AUDIT QUALITY THEMATIC REVIEW
OTHER INFORMATION IN THE ANNUAL REPORT

THE WORK PERFORMED BY AUDITORS TO MEET THEIR REPORTING RESPONSIBILITIES IN RESPECT OF THE OTHER INFORMATION IN THE ANNUAL REPORT

DECEMBER 2018
The FRC’s mission is to promote transparency and integrity in business. The FRC sets the UK Corporate Governance and Stewardship Codes and UK standards for accounting and actuarial work; monitors and takes action to promote the quality of corporate reporting; and operates independent enforcement arrangements for accountants and actuaries. As the Competent Authority for audit in the UK the FRC sets auditing and ethical standards and monitors and enforces audit quality.

The FRC does not accept any liability to any party for any loss, damage or costs howsoever arising, whether directly or indirectly, whether in contract, tort or otherwise from any action or decision taken (or not taken) as a result of any person relying on or otherwise using this document or arising from any omission from it.

© The Financial Reporting Council Limited 2017
The Financial Reporting Council Limited is a company limited by guarantee.
Registered in England number 2486368.
Registered Office: 8th Floor, 125 London Wall, London EC2Y 5AS
# Executive Summary

1.1 Overview
1.2 Our key messages
1.3 Summary of our findings

# Background and Scope

2.1 Background
2.1 What is the Other Information in the Annual Report?
2.3 What are auditors required to do in respect of the Other Information?
2.4 What does the auditor say about the Other Information in the auditor’s report?
2.5 Auditing the Directors’ Remuneration Report
2.6 Scope of our review

# Review Findings

3.1 Introduction
3.2 Overall approach to the Other Information
3.3 UK Corporate Governance Code Reporting: The Directors’ Fair Balanced and Understandable Statement
3.4 UK Corporate Governance Code Reporting: Principal Risk Disclosures
3.5 UK Corporate Governance Code Reporting: The Viability Assessment/Statement
3.6 Key Performance Indicators/Alternative Performance Measures
3.7 The Directors’ Remuneration Report
**Definition of the Other Information**

Financial or non-financial information (other than the financial statements and the audited parts of the Directors’ Remuneration report) included in an entity’s Annual Report.

In the UK the Other Information typically includes the following:
- The Strategic Report
- The Directors’ Report
- The Corporate Governance Statement
- The Directors’ Remuneration Report

**Firms included in this thematic review**

The scope of this thematic covered the following six audit firms:
- BDO LLP (“BDO”)
- Deloitte LLP (“Deloitte”)
- Ernst & Young LLP (“EY”)
- Grant Thornton UK LLP (“GT”)
- KPMG LLP (“KPMG”)
- PricewaterhouseCoopers LLP (“PwC”)
1 Executive Summary

1.1 Overview

This thematic review considers the auditors’ work on the Other Information in the Annual Report.

The Other Information is all financial and non-financial information included in an entity's Annual Report other than the financial statements and the audited parts of the Directors' Remuneration Report (“DRR”). It includes items of significant importance to investors such as the Strategic Report and Directors’ Report.

Our review focussed on those aspects of the Other Information where the auditor has specific reporting responsibilities. This is the first time that the FRC has undertaken a detailed review of auditors’ work in this area.

The Directors have ultimate responsibility for the Other Information, the extent of which has increased significantly over the years, and in most instances is more extensive than the financial statements themselves. There is heightened interest in the Other Information as users of the Annual Report increasingly focus on it to assist their investment decisions because it includes information that is helpful in assessing a company’s future prospects.

Many users of the Annual Report do not understand the differences in the work auditors are required to perform on the Other Information compared with that for the financial statements (see section 2.3). Many incorrectly assume that the Annual Report as a whole has been audited. Whilst the auditor's report describes the auditor's responsibilities in respect of the Other Information, including the different reporting requirements, these are complex and not always well understood.

This can lead to an expectation gap between the work auditors are required to perform on the Other Information and the expectations of users of the Annual Report, which could increase as more information is required to be included in the Annual Report. In recognition of this, the FRC is looking at the work that auditors are required to carry out on the Other Information, and also intends to consider assurance requirements as part of its planned review of the Future of Corporate Reporting.

This review is not intended to address this expectation gap. Rather, the purpose of this review is to gain an understanding of the work auditors at the six major UK audit firms are currently performing on the Other Information, and to ascertain the extent to which it meets the requirements placed upon them, with a view to identifying any significant differences in practice and to assist firms in improving the quality and consistency of the work performed. Our conclusions will provide insight to inform the FRC's further work noted above.
1.2 Our key messages

The nature, extent and quality of the work performed by audit teams on the Other Information vary considerably both between and within audit firms. This variation can be linked to the absence of prescriptive requirements in Auditing Standards, which in turn have been replicated, our work would suggest, by a lack of prescription in firms’ procedures.

A lack of prescription does not prevent audit teams from undertaking good work. We have seen a number of examples of good practice. An absence of prescription does, though, increase the risk of inconsistent approaches being adopted by different audit teams. As a consequence, we observed a number of instances where insufficient work was performed to support the statements auditors make in respect of the Other Information in the auditor’s report. The size of the company did not appear to be a factor as we saw variation across all categories of companies (FTSE 100, FTSE 250 and Other Premium Listed) included in this review.

