Standard

Audit and Assurance

Financial Reporting Council

September 2014

Extracts from International Standards on Auditing (UK and Ireland) 260, 570 and 700 (Revised September 2014)

This document presents revised paragraphs from ISAs (UK and Ireland) 260, 570 and 700. The revisions are effective for audits of financial statements for periods commencing on or after 1 October 2014.

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

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September 2014

Extract from International Standard on Auditing (UK and Ireland) 260 (Revised September 2014)

Communication with those charged with governance

EXTRACT FROM INTERNATIONAL STANDARD ON AUDITING (UK AND IRELAND) 260 (REVISED SEPTEMBER 2014)

COMMUNICATION WITH THOSE CHARGED WITH GOVERNANCE

(Effective for audits of financial statements for periods commencing on or after 1 October 2014)

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

Planned Scope and Timing of the Audit

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

Significant Findings from the Audit

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

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

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

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

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

      (ii) Written representations the auditor is requesting; and

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

Entities that Report on Application of the UK Corporate Governance Code

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

- The board (in the context of fulfilling its responsibilities under Code provisions C.1.1, C.1.3, C.2.1, C.2.2 and C.2.3) and, where applicable, the audit committee (in the context of fulfilling its responsibilities under Code provision C.3.4); and

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

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

If not already covered by communications under paragraphs 15 and 16 above and paragraph 23 of ISA (UK and Ireland) 570, “Going Concern”, this information shall include the auditor’s views: (Ref: Para. A20-2 – A20-5)

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

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

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

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

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

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

(e) About the robustness of the directors’ assessment of the principal risks facing the entity, including those that would threaten its business model, future performance, solvency or liquidity and its outcome, including the related disclosures in the annual report confirming that they have carried out such an assessment and describing those risks and explaining how they are being managed or mitigated (in accordance with Code provision C.2.1);

(f) The directors’ explanation in the annual report as to how they have assessed the prospects of the entity, over what period they have done so and why they consider that period to be appropriate (in accordance with Code provision C.2.2), and their statements:

 (i) in the financial statements, as to whether they considered it appropriate to adopt the going concern basis of accounting in preparing them, including any related disclosures identifying any material uncertainties to the entity’s ability to continue to do so over a period of at least twelve months from the date of approval of the financial statements (in accordance with Code provision C.1.3); and

 (ii) in the annual report as to whether they have a reasonable expectation that the entity will be able to continue in operation and meet its liabilities as they fall due over the period of their assessment, including any related disclosures drawing attention to any necessary qualifications or assumptions (in accordance with Code provision C.2.2); and

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

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

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Application and Other Explanatory Material

OTHER SIGNIFICANT MATTERS RELEVANT TO THE FINANCIAL REPORTING PROCESS (REF: PARA. 16(D))

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

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

A20-1. Under the UK Corporate Governance Code, the responsibilities of the directors under Code provision C.1.1 include making a statement that they consider the annual report and accounts taken as a whole is fair, balanced and understandable and provides the information necessary for shareholders to assess the entity's position and performance, business model and strategy. The responsibilities of the audit committee under Code provision C.3.4 include, where requested by the board, providing advice in relation to that statement[7a]. The responsibilities of the board under Code provision C.2.3 include monitoring the entity's risk management and internal control systems and, at least annually, carrying out a review of their effectiveness and reporting on that review in the annual report[7b]. The responsibilities of the board under Code provisions C.1.3, C.2.1 and C.2.2 are described in paragraphs 16-1 (e) and (f). The responsibilities of the audit committee under Code provision C.3.2 include: monitoring the integrity of the financial statements of the entity and any formal announcements relating to the entity's financial performance, reviewing significant financial reporting judgments contained in them; reviewing the entity's internal financial controls and, unless

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

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

expressly addressed by a separate board risk committee composed of independent directors or by the board itself, the entity's internal control and risk management systems[7c]; review and monitor the effectiveness of the audit process; and reporting to the board on how it has discharged its responsibilities. The supporting Guidance on Audit Committees indicates that the report to the board should include, inter alia[7d]:

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

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

(a) Issues that involve significant judgment; and

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

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

A20-3. The audit procedures that the auditor designs as part of the audit of the financial statements are not designed for the purpose of expressing an opinion on the effectiveness of the entity's system of internal control as a whole and accordingly the auditor does not express such an opinion on the basis of those procedures. However, communication of the auditor's views about the effectiveness of elements of the entity's system of internal control,

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[7c] The FRC issues 'Guidance on Risk management and Internal Control and Related Financial and Business Reporting' for directors on their responsibilities under the UK Corporate Governance Code. The guidance indicates that it is for the board to decide what arrangements to put in place to enable it to exercise its responsibilities. The guidance also indicates the nature of the information the board may include in its narrative statement about these matters. Supplementary considerations for the banking sector are provided in 'Guidance for Directors of Banks on Solvency and Liquidity Risk Management and the Going Concern Basis of Accounting'.

