to the meaning and would be useful if repeated in the guidance, however there still may be some difficulty and variation in interpretation.

We note that the Sharman Panel recommended the implementation of stress tests which both the 2013 draft guidance and the draft revised guidance incorporate. We support the Panel's recommendation. However, as stated in our original response, although likely to be of more concern to smaller entities not impacted by this draft revised guidance, this may be a new concept and hence require some more guidance in terms of how such an exercise would be completed.

Appendix C

One of the main objectives of the draft revised guidance (and as its title suggests) is to integrate the current guidance on going concern, the purpose of which is primarily to assist in determining whether the going concern basis for preparing financial statements is appropriate. It therefore seems unusual that this particular aspect of the guidance should be contained in an Appendix rather than in the main body of the guidance. We would therefore prefer to see a separate section within the main body of the guidance which deals with this particular aspect of going concern. This also ties into the point made in our covering letter, that some useful aspects of the 2009 Guidance have not been brought forward to the draft revised guidance. We would therefore prefer to see the section on the determination of the going concern basis of accounting more closely aligned with that in the 2009 Guidance.

As stated in our covering letter, the 2009 Guidance has been widely used in practice and to good effect. We therefore expected that the draft revised guidance would adhere to the structure and content of that guidance. However, Appendix C contains some new terms that may be confusing to those familiar with the 2009 Guidance.

The 2009 Guidance also gives practical examples of factors to think about in arriving at the determination of the going concern basis of accounting and questions to ask as well as key questions for boards to consider, for example in relation to contingent liabilities, borrowing facilities, cash flow timing etc.

In Appendix C the discussion of severe distress alongside material uncertainties is also confusing. For example, it is not clear whether severe distress is the point at which the going concern basis of accounting is no longer appropriate or whether severe distress is an indicator that there is a material uncertainty that requires disclosure. This could be clearer.

We note that the Appendix also uses the term 'normal course of business' in the context of determining whether or not a company has material uncertainties which require disclosure. As there is no clear definition of what constitutes 'normal course of business' there may be difficulties in applying the guidance where this is used as a test in determining the existence of material uncertainties. It would be more helpful if practical examples were given of the matters that are likely to be under discussion at board level in situations where material uncertainties exist.

Appendix D

Appendix D provides some questions that the board may wish to consider. Whilst useful, their relevance would be clearer if they were better aligned to the relevant sections within the main body of the guidance. At present, it is not immediately clear as to how these questions fit into the structure of the main guidance. A further point, as noted above, is that one might expect to see a separate section that boards might wish to consider in relation to the adoption of the going concern basis of accounting. Appendix III of the 2009 Guidance would be useful in this regard.

In respect of the section on Public Reporting, given that there has been much focus on the quality of reporting in this area, one would expect some more weight and prominence to be given to this section of Appendix D.

Appendix E

Of all the Appendices, in our view this one is the least helpful. For example, it is unclear as to which specific parts of the guidance it actually supplements. If there are specific indicators that could usefully be highlighted to users in applying the guidance, we would recommend that they are identified in the appropriate sections of the main guidance.

Proposed changes to the UK Corporate Governance Code

In respect of the proposed new Code Provision C.2.2 we make the following observations. It is unclear as to what constitutes a 'robust assessment' in terms of the principal risks facing the company. Would, for example, applying the draft revised guidance meet this requirement? Whilst there is some discussion of this in Appendix B, Appendix B addresses solvency and liquidity risks, and not the broader concept of risk.

We support the fact that a link is made between the Code requirement and the statutory requirement to give a description of principal risks in the Strategic Report. There has been criticism in the past of companies that have simply provided a list of risks and not explained why they are important and what their impact could be. The expansion of the Code provision to require an explanation as to how they are being managed or mitigated should help to enhance this area of reporting. However, we think that the Code provision could go further and require that companies specifically explain how the risk relates to the business together with an analysis of the potential impact on the company.

In respect of the main principle C.2, we agree with the use of the word 'principal' rather than 'significant' as this is consistent with the statutory term.

We agree with the removal of the existing Provision C.1.3.