A lack of work by the auditors does not of itself mean that the Other Information is inaccurate. However, it does increase the risk that material inconsistencies or misstatements may go undetected.

Whilst Auditing Standards may not be prescriptive, revisions made to them in 2016 raised the bar in terms of the work auditors were expected to perform on the Other Information. The FRC consulted extensively with firms on these changes and their implications. Despite this, it is clear that audit teams have not responded consistently to these additional expectations and that the revised Standards have not been fully effective in achieving the objectives set for them. The FRC therefore proposes to look again at these as part of the FRC’s post implementation review of the 2016 Standards.

Changes to Standards and related guidance alone will not result in the necessary improvements in the quality and consistency of the work on the Other Information unless firms also drive improvement in the following areas:

• More prescriptive and targeted procedures, including templates and workbooks, to guide audit teams in the work they perform;
• Specific consideration of the Other Information at the planning stage of the audit;
• Greater emphasis on the review of key non-financial information, in addition to the financial information;
• Increased scepticism and more attention on the completeness of the information, particularly the principal risk disclosures, and their linkage with the Viability Assessment/Statement;
• Consistently requiring Boards to prepare, on a timely basis, separate papers and other documentation to support their Fair Balanced and Understandable (“FBU”) and Viability Assessment/Statements; and
• Ensuring staff with appropriate experience and knowledge of the audit are assigned to review the Other Information to identify potential material misstatements and inconsistencies.

Audit Committees also have a key role to play in supporting and improving the auditor’s work on the Other Information including:

• Ensuring the Directors or their delegates provide the auditors with high quality papers and other documentation on a timely basis to support their FBU and Viability Assessment/Statements; and
• Engaging with the auditors at both the planning and completion stages of the audit on the work the auditor plans to/has performed on the Other Information to understand the level of assurance that this provides. Particular areas to focus on include:
  - The procedures performed in considering the FBU assessment
  - The consideration given to the completeness of the principal risk disclosures
  - The extent of challenge of the appropriateness of the viability assessment period
  - The nature of the evidence obtained to support the disclosures in the audited parts of the DRR
1.3 Summary of our findings

The table below summarises our findings. Section 3 provides further detail.

<table>
<thead>
<tr>
<th>Area</th>
<th>Section</th>
<th>Summary of our findings</th>
</tr>
</thead>
<tbody>
<tr>
<td>Overall approach to the Other Information</td>
<td>3.2</td>
<td>Firms’ procedures do not yet reflect the additional work effort required following revisions to Auditing Standards in 2016.</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>UK Corporate Governance Code Reporting: The Directors’ Fair Balanced and Understandable Statement</td>
<td>3.3</td>
<td>The procedures performed by audit teams to consider FBU typically included reading the Annual Report, attending Audit Committee meetings, reading the Board minutes, and completing standard disclosure checklists.</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>UK Corporate Governance Code Reporting: Principal Risk Disclosures</td>
<td>3.4</td>
<td>Firms do not generally require audit teams to obtain the company’s risk register and to consider explicitly its completeness, as part of their review and consideration of the principal risk disclosures in the Strategic Report.</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Continued over
### Summary of our findings

<table>
<thead>
<tr>
<th>Area</th>
<th>Section</th>
<th>Summary of our findings</th>
</tr>
</thead>
<tbody>
<tr>
<td>UK Corporate Governance Code Reporting: The Viability Assessment/Statement</td>
<td>3.5</td>
<td>Firms’ procedures in respect of viability tended to be compliance and disclosure focussed, with limited prescription of the work that should be performed in reviewing the Viability Assessment/ Statement. In only a few instances did we observe procedures targeted specifically at viability that were performed and documented separately from the going concern work. There was no evidence of an explicit assessment performed by the Directors to support the Viability Statement on five of the 30 audits we reviewed. We also noted some instances of discrepancies, that had not been identified by the audit team, between the risks and scenarios included in the company’s Viability Assessment and those disclosed in the Viability Statement. The Viability Assessment period was three years for most of the companies included in our sample of audits. Audit teams did not challenge the appropriateness of the Viability Assessment period in most cases (23 of the 30 audits we reviewed). Identical forecast information was frequently used to assess viability, going concern and impairment testing. The appropriateness of using the same information, without any adjustments, was not considered by audit teams in most cases. The nature and extent of the challenge of the key assumptions underlying the forecasts and related stress testing were also mixed.</td>
</tr>
<tr>
<td>Key Performance Indicators/Alternative Performance Measures</td>
<td>3.6</td>
<td>We concluded that audit teams performed sufficient procedures in respect of Key Performance Indicators (&quot;KPIs&quot;), including corroboration to supporting documentation, on 20 of the 30 audits we reviewed. The work performed on Alternative Performance Measures (&quot;APMs&quot;) was generally better than that for other KPIs.</td>
</tr>
<tr>
<td>The Directors’ Remuneration Report</td>
<td>3.7</td>
<td>Half of the firms have separate work programmes and targeted procedures in respect of the DRR. Most firms do not explicitly require audit teams to undertake the audit of the DRR to its own (lower) materiality. We concluded that insufficient procedures were carried out to verify the different components of remuneration, included in the audited parts of the DRR, on ten of the 30 audits that we reviewed. Less work was performed on the unaudited parts of the DRR, with no clear evidence that audit teams had assessed and considered the information on 12 of the 30 audits we reviewed.</td>
</tr>
</tbody>
</table>
2 Background and Scope

2.1 Background

The objective of this thematic review is to gain an understanding of the work auditors perform to meet their reporting responsibilities in respect of the Other Information in the Annual Report.