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

based on the audit procedures performed in the audit of the financial statements, may help the audit committee and the board fulfil their respective responsibilities with respect to the entity's internal control and risk management systems.

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

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

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

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Extract from International Standard on Auditing (UK and Ireland) 570 (Revised September 2014)

Going concern

EXTRACT FROM INTERNATIONAL STANDARD ON AUDITING (UK AND IRELAND) 570 (REVISED SEPTEMBER 2014)

GOING CONCERN

(Effective for audits of financial statements for periods commencing on or after 1 October 2014)

CONTENTS

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

Interpreting the term ‘going concern’ in this ISA (UK and Ireland)

The financial reporting frameworks applicable in the UK and Ireland [generally] require the adoption of the ***going concern basis of accounting*** in financial statements, except in circumstances where management intends to liquidate the entity or to cease trading, or has no realistic alternative to liquidation or cessation of operations. In effect, an entity that does not meet the threshold for that exception is described as a ***going concern***. This requirement applies even when there are uncertainties about events or conditions that may cast significant doubt upon the entity’s ability to continue as a going concern in the future. Such uncertainties are required to be disclosed in the financial statements when they are material.

The term ***going concern assumption*** is the defining assumption about the condition of an entity for which adoption of the going concern basis of accounting is appropriate: that the entity is, and will be able to continue as, a going concern.

Accordingly, as used in this ISA (UK and Ireland):

A. The term ‘going concern’ applies to any entity unless its management intends to liquidate the entity or to cease trading, or has no realistic alternative to liquidation or cessation of operations; and
B. The term ‘ability to continue as a going concern’ is equivalent to the term ‘ability to continue to adopt the going concern basis of accounting’ in the future.

Audit Conclusions and Reporting

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

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

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

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

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

    (a) The directors' confirmation in the annual report that they have carried out a robust assessment of the principal risks facing the entity, including those that would threaten its business model, future performance, solvency or liquidity;

    (b) The disclosures in the annual report that describe those risks and explain how they are being managed or mitigated;

    (c) The directors' statement in the financial statements about whether they considered it appropriate to adopt the going concern basis of accounting in preparing them, and their identification of any material uncertainties to the entity's ability to continue to do so over a period of at least twelve months from the date of approval of the financial statements; and

    (d) The director's explanation in the annual report as to how they have assessed the prospects of the entity, over what period they have done so and why they consider that period to be appropriate, and their

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

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

statement as to whether they have a reasonable expectation that the entity will be able to continue in operation and meet its liabilities as they fall due over the period of their assessment, including any related disclosures drawing attention to any necessary qualifications or assumptions.

The auditor shall determine whether the auditor has anything material to add or to draw attention to in the auditor's report on the financial statements in relation to these disclosures, and shall report in accordance with the requirements of ISA (IUK and Ireland) 700[4d].

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

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

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

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

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Extract from International Standard on Auditing (UK and Ireland) 700 (Revised September 2014)

The independent auditor’s report on financial statements

EXTRACT FROM INTERNATIONAL STANDARD ON AUDITING (UK AND IRELAND) 700 (REVISED SEPTEMBER 2014)

THE INDEPENDENT AUDITOR'S REPORT ON FINANCIAL STATEMENTS

(Effective for audits of financial statements for periods commencing on or after 1 October 2014)

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

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

Statement on the Directors' Assessment of the Principal Risks that Would Threaten the Solvency or Liquidity of the Entity

22C In the case of entities that are required[6], and those that choose voluntarily, to report on how they have applied the UK Corporate Governance Code or to explain why they have not, the auditor shall, having regard to the work performed in accordance with the requirement of paragraph 17-2 of ISA (UK and Ireland) 570, give a statement as to whether the auditor has anything material to add or to draw attention to in relation to:

(a) The directors' confirmation in the annual report that they have carried out a robust assessment of the principal risks facing the entity, including those that would threaten its business model, future performance, solvency or liquidity,

(b) The disclosures in the annual report that describe those risks and explain how they are being managed or mitigated,

(c) The directors' statement in the financial statements about whether they considered it appropriate to adopt the going concern basis of accounting in preparing them, and their identification of any material uncertainties to the entity's ability to continue to do so over a period of at least twelve months from the date of approval of the financial statements, and

(d) The director's explanation in the annual report as to how they have assessed the prospects of the entity, over what period they have done so and why they consider that period to be appropriate, and their statement as to whether they have a reasonable expectation that the entity will be able to continue in operation and meet its liabilities as they fall due over the period of their assessment, including any related disclosures drawing attention to any necessary qualifications or assumptions.

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