Finally, we note the proposed change to Code provision C.2.2. If one of the main concerns is that the monitoring of the company's risk management and internal control systems is an ongoing process rather than an annual compliance test then we would recommend that the Code provision make this clear, ie 'The board should monitor the company's risk management and internal control *systems on an ongoing basis* and, at least annually, carry out a review of their effectiveness and report that they have done so.'

Question 4. Do you agree with the draft revised auditing standards? If not, what should be changed and why?

As noted in our covering letter, overall we sense that the objective of the FRC in developing the new requirements is to enhance the auditor's role to review and challenge the adequacy and accuracy of the information prepared by the directors, and to report accordingly. We support this objective. However, we do not agree that the proposed requirements in relation to the robustness of the directors' assessment of the principal risks facing the company meet the FRC's objective.

In summary:

– ISA 260 requires the auditor to communicate their "view" on the robustness of the directors' assessment of the principal risks facing the company, including those that would threaten its solvency and liquidity and related disclosures. This implies an opinion is required to be communicated, but there is no explicit requirement regarding an evaluation of the robustness of the directors' assessment by the auditor.

- ISA 570 requires the auditor to "read and consider" the information in light of their knowledge of the entity and evaluation of management's assessment of going concern. Yet, in our view an understanding of risks that would threaten an entity's solvency and liquidity *forms part of* the assessment of going concern.
- ISA 570 and ISA 700 require the auditor to determine if there is anything to add to the directors' disclosures. This introduces a new type of auditor reporting not currently permissible in the auditing standards.

Accordingly we have set out below our suggested amendments to the requirements.

Proposed revised ISA 260 (UK and Ireland) Communication with Those Charged with Governance (ISA 260)

ISA 260 requires the auditor to give a view about the "robustness of the directors' assessment of the principal risks facing the company including those that would threaten its solvency and liquidity…"

As noted above, we interpret 260.16-1 as an implicit requirement for the auditor to express a conclusion/opinion to those charged with governance (TCWG) on the *robustness of*, or otherwise, the "directors' assessment of the principal risks facing the company, including those that would threaten its solvency and liquidity…"(directors' assessment).

This interpretation is supported somewhat by application material in 260.A20-7 that states that "the directors may also be assisted in making their assessment by an understanding of the auditor's views on the robustness of the directors' assessment and its outcome, including the related disclosures in the annual report and accounts". In order for auditors to be able to provide their views on the robustness of the directors' assessment they would need to carry out their own evaluation.

In order to express a conclusion/opinion on any type of subject matter, the auditor has to evaluate or measure that subject matter against criteria. According to the Consultation Paper, "Appendix B to the revised guidance describes a robust assessment process for a company applying the Code". The proposed application material 260.A20-6 and 260.A20-7 implies that this guidance can also be used by auditors in making their evaluation; in other words, that it is suitable criteria in which to evaluate or measure the *robustness of* the directors' assessment.

However, having read this guidance, we are concerned that it is too vague to allow for a reasonably consistent measurement or evaluation by auditors of the directors' assessment.

Accordingly, if it is the intention of the FRC that the auditor should make an independent assessment of the robustness of the directors' assessment, we strongly suggest that the FRC makes this an explicit requirement. In addition, to support auditors in making this assessment, the FRC will need to develop more guidance for auditors (and directors) in this regard. We suggest that the FRC looks to the guidance "Risk Assessment in Practice" issued by the Committee of Sponsoring Organizations of the Treadway Commission in October 2012 in developing such guidance for directors and auditors. This guidance gives an overview of risk assessment approaches and techniques that have emerged as the most useful and sustainable for decision-making and pursuing strategic goals.

Proposed revised ISA 570 (UK and Ireland) Going Concern (ISA 570)

We were confused by the purpose, structure and layout of the proposed requirements in ISA 570.

As noted, 570.17-2 requires the auditor to *read and consider* the directors' confirmation regarding the robustness of their assessment of principle risks, and related disclosures, in light of knowledge acquired during the audit*, including that acquired in the evaluation of management's assessment of the entity's ability to continue as a going concern*.

Yet, when the auditor evaluates management's assessment of the entity's ability to continue as a going concern, as required by paragraphs 570.12 to 570.14, it is likely that the auditor would take into account the knowledge they have gained from their evaluation of the robustness of the directors' assessment, not the other way around as suggested in 570.17-2. This is because management's risk identification and assessment and evaluation of going concern are intrinsically linked and part of the same on-going process.