Thematic reviews, which we have undertaken since 2013, supplement our annual programme of inspections of individual audits carried out by audit firms. They are deliberately more focussed in scope and consider selected areas in greater depth than is generally possible in our review of individual audits.

In this Section we define what the Other Information comprises and explain what Auditing Standards require auditors to do in respect of it. We also provide an outline of the scope of the work that we performed.

2.2 What is the Other Information in the Annual Report?

In the UK a typical company Annual Report contains the following sections:

- Strategic Report
- Directors’ Report
- Corporate Governance Statement
- Directors’ Remuneration Report
- Financial Statements
- Auditor’s Report on the Financial Statements

Any financial or non-financial information included in the Annual Report – apart from the financial statements and the audited parts of the DRR – is classed as the Other Information for the purposes of an audit. Users of the Annual Report increasingly focus on this information as a way of assessing a company’s prospects, and may use this information, along with the financial statements, to support investment decisions in the capital markets.

2.3 What are Auditors Required to do in respect of the Other Information?

As part of the audit, the auditor is required to report on the Other Information (see Section 2.4 below). To fulfil these reporting responsibilities, the auditor reads and considers the Other Information because a material misstatement of that information may undermine the credibility of the audited financial statements or may inappropriately influence the decisions of users of the Annual Report.

The auditor’s responsibilities relating to all the Other Information, which are set out in ISA (UK) 7201, require the auditor to:

- Read the Other Information and consider whether there is a material inconsistency between the Other Information and both the financial statements and the auditor’s knowledge obtained in the audit;
- Be alert for indications that the Other Information appears to be materially misstated;
- Respond appropriately when the auditor identifies an apparent material inconsistency or misstatement. For example, the auditor may request management amends the Other Information or the financial statements; and
- Report on the Other Information in the auditor’s report.

1 International Standard on Auditing (UK) 720 (Revised June 2016) The Auditor’s Responsibilities Relating To Other Information.
The auditor is also required by legislation or regulation to report specifically in the auditor’s report on certain aspects of the Other Information known as Statutory Other Information. The auditor is therefore required to:

- Obtain an understanding of the legal and regulatory requirements applicable to the Statutory Other Information and how the company is complying with them.
- Read the Statutory Other Information and consider whether it has been prepared in accordance with the legal and regulatory requirements.
- Perform such procedures as are necessary in the auditor’s professional judgment to identify:
  - Any material inconsistences between the Statutory Other Information and the financial statements and the auditor’s knowledge obtained in the audit; and
  - Whether the Statutory Other Information appears to be materially misstated in the context of the auditor’s knowledge of the legal and regulatory requirements.
- Report on the Statutory Other Information in the auditor’s report.

2.4 What does the auditor say about the Other Information in the auditor’s report?

The auditor has reporting responsibilities on all the Other Information and more specific requirements apply in respect of those elements of Other Information that are Statutory Other Information. For companies, the Statutory Other Information will always include the Strategic Report, the Directors’ Report and, where prepared, the separate Corporate Governance Statement.

Reporting on all the Other Information

The auditor includes a statement that they have nothing to report in respect of the Other Information when they have not identified any apparent material misstatements as part of their audit.

Reporting on the Statutory Other Information

The auditor’s report is required to state whether, based on the work undertaken in the course of the audit, the information in the Strategic Report, Directors’ Report and Corporate Governance Statement:

- Is consistent with the financial statements;
- Has been prepared in accordance with applicable legal requirements; and
- Contains any material misstatements.

The auditor is also required to report by exception on the Directors’ statements about:

- Whether the Annual Report taken as a whole is fair, balanced and understandable;
- The matters they discussed with the audit committee;
- The robust assessment of principal risks;
- The assessment of the company’s viability;
- Going concern; and
- The company’s compliance with certain Listing Rules.

Statutory Other Information is defined as “those documents or reports that are required to be prepared and issued by the entity (including any reports or documents that are incorporated by cross reference) in relation to which the auditor is required to report publicly in accordance with law or regulation.”
2.5 Auditing the Directors’ Remuneration Report

The Directors of quoted companies are required to prepare a DRR for each financial year of a company. Not all the information included in this report is required to be audited, so the auditor usually seeks to ensure that the audited disclosures are clearly distinguished from those that have not been audited. The auditor is also required to give an opinion in the auditor’s report on whether the part of the DRR that has been audited has been properly prepared in accordance with the Companies Act 2006.

2.6 Scope of our review

Our review comprised:

- An assessment of firms’ policies and procedures in respect of the Other Information in the Annual Report;
- Consideration of the specific changes firms have made to their policies and procedures to reflect the new requirements in Auditing Standards; and
- An assessment of the application of the policies and procedures on a sample of 30 audits.

