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***The Combined Code on  
Corporate Governance:  
Requirements of Auditors  
under the Listing Rules of  
the Financial Services  
Authority and the Irish  
Stock Exchange***

2006/5

BULLETIN

## THE AUDITING PRACTICES BOARD LIMITED

The Auditing Practices Board Limited, which is part of the Financial Reporting Council, prepares for use within the United Kingdom and the Republic of Ireland:

- Standards and guidance for auditing;
- Standards and guidance for the work of reporting accountants in connection with investment circulars; and
- Standards and guidance for auditors' and reporting accountants' integrity, objectivity and independence

with the objective of enhancing public confidence in the audit process and the quality and relevance of audit services in the public interest.

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This Bulletin is issued by the APB and does not constitute guidance from either the Financial Services Authority ("FSA") or the Irish Stock Exchange ("ISE"). However the APB acknowledges the advice and assistance provided by both the FSA and the ISE during the development of the Bulletin.

For accounting periods commencing on or after 1 January 2006, this Bulletin supersedes Bulletins 2004/3 and 2004/4.

## THE AUDITING PRACTICES BOARD

### ***THE COMBINED CODE ON CORPORATE GOVERNANCE: REQUIREMENTS OF AUDITORS UNDER THE LISTING RULES OF THE FINANCIAL SERVICES AUTHORITY AND THE IRISH STOCK EXCHANGE***

<b>Contents</b>	<b>Paragraphs</b>
Introduction	1 - 4
Requirements of the Listing Rules relating to corporate governance matters	5 - 10
The auditor's review of the statement of compliance	11 - 13
Combined Code provisions that the auditor is required to review	14
General procedures	15 - 22
Specific procedures	23 - 67
Directors' statement on going concern	68 - 72
Reporting requirements derived from other Auditing Standards	73
<b>Appendices</b>	
1. <i>Extracts from the FSA Listing Rules</i>	
2. <i>Equivalent Irish Stock Exchange Listing Rules</i>	
3. <i>Example terms of engagement paragraphs</i>	

## INTRODUCTION

1. This Bulletin provides guidance for auditors when reviewing a company's statement made in relation to "The Combined Code on Corporate Governance" ("Combined Code") in accordance with Listing Rule ("LR") 9.8.10R of the Financial Services Authority ("FSA") or LR 6.8.9 of the Irish Stock Exchange ("ISE"). It replaces the guidance in:
  - APB Bulletin 2004/3, "The Combined Code on Corporate Governance: Requirements of Auditors under the Listing Rules of the Financial Services Authority" published in November 2004; and
  - APB Bulletin 2004/4 "The Combined Code on Corporate Governance: Requirements of Auditors under the Listing Rules of the Irish Stock Exchange" published in December 2004.
2. This Bulletin reflects the following:
  - (a) The issuance of "Internal Control: Revised Guidance for Directors on the Combined Code" ("Turnbull Guidance") by the Financial Reporting Council in October 2005. The Turnbull Review Group made only a small number of changes to the Turnbull Guidance as first issued in 1999. One of these changes is that the board's statement on internal control should confirm that necessary actions have been, or are being, taken to remedy any significant failings or weaknesses identified from its review of the effectiveness of the system of internal control. This development is set out in paragraph 36 of the revised Turnbull Guidance and is discussed in paragraphs 40 to 44 in this Bulletin.
  - (b) The issuance of revised Listing Rules in July 2005. Although there has been no change to the substance of the requirements of the Listing Rules in this regard the text of the rules differs from the previous rules.
3. This Bulletin provides guidance for auditors of both:
  - (a) companies listed on the Official List maintained by the FSA that are incorporated in the United Kingdom; and
  - (b) companies listed on the Official List maintained by the ISE that are incorporated in Ireland.

The text of the applicable revised Listing Rules issued by the FSA is set out in Appendix 1. Appendix 2 sets out the references to the equivalent Listing Rules of the ISE. In the remainder of this Bulletin reference is made to the "Listing Rules" and footnotes provide the specific references to the Listing Rules issued by the FSA and the ISE.

4. This Bulletin does not address the report to shareholders on executive directors' remuneration that is required by the Listing Rules<sup>1</sup>.