It is important to present the requirements in auditing standards in a logical order that generally follow the flow of the audit process. This also helps auditors navigate their way around the standards and ensures activities are performed in a timely manner. In our view, as the knowledge acquired from the auditor's assessment on the robustness of the directors' assessment should be part of their evaluation of management's going concern assessment, then the requirement proposed by the FRC would be more suitably presented after paragraph 14 and before paragraph 15, with supporting application material presented as A10-5 onwards.

We have illustrated our suggested wording below:

14-1 In the case of entities that are required, and those that choose voluntarily, to report on how they have applied the UK Corporate Governance Code, or to explain why they have not, in evaluating management's assessment of the entity's ability to continue as a going concern, the auditor shall take into account ~~the auditor shall read and consider in light of the knowledge the auditor has acquire during the audit, including that acquired in the evaluation of~~:

(a) The auditor's view on the robustness of the directors' ~~confirmation in the annual report 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 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.~~

As explained further below, proposed 570.17-3 should be restated as application material.

Proposed revised ISA 700 (UK and Ireland) The Auditor's Report on Financial Statements (ISA 700)

The proposed requirement in 700.22C to "give a statement as to whether the auditor has anything material to add or to draw attention to" is not a reporting activity currently permitted by the reporting standards (ie ISA 700 series).

Under the FRC's proposals, this statement would be given if there were a "material" omission in the annual report and accounts from (a) the directors' confirmation they have carried out a robust assessment of the principal risks facing the company; (b) the disclosures in the annual report that address how those risks are being managed or mitigated or (c) the going concern note.

A material omission under the current auditing standards is, in accordance with ISA (UK and Ireland) 705 'Modifications to the Opinion in the Independent Auditor's Report' (ISA 705), a misstatement and the auditor is therefore required to express a qualified opinion under 705.7(a) or an adverse opinion under 705.8 if the matter is pervasive. This is particularly relevant for the proposed requirements 570.17-2 and 700.22C which refer to "material uncertainties in relation to the company's ability to continue to adopt the going concern basis of accounting".

Arguably if the auditor believes there is a material omission in the annual report regarding the statement to be made by the directors and corresponding disclosures, then this matter should be dealt with in accordance with ISA 720 'the Auditor's Responsibilities relating to Other Information in Documents Containing Audited Financial Statements'. 720.A11-1 suggests that the auditor might deal with material misstatements of fact in an Other Matter(s) paragraph.

Accordingly, we do not believe the proposed requirements in 570.17-2 (fourth paragraph), 570.17-3 or 700.22C, as currently written, are appropriate. We suggest that instead the fourth paragraph of 570.12-2 should be rewritten and make reference to ISA 705 and 570.17-3 should be restated as application material as follows:

20-1 In the case of entities that are required, 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 determine ~~whether the auditor has anything material to add or to draw attention to~~ if adequate disclosure has been made in relation to:

(a) The directors' 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 of the annual report that addresses how the principal risks facing the entity that would threaten its solvency or liquidity are being managed or mitigated

in relation to the company's ability to continue to adopt the going concern basis of accounting. If adequate disclosure is not made, the auditor shall express a qualified opinion or adverse opinion, as appropriate, in accordance with ISA (UK and Ireland) 705.

Application Material

~~17-3~~. A24-1 Matters the auditor might consider~~s~~ ~~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 assessment of the entity's ability to continue as a going concern, whether:~~ if 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 principal risks facing the company that would threaten its solvency or liquidity; ~~and~~ or matters relating to 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 and that are not appropriately addressed in the section of the annual report that describes the work of the audit committee.

Other matters

Notwithstanding our suggestions made above regarding the structure and layout of some of the proposed requirements, there is terminology used in both proposed ISAs 570 and 700 with the same meaning but they are inconsistent. Specifically 570.17-2(a) refers to the "directors' confirmation that they have carried out a robust assessment…", whereas 700.22C refers to the "directors' statement that they have carried out a robust assessment…"

We recommend that the terminology should be consistent in both standards and with that used in the proposed Code provision. C.2.1 states that "in the annual report the directors should confirm that they have carried out such an assessment…" Therefore the term used should be 'confirm'.