The following six audit firms were included within the scope of this review: BDO LLP (“BDO”), Deloitte LLP (“Deloitte”), Ernst & Young LLP (“EY”), Grant Thornton UK LLP (“GT”), KPMG LLP (“KPMG”) and PricewaterhouseCoopers LLP (“PwC”).

All audits were of companies with a Premium Listing on the London Stock Exchange. The sample included nine FTSE 100 and nine FTSE 250 companies. The audits we reviewed all related to reporting periods ending in December 2017.

\* Quoted companies are defined in Section 385 of the Companies Act 2006.
3 Review Findings

3.1 Introduction

In this Section we set out the findings from our review of firms’ policies and procedures and individual audit files, including examples of good practice.

We initially discussed the approach firms take to the Other Information in general. We also looked at certain areas in more detail. This included aspects of the UK Corporate Governance Code reporting, where auditors have specific reporting requirements, and the DRR.

Throughout this section we refer to the work undertaken by auditors on the Other Information as “work effort” in recognition that this information is not required to be audited other than the audited parts of the DRR.

3.2 Overall approach to the Other Information

Policies and procedures

The policies and procedures discussed below relate to Other Information in general. This should be read in conjunction with a more detailed discussion of policies and procedures relevant to particular Other Information areas, in other parts of this report.

<table>
<thead>
<tr>
<th></th>
<th>Firm A</th>
<th>Firm B</th>
<th>Firm C</th>
<th>Firm D</th>
<th>Firm E</th>
<th>Firm F</th>
</tr>
</thead>
<tbody>
<tr>
<td>Policies and procedures</td>
<td>✔︎</td>
<td>✔︎</td>
<td>✔︎</td>
<td>✔︎</td>
<td>✔︎</td>
<td>✔︎</td>
</tr>
<tr>
<td>Evidencing the work effort</td>
<td>✔︎</td>
<td>✘</td>
<td>✘</td>
<td>✘</td>
<td>✘</td>
<td>✘</td>
</tr>
<tr>
<td>RI and EQCR review</td>
<td>✔︎</td>
<td>✔︎</td>
<td>✔︎</td>
<td>✔︎</td>
<td>✔︎</td>
<td>✔︎</td>
</tr>
<tr>
<td>Mandated hot review</td>
<td>✔︎</td>
<td>✘</td>
<td>✘</td>
<td>✔︎</td>
<td>✘</td>
<td>✔︎</td>
</tr>
<tr>
<td>Training</td>
<td>✔︎</td>
<td>✔︎</td>
<td>✘</td>
<td>✔︎</td>
<td>✘</td>
<td>✔︎</td>
</tr>
</tbody>
</table>

ISA (UK) 720 was extensively revised in 2016. A key change to this Standard was the introduction of a requirement to perform specific procedures in respect of the Statutory Other Information (see Section 2.3). We considered how firms had responded to the additional requirements in the Standard.

Firm A developed a new work programme. Firms B, D and F did not change their existing programmes substantively other than revising them to align them with the wording and requirements of the new Standard. Firm C did not make any changes to its work programme as it considered that the revisions would not have a significant impact in the level of work required. Firm E expanded its existing procedures for clarity but did not change them significantly.

All six firms have policies and procedures in respect of the work required on the Other Information. These broadly repeat the requirements set out in ISA (UK) 720.

In all cases, the firms require audit teams to read and consider the Other Information and to apply their professional judgement in areas where they believe that further work effort is required.
There was limited prescription of the work audit teams were expected to perform on the Other Information. Work required on the review of APMs and cross-checking numbers to the financial statements were the exception. All firms have mandatory procedures requiring figures included within the Other Information to be agreed to the financial statements and for ensuring that the APMs were prepared in line with the European Securities Market Authority (“ESMA”) guidelines.

Only two firms mandate the completion of a specific “Other Information” checklist. The checklists repeat the requirement to read and consider the Other Information.

**Evidencing the work effort**

Only one firm provides explicit guidance on how to evidence the audit team’s work effort on the Other Information. The firm’s suggested approach to the Other Information provides flexibility to teams to decide which evidencing approach is more appropriate. Options include a workbook, document or marked-up copy of the Other Information. All other firms require teams to evidence their work effort but are not prescriptive in the manner.

**Responsible Individual review (“RI”) and Engagement Quality Control Review (“EQCR”)**

All firms require members of the audit team with appropriate seniority to read and consider the Other Information. For six out of the 30 audits we reviewed (including two FTSE 100 and one FTSE 250) there was no or insufficient evidence of the RI and EQCR review of the Other Information in the Annual Report.

**Hot reviews**

Hot reviews are undertaken prior to the completion of the audit, by individuals not involved in the audit. Half the firms mandate the inclusion of the “Other Information” in their hot review procedures. Typically, the hot reviews focus on compliance with regulatory disclosure requirements rather than considering the work performed by the audit team.

Firms, through their guidance, prompt the hot reviewer to consider whether the Strategic Report presents narrative information in a fair, balanced and comprehensive way, whether the Other Information is consistent with the financial statements and if the messages that the report is communicating are potentially misleading.

**Training**

Four firms provided specific and targeted training in relation to the Other Information. This included cases studies, blogs and publications. For the two remaining firms, one had training relevant to the Other Information areas but not targeted in relation to the procedures required to be performed while the other had not rolled-out any updated training.
Audit Quality Thematic Review Other Information in the Annual Report – December 2018

The three “Level 3” files comprised two FTSE 100 and one FTSE 250. The “Level 2” files included two FTSE 100 and three FTSE 250.