## REQUIREMENTS OF THE LISTING RULES RELATING TO CORPORATE GOVERNANCE MATTERS

### Requirement for companies to “comply or explain”

5. The FSA Listing Rules require listed companies<sup>2</sup> that are incorporated in the United Kingdom to include in their annual report and accounts a two-part disclosure statement in relation to the Combined Code. The Listing Rules of the ISE have a similar requirement with respect to listed companies that are incorporated in the Republic of Ireland. The first part of the disclosure statement is to explain how the company has applied the principles set out in Section 1 of the Combined Code, in a manner that would enable shareholders to evaluate how the principles have been applied<sup>3</sup>.
6. The second part of the disclosure statement requires the company to either<sup>4</sup>:
  - (a) Comply - include “a statement as to whether the listed company has complied throughout the accounting period with all relevant provisions set out in Section 1 of the Combined Code”; or
  - (b) Explain – include “a statement as to whether the listed company has not complied throughout the accounting period with all relevant provisions set out in Section 1 of the Combined Code and if so, setting out:
    - (i) those provisions, if any, it has not complied with;
    - (ii) in the case of provisions whose requirements are of a continuing nature, the period within which, if any, it did not comply with some or all of those provisions; and
    - (iii) the company's reasons for non-compliance”.
7. It is expected that listed companies will comply with the provisions of the Combined Code most of the time. However, it is recognised that departures from the provisions of the Code may be justified in particular circumstances. The auditor has no responsibility to review or otherwise assess and comment upon a company's decision to depart from the provisions of the Code. It is for shareholders and others to evaluate any such departure and the company's explanation for it.

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1 FSA LR 9.8.6R(7) and LR 9.8.8R; ISE LR 6.8.6(8) and LR 6.8.8.

2 A listed company is defined by the FSA and the Irish Stock Exchange as “a company that has any class of its securities listed”.

3 FSA LR 9.8.6R(5); ISE LR 6.8.6(6)

4 FSA LR 9.8.6R(6); ISE LR 6.8.6(7)

8. The Listing Rules<sup>5</sup> requires an overseas company with a primary listing to disclose in its annual report and accounts certain matters relating to its corporate governance. There are no requirements relating to auditors in respect of these Listing Rules.

### **Review of the company's disclosure statement by the auditor**

9. The Listing Rules<sup>6</sup> require that "*A listed company must ensure that the auditors review the parts of the statement that relate to the following provisions of the Combined Code C1.1, C2.1, and C3.1 to C3.7.*" They require the auditor to review nine of the ten objectively verifiable Combined Code provisions relating to accountability and audit.
10. The tenth accountability and audit Combined Code provision (C.1.2 on going concern) is addressed by different Listing Rules<sup>7</sup>. These Listing Rules require the directors to make a statement that the business is a going concern, together with supporting assumptions or qualifications as necessary. This statement is required to be included in the annual report and accounts and to be reviewed by the auditor before publication.

### **THE AUDITOR'S REVIEW OF THE STATEMENT OF COMPLIANCE**

11. The scope of the auditor's review required by the Listing Rules<sup>8</sup>, in comparison to the totality of the Combined Code, is narrow. The auditor is not required to review the directors' narrative statement of how they have applied the Code principles and is required only to review the directors' compliance statement in relation to nine of the forty-eight Code provisions applicable to companies. Nevertheless, because the directors' narrative statement comprises other information included in a document containing audited financial statements there is a broader requirement under Auditing Standards<sup>9</sup> for the auditor to read such "other information" and if the auditor becomes aware of any apparent misstatements therein, or identifies any material inconsistencies with the audited financial statements, to seek to resolve them.
12. The Listing Rules are silent as to whether the auditor should report on the auditor's review of the directors' compliance statement and whether any such report should be published or referred to in the annual report. The APB is of the view that if the auditor's report itself contains a description of the auditor's responsibilities (including the auditor's responsibilities under the Listing Rules), as discussed in paragraphs 24 to 29, there is no necessity for a separate auditor's report dealing with the auditor's review of corporate governance matters.

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5 FSA LR 9.8.7R; ISE LR 6.8.7

6 FSA LR 9.8.10R(2); ISE LR 6.8.9(2)

7 FSA LR 9.8.6R(3) and LR 9.8.10R(1); ISE LR 6.8.6(3) and LR 6.8.9(1)

8 FSA LR 9.8.10R; ISE LR 6.8.9

9 ISA (UK and Ireland) 720 (Revised) Section A, "Other information in documents containing audited financial statements".

13. Because of the limited nature of the auditor's review and in order to avoid the possibility of misunderstandings arising the APB recommends that:
- (a) the auditor's engagement letter explains the scope of the auditor's review. Example paragraphs are set out in Appendix 3; and
  - (b) prior to the release of the annual report and accounts the auditor communicates, and discusses, with those charged with governance the factual findings of the auditor's review.

