SUMMARY OF THE MAIN COMMENTS RECEIVED ON THE DRAFT REVISED TURNBULL GUIDANCE

1. A public consultation on draft revised guidance was held between 16th June and 16th September 2005.

2. 54 responses were received, including from companies representing over 31% of the total market capitalisation of UK companies listed on the London Stock Exchange’s Main Market, institutional investors and investor representative bodies that are between them responsible for funds under management in excess of £3,100 billion, as well as many accountancy firms and other representative bodies. A full list of respondents can be found at: http://www.frc.org.uk/corporate/internalcontrol.cfm.

3. All respondents endorsed the Review Group’s conclusions that the guidance should remain high-level and principles-based, that boards should not be required to make a statement in the annual report and accounts on the effectiveness of the company’s internal control system, and that there should be no expansion of the external auditors’ responsibilities in relation to the company’s internal control statement. Nearly three-quarters of respondents agreed in full with, or had no comments on, the proposed revisions to the guidance and the majority of the rest commented only on points of detail.

   Maintaining and reviewing the internal control system

4. All respondents supported the Review Group’s proposal to add a preface to the updated guidance to encourage boards to review on a continuing basis their application of the guidance, although some commented on the wording in the preface. The Review Group has made some revisions to the preface to reflect these comments.

5. The Review Group’s proposed changes to the introduction and those sections of the guidance that deal with maintaining and reviewing the internal control system were supported by all respondents, while all but one supported the recommendation that the guidance concerning the need for an internal audit function should be incorporated into the Smith guidance to audit committees.

6. In relation to the standard of care to be exercised by the board (dealt with in paragraph 24 of the updated guidance), the Review Group had proposed that the guidance should adopt the wording used in the draft Company Law Reform Bill in setting out the general standard of care to be exercised by directors. While all respondents agreed that the standard of care should be the same, some pointed out that the wording in the Bill might change during
the course of its passage through Parliament. The Review Group has therefore amended paragraph 24 of the guidance to avoid the risk of the standard of care to be exercised when reviewing the effectiveness of the internal control system inadvertently differing from the general standard of care.

7. A number of respondents suggested additional amendments to the guidance to address in more detail issues such as sources of assurance and evidence, ethics and strategic risk. In considering these suggestions the Review Group applied the same four tests as it had applied when considering suggestions made during the initial consultation exercise:

- Does the proposed change address an issue that is not already substantially covered by the existing guidance?
- Is a change to the guidance the most appropriate way to address the issue concerned?
- Would any proposed change materially improve internal control and risk management at a reasonable cost?
- Would any proposed change restrict a company’s ability to apply the guidance in a manner suitable to its own particular circumstances?

8. The Review Group considered that further changes to the guidance were not justified on these grounds. For example, in the case of comments that the guidance should say more about the sources of internal assurance available to the board, the Review Group considered that the revised guidance already contained sufficient references, and noted that the work of internal audit was further amplified in the updated Smith guidance to audit committees.

The internal control statement

9. The proposal that boards should confirm in the annual report that necessary action had been or was being taken to remedy any significant failings or weaknesses identified from their review of the effectiveness of the internal control system was supported by all but one respondent.

10. During the initial evidence gathering phase, investors commented that in their view there was considerable scope for internal control statements to be more informative. All respondents to the consultation on the draft revised guidance supported the Review Group’s recommendation that companies should include in the annual report such meaningful, high-level information as the board considers necessary to assist shareholders’ understanding of the main features of the company’s internal control system. There was also support for the proposal to use the new preface to encourage companies to provide investors with more meaningful and company-specific information, although some respondents considered that the wording of the preface could
be strengthened.

11. Some respondents also commented on the potential overlap between the internal control statement and the requirement on companies to comment on the principal risks facing the company in the OFR. While some respondents felt that the relationship between the two disclosures should be more clearly defined, the majority agreed with the Review Group’s view that it was not appropriate at this time to prescribe how any overlap should be managed.

Financial Reporting Council
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