**Audit files**

The following graph provides an overview of the work effort on the Other Information as a whole (primarily the Strategic Report and Directors’ Report), based on our review of 30 audit files. We provide more detailed commentary in the following sections of this Report on specific areas, particularly those relating to the UK Corporate Governance Code reporting and the DRR.

We have grouped the population of audit files into three groups representing the different levels of work that we observed. The table below provides an explanation of each of the three levels.

<table>
<thead>
<tr>
<th>Level 1 (19 files)</th>
<th>Level 2 (8 files)</th>
<th>Level 3 (3 files)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Work effort</td>
<td></td>
<td></td>
</tr>
<tr>
<td>• Work effort covered both financial and non-financial aspects of the Other Information</td>
<td>• Work effort consisted primarily of a basic ‘tie-through’ to the financial statements with limited or no evidence of consideration of the non-financial aspects of the Other Information</td>
<td>• Insufficient evidence of work effort including:</td>
</tr>
<tr>
<td>• Evidence to support the work effort</td>
<td>• Support for non-financial information not obtained, with little or no justification of why further evidence was not obtained</td>
<td>• ‘Tie-through’ of the Other Information performed on an incomplete set of the annual report and accounts</td>
</tr>
<tr>
<td>• Links to audit work and knowledge obtained during the audit</td>
<td>• Insufficient evidence of RI/EQCR review in some instances</td>
<td>• No evidence of tie-through retained on file</td>
</tr>
</tbody>
</table>

The three “Level 3” files comprised two FTSE 100 and one FTSE 250. The “Level 2” files included two FTSE 100 and three FTSE 250.

**Good practice examples**

We observed examples of good practice on some files including the following:

• Detailed consideration at the audit planning stage of the procedures to be performed on the Other Information;
• Specific work papers in addition to the “tie-through” evidencing the work performed on key non-financial and narrative aspects of the Other Information; and
• Clear linkages to the auditor’s knowledge obtained during the audit. This included explicit statements confirming the accuracy and consistency of the Other Information with evidence obtained in the course of the audit.
3.3 UK Corporate Governance Code Reporting: The Directors’ Fair Balanced and Understandable Statement

The Corporate Governance Code (C.1.1) requires Directors to explain their responsibility for preparing the Annual Report, and to state that they consider the Annual Report and Accounts, taken as a whole, to be fair balanced and understandable and provides the information necessary for shareholders to assess the company’s position and performance, business model and strategy.

The auditor is required to consider whether this statement is consistent with their knowledge obtained in the audit, and if so state in the auditor’s report that there is nothing to report or alternatively to make a statement that describes the uncorrected material misstatement.

Policies and procedures

<table>
<thead>
<tr>
<th></th>
<th>Firm A</th>
<th>Firm B</th>
<th>Firm C</th>
<th>Firm D</th>
<th>Firm E</th>
<th>Firm F</th>
</tr>
</thead>
<tbody>
<tr>
<td>Consideration at the planning phase of the audit</td>
<td>✗</td>
<td>✗</td>
<td>✗</td>
<td>✗</td>
<td>✗</td>
<td>✔</td>
</tr>
<tr>
<td>Requirement to understand the Board’s FBU process</td>
<td>✗</td>
<td>✗</td>
<td>✔</td>
<td>✗</td>
<td>✔</td>
<td>✔</td>
</tr>
<tr>
<td>Requesting the Board’s FBU assessment</td>
<td>✗</td>
<td>✗</td>
<td>✗</td>
<td>✗</td>
<td>✗</td>
<td>✗</td>
</tr>
</tbody>
</table>

All firms have UK Corporate Governance Code checklists or specific work programmes for “FBU”. The completion of such checklists and programmes is mandatory. Only one firm has separate procedures for both the planning and completion stages of the audit. The planning procedures include revisiting the prior year’s FBU and considering improvement points for the current year’s reporting.

Three firms require teams to obtain an understanding of the process the Board has gone through to ensure it complies with the FBU provisions in the Code and to review any supporting documents prepared by or for the Board in that respect (“FBU assessment”).

None of the checklists/work programmes explicitly require audit teams to request and obtain the Board’s FBU assessment.
Audit files

There was evidence that the Board and/or its delegates had prepared a Board paper or other documentation to support the FBU statement in 13 of the 30 audit files we reviewed. The audit team obtained this documentation in 11 of these cases.

The 17 audit files where there was no evidence that the Board had prepared documentation to support the FBU statement included five FTSE 100 and three FTSE 250 companies.

The procedures performed by the audit team to consider FBU typically included reading the Annual Report, attending Audit Committee meetings/reading the Board minutes where matters relevant to FBU were discussed and completing standard disclosure checklists.

Good practice examples

In four cases, a separate working paper had been prepared by the audit team evidencing targeted procedures performed by the audit team in respect of FBU. Examples of these procedures were:

- Evidence of the audit team’s challenge in relation to the use of APMs, the presentation of critical accounting judgements and the key sources of estimation uncertainty;
- Evidence of consultation with component teams to identify issues that could impact FBU such as control deficiencies; and
- Performing research on comparable companies.
3.4 UK Corporate Governance Code Reporting: Principal Risk Disclosures

The Corporate Governance Code (C.2.1) requires the Directors to confirm 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 business model, future performance, solvency or liquidity. The Directors should describe those risks and explain how they are being managed or mitigated.

The auditor is required to state in the auditor’s report, having regard to their work on going concern, whether they have anything material to add or draw to attention, in respect of the directors’ confirmation of the principal risk assessment process and disclosures.

Policies and procedures

<table>
<thead>
<tr>
<th></th>
<th>Firm A</th>
<th>Firm B</th>
<th>Firm C</th>
<th>Firm D</th>
<th>Firm E</th>
<th>Firm F</th>
</tr>
</thead>
<tbody>
<tr>
<td>Obtain evidence of directors’</td>
<td>✘</td>
<td>✘</td>
<td>✔</td>
<td>✔</td>
<td>✔</td>
<td>✔</td>
</tr>
<tr>
<td>assessment of principal risks</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Link to planning</td>
<td>✘</td>
<td>✘</td>
<td>✘</td>
<td>✘</td>
<td>✘</td>
<td>✘</td>
</tr>
<tr>
<td>Review of risk register</td>
<td>✘</td>
<td>✘</td>
<td>✘</td>
<td>✘</td>
<td>✘</td>
<td>✘</td>
</tr>
</tbody>
</table>

Evidence of the Directors’ risk assessment

In all six firms, the relevant UK Corporate Governance Code checklists and programmes require teams to read and consider the Directors’ confirmation in the Annual Report that they have carried out a robust assessment of the principal risks facing the entity. For four firms, the procedures explicitly require teams to obtain and review evidence that such an assessment has taken place.

Link to planning

In planning the audit, auditors are required to obtain an understanding of the entity's objectives and strategies, and related business risks. In a number of instances, we observed that audit teams combined the work in this area with their consideration of the robustness of the Directors’ assessment of principal risks. The linkage between these respective areas was not explicitly referred to in firms’ guidance and/or work programmes.

Risk register review

The firms’ procedures do not explicitly require teams to obtain the risk register to confirm that the principal risk disclosures are consistent with the register, nor to review it for completeness.
Good practice examples

The UK Corporate Governance Code checklist for one firm included guidance in the form of questions to assist the team’s assessment of principal risks. The questions included: “How has the Board ensured completeness?” and “Were all the business units engaged?”. This was the only example we saw where the completeness of risks was referred to.

Audit files

In reviewing the auditors’ work on the principal risks, we noted that the audit team obtained and reviewed the risk register, as part of targeted procedures in this area, in 12 out of the 30 audits. In four other cases, work completed for planning risk assessment purposes and work on entity level controls or the review of minutes of Board meetings and attendance at Audit Committee meetings provided sufficient evidence of the audit team’s consideration of risks.

On only ten audits did we observe procedures performed by audit teams to assess and confirm the completeness of the risk register and the principal risk disclosures.
3.5 UK Corporate Governance Code Reporting: The Viability Assessment/Statement

“The Viability Assessment/Statement”- Corporate Governance Code (C.2.2): Taking account of the company’s current position and principal risks, the Directors should explain in the Annual Report how they have assessed the prospects of the company (“the Viability Assessment”), over what period they have done so (“the Viability Assessment Period”) and why they consider that period to be appropriate. The Directors should state whether they have a reasonable expectation that the company will be able to continue in operation and meet its liabilities as they fall due over the period of their assessment, drawing attention to any qualifications or assumptions as necessary (“the Viability Statement”).

The auditor is required to state in the auditor’s report, having regard to their work on going concern, whether they have anything material to add or draw to attention, in respect of:

• The Directors’ explanation of the Viability Assessment and the appropriateness of the Viability Assessment Period; and
• The Viability Statement.

Policies and procedures

All firms, as part of either their UK Corporate Governance Code checklists and/or work programmes, require teams to assess the statements and disclosures made by the Directors to comply with the UK Corporate Governance Code in this area.

With one exception, firms explicitly require audit teams to obtain an understanding of the Board’s process to assess viability, to review the documentation prepared by the Directors to support their assessment and to consider whether the assessment is in line with the auditor’s knowledge obtained during the audit.
None of the firms mandate the use of a separate viability assessment template. All firms expect audit teams to consider the knowledge obtained in other areas of the audit when considering management’s viability assessment, but there is no specific guidance on how to approach this, particularly for closely related areas like impairment and going concern.

**Audit files**

Overall, we noted that the auditor’s consideration of viability and going concern was often combined. In some cases, the viability assessment work was viewed as an extension of the work on going concern. In other instances, the work on viability was considered as also covering going concern. In only a few instances were procedures targeted specifically at viability performed and documented separately from the going concern work (we comment on this under good practice).

**Viability assessment**

In five cases, there was no evidence of an explicit Board assessment of viability prepared to support the Viability Statement. In two of these cases (including one FTSE 100) the Viability Assessment had not been retained on the audit file in error. In one other case (FTSE 100) the audit team obtained the prior year’s viability assessment but did not consider the appropriateness of one not being prepared for the current year.
The viability assessment period for the companies included in our sample ranged between three to five years. For the majority (22 companies), the Directors assessed the viability of the company over a three-year period. Of the remainder, seven used five years and one company used four years.

There was evidence that the audit team had challenged the appropriateness of the viability assessment period for seven out of the 30 companies.

Such evidence included the consideration of the maturity of debt facilities, management’s longer-term plan and strategy outlook, the average contract life, the pipeline of products under development, restructuring, acquisition and other operational plans.

Of the 23 companies where there was no evidence of challenge, we noted factors that might have called into question the appropriateness of the assessment period, in particular, key debt facilities maturing after the viability assessment period (13 out of 23).

Cash flow forecasts

The same cash flow forecasts were used for the viability assessment, going concern and the impairment review by 18 companies of the 30 whose audits we reviewed.

The underlying forecasts used to assess viability, going concern and impairment should be the same. However, depending on the use of the forecasts, there are a number of potential adjustments that could be made (for example, remedial actions). In only two instances did we see evidence of the audit team challenging the appropriateness of using identical forecast information for these areas.

There was evidence that the audit team had challenged the appropriateness of the key assumptions underlying the cashflow forecasts on 15 audits.
Stress testing

The Director’s Viability Assessment included stress and/or risk scenario testing for 27 of the 30 companies.

There was evidence that the audit team had considered and challenged the appropriateness of the stress testing on only eight of the audits we reviewed.

Audit teams also performed stress testing of the cashflow forecasts, independently of the Directors, on seven audits.

Disclosures

The Viability Statement disclosures in the Annual Report were not consistent in all respects with the supporting viability assessment for 12 companies. The discrepancies included the omission of scenarios and risks included within the viability assessment or the inclusion of different scenarios and risks to those included in the viability assessment.

There was insufficient evidence that the audit team had considered these discrepancies, and in particular, whether they should have reported on these as required by Auditing Standards.

Good practice examples

We observed examples of good practice on three audits (one FTSE 100 and two FTSE 250 companies). These comprised targeted and comprehensive procedures on viability, usually specified and executed on a separate work paper. These procedures included:

- Considering and challenging the appropriateness of the viability assessment period;
- Assessing the reasonableness of the cash flows and underlying assumptions with appropriate commentary;
- Considering the appropriateness of the stress testing;
- Considering the financial covenants and funding requirements;
- Considering the mitigating actions, for example reduction in planned acquisitions, dividends and capital expenditure; and
- Commenting on and reviewing the mathematical accuracy of the cash flow forecasts.
### 3.6 Key Performance Indicators/Alternative Performance Measures

The Companies Act requires the Strategic Report to provide an analysis of the development and performance of the business in the financial year and of its position at the end of that year. This analysis should include financial and non-financial key performance indicators (KPIs). Some KPIs will meet the definition of APMs.

An APM is “a financial measure of historical or future financial performance, position or cash flows of an entity which is not a financial measure defined or specified in the financial reporting framework (e.g. EU-adopted IFRS) applied by the entity”.

The auditor is required to state in the auditor’s report whether:

- in their opinion, based on their work undertaken on the audit, the information in the Strategic Report is consistent with the financial statements and has been prepared in accordance with applicable legal requirement; and
- in light of the knowledge obtained on the audit, whether they have identified any material misstatements in the Strategic Report.

#### Audit files

Limited work was performed to corroborate all KPIs, particularly comparison of the non-financial KPIs to supporting documentation, on ten of the audits we reviewed.

For those KPIs that were also APMs we considered the work the audit team performed to review and corroborate these to be generally done well. We identified only one case where the audit team had not considered whether the APMs were prepared and disclosed in accordance with the ESMA guidelines.

Non-financial KPIs should be linked to the achievement of strategic objectives. Typical non-financial KPIs include metrics that relate to customer relationships (for example, customer retention and satisfaction), employees (for example, employee retention, operations, quality, cycle-time), the organisation’s supply chain or its pipeline as well as health and safety incidents (for example, lost injury time).

There was limited evidence that audit teams had considered their relative importance or justified why further evidence to ensure their accuracy was not required. Supporting evidence was generally missing from the audit files.

In three instances, different KPIs were used from those in the prior year. The companies concerned had undergone restructuring following a challenging year in terms of performance and the revised KPIs reported performance more positively than those used previously. There was no evidence that the audit teams had explicitly considered the appropriateness of these changes to the KPIs and, in particular, their implications for FBU.
3.7 The Directors’ Remuneration Report

The DRR comprises:
• An Annual Statement by the Chairman of the Remuneration Committee
• An Annual Report on Remuneration
• A Remuneration Policy Report

The Companies Act, the “Accounts Regulations” and the Listing Rules set out the information to be included in the DRR. The DRR includes both audited and unaudited information.

Paragraphs 4 to 17 of Part 3 of Schedule 8 of the Statutory Instrument for “The Large and Medium-sized Companies and Groups (Accounts and Reports) (Amendment) Regulations 2013” are subject to audit. The audited parts of the DRR form part of the Annual Report on Remuneration.

The auditor is required to state in the auditor’s report, whether in their opinion, the part of the DRR required to be audited has been properly prepared in accordance with the Companies Act.

The auditor is also required to report, where in their opinion:
• the part of the DRR to be audited is not in agreement with the accounting records and returns; and
• certain disclosures of Directors’ remuneration specified by law are not made;
Or to state they have nothing to report in respect of these matters.

Policies and Procedures

<table>
<thead>
<tr>
<th></th>
<th>Firm A</th>
<th>Firm B</th>
<th>Firm C</th>
<th>Firm D</th>
<th>Firm E</th>
<th>Firm F</th>
</tr>
</thead>
<tbody>
<tr>
<td>Separate work programme for the DRR</td>
<td>✔</td>
<td>✔</td>
<td>✘</td>
<td>✔</td>
<td>✘</td>
<td>✔</td>
</tr>
<tr>
<td>Explicit procedures</td>
<td>✘</td>
<td>✔</td>
<td>✘</td>
<td>✘</td>
<td>✘</td>
<td>✔</td>
</tr>
<tr>
<td>Specific procedures for the unaudited information</td>
<td>✘</td>
<td>✔</td>
<td>✘</td>
<td>✘</td>
<td>✘</td>
<td>✔</td>
</tr>
<tr>
<td>Lower materiality guidance</td>
<td>✔</td>
<td>✘</td>
<td>✔</td>
<td>✘</td>
<td>✔</td>
<td>✘</td>
</tr>
</tbody>
</table>

Audited information

Four firms have a separate work programme for the audited parts of the DRR. For one of those firms, the procedures are basic, with teams only required to agree the Directors’ remuneration to Board minutes and to emolument certificates. For the other firms the procedures are more focussed. Typically, these include:
• Obtaining Directors’ service contracts and signed emolument certificates;
• Testing remuneration to payroll records or service contracts where applicable;
• Obtaining supporting evidence /or recalculating bonuses;
• Agreeing benefits to P11D forms; and
• Inspecting the register of Directors’ interests in shares and options and the register of members, and checking options granted to the underlying agreements.
Unaudited information

Two firms have specific procedures in respect of the unaudited part of the DRR. One firm includes these procedures with those to be performed on the audited part of the DRR while the other one has a separate work programme.

For all other firms the unaudited part of the DRR is subject to the same policies and procedures as ‘Other Information’.

Lower materiality levels applied to the audited parts of the DRR

Firms C and E expect audit teams to consider applying a lower materiality level as the users of the financial statements place a high level of importance on the DRR.

Firm A does not mandate using a lower materiality level but includes the DRR as an example of an area where a lower materially level could be applied when law, regulation, or the applicable financial reporting framework affect users’ expectations.

Firm B does not require teams to set a lower materiality level but expects teams to consider whether errors identified are qualitatively material rather than relying on the overall financial statements audit materiality.

Firms D and F do not have any guidance on the application of audit materiality to their work on the DRR.

Audit files

Audited parts of the DRR

Insufficient procedures were performed on aspects of the audited parts of the DRR on ten audit files as noted below.

- **Salaries and benefits**

  Procedures in respect of salaries and benefits were limited to reliance on self-certification by the Directors on nine audits. No consideration was given by the audit team to the appropriateness of the evidence and, in particular, the reliability of these certificates. This included three cases where the audit team considered the benefits to be immaterial. In another case, where there was no change to the salaries and benefits year-on-year, the audit team decided not to test further.

- **Bonuses**

  We identified deficiencies on nine audits in the testing of the work on the Directors’ performance bonus. In two instances the audit team did not recalculate the bonus, while in seven cases there was insufficient work to corroborate the actual performance against bonus targets. In one case the team also had not ensured the accuracy and completeness of the information provided by management to support one of the performance measures.
• **Share-based payments and Directors’ shareholdings**
For ten audits, we identified issues with the audit work on share-based payments or Directors’ shareholdings. In most cases there was no clear link to the audit work on share-based payments/incentives to demonstrate how this work provided assurance over the DRR disclosures. We also identified instances where audit teams had not tested the Directors’ shareholdings, the accuracy of share prices relevant to share awards as well as the accuracy of the number of awards granted, vested and/or held.

**Unaudited information**

The unaudited information in the DRR is extensive and complex. In some cases, we noted the distinction between the audited and unaudited information was blurred or incorrectly labelled.

There was clear evidence that audit teams had assessed and considered the unaudited parts of the DRR in 18 of the files that we reviewed.

Examples of work performed on the unaudited information, in addition to reading the unaudited sections and considering any material inconsistencies between the Other Information and the financial statements, included:

- Reviewing the disclosures in conjunction with the appropriate GAAP checklist to ensure completeness; and
- Checking for a clear distinction between the parts of the remuneration report that are subject to audit and those that are not subject to audit.

The twelve audits where there was limited consideration of the unaudited information included one FTSE 100 and five FTSE 250 companies.

**Good practice examples**
We observed good practice on five audit files. All were at firms which had targeted procedures in relation to the DRR. Examples included the following:

- Technical review by the firms’ specialists of compliance with the disclosure requirements;
- Corroboration of the achievement of bonus-related operational targets including, where applicable, to third-party information;
- Agreeing the appointment of Remuneration Committee advisors and the nature of services provided to the Committee minutes, the fees paid to third party documentation and ensuring that the disclosure requirements in respect of those services had been met; and
- Ensuring the accuracy of any charts or graphs included that are not subject to audit.