## COMBINED CODE PROVISIONS THAT THE AUDITOR IS REQUIRED TO REVIEW

14. The provisions of the Combined Code that the auditor is required to review are set out below, together with a reference to the specific procedures recommended by the APB:

Provision	Detailed recommendation	Specific procedures
C.1.1	The directors should explain in the annual report their responsibility for preparing the accounts and there should be a statement by the auditors about their reporting responsibilities.	23-29
C.2.1	The board should, at least annually, conduct a review of the effectiveness of the group's system of internal controls and should report to shareholders that they have done so. The review should cover all material controls, including financial, operational and compliance controls and risk management systems.	30-55
C.3.1	The board should establish an audit committee of at least three, or in the case of smaller companies <sup>10</sup> two, members, who should all be independent non-executive directors. The board should satisfy itself that at least one member of the audit committee has recent and relevant financial experience.	56-59
C.3.2	The main role and responsibilities of the audit committee should be set out in written terms of reference and should include:	60

10 In the UK, a smaller company is one that is below the FTSE 350 throughout the year immediately prior to the reporting year. The Irish Stock Exchange considers a smaller company to be one that is included in the ISEQ Small Cap Index throughout the year immediately prior to the reporting year.

	<ul style="list-style-type: none"> <li>• to monitor the integrity of the financial statements of the company, and any formal announcements relating to the company's financial performance, reviewing significant financial reporting judgements contained in them;</li> <li>• to review the company's internal financial controls and, unless expressly addressed by a separate board risk committee composed of independent directors, or by the board itself, to review the company's internal control and risk management systems;</li> <li>• to monitor and review the effectiveness of the company's internal audit function;</li> <li>• to make recommendations to the board, for it to put to the shareholders for their approval in general meeting, in relation to the appointment, re-appointment and removal of the external auditor and to approve the remuneration and terms of engagement of the external auditor;</li> <li>• to review and monitor the external auditor's independence and objectivity and the effectiveness of the audit process, taking into consideration relevant UK professional and regulatory requirements;</li> <li>• to develop and implement policy on the engagement of the external auditor to supply non-audit services, taking into account relevant ethical guidance regarding the provision of non-audit services by the external audit firm; and to report to the board, identifying any matters in respect of which it considers that action or improvement is needed and making recommendations as to the steps to be taken.</li> </ul>	
C.3.3	<p>The terms of reference of the audit committee, including its role and the authority delegated to it by the board, should be made available. A separate section of the annual report should describe the work of the committee in discharging those responsibilities.</p>	61
C.3.4	<p>The audit committee should review arrangements by which staff of the company may, in confidence, raise concerns about possible improprieties in matters of financial reporting or other matters. The audit committee's objective should be to ensure that arrangements are in place for the proportionate and</p>	62



	independent investigation of such matters and for appropriate follow-up action.	
C.3.5	The audit committee should monitor and review the effectiveness of the internal audit activities. Where there is no internal audit function, the audit committee should consider annually whether there is a need for an internal audit function and make a recommendation to the board, and the reasons for the absence of such a function should be explained in the relevant section of the annual report.	63
C.3.6	The audit committee should have primary responsibility for making a recommendation on the appointment, reappointment and removal of the external auditors. If the board does not accept the audit committee's recommendation, it should include in the annual report, and in any papers recommending appointment or re- appointment, a statement from the audit committee explaining the recommendation and should set out reasons why the board has taken a different position.	64
C.3.7	The annual report should explain to shareholders how, if the auditor provides non-audit services, auditor objectivity and independence is safeguarded.	65-67

## GENERAL PROCEDURES

15. Paragraphs 16 to 22 set out general procedures relating to the auditor's review of the statement of compliance. These general procedures are applicable to all of the nine provisions of the Combined Code that the auditor is required to review.
16. In relation to all elements of the corporate governance disclosures relating to the provisions of the Combined Code that are within the scope of the auditor's review, the auditor obtains appropriate evidence to support the compliance statement made by the company. The type of procedures usually performed include:
- (a) reviewing the minutes of the meetings of the board of directors, and of relevant board committees;
  - (b) reviewing supporting documents prepared for the board of directors or board committees that are relevant to those matters specified for review by the auditor;
  - (c) making enquiries of certain directors (such as the chairman of the board of directors and the chairmen of relevant board committees) and the company secretary to satisfy themselves on matters relevant to those provisions of the Combined Code specified for review by the auditor; and

- (d) attending meetings of the audit committee (or the full board if there is no audit committee) at which the annual report and accounts, including the statement of compliance, are considered and approved for submission to the board of directors.
17. The auditor may request the directors to provide written confirmation of oral representations made during the course of the review.

### **Non-compliance with provisions of the Combined Code**

18. Where the auditor becomes aware of any provision of the Combined Code that is within the scope of the auditor's review and with which the company has not complied, the auditor establishes that the departure is described in the directors' statement of compliance. However, the auditor is not required to, and does not, perform additional procedures to investigate the appropriateness of reasons given for non-compliance with the provision.
19. Where there is a departure from a provision specified for the auditor's review but there is proper disclosure of this fact and of the reasons for the departure, as envisaged by the Listing Rules<sup>11</sup>, the auditor does not refer to this in its report on the financial statements.
20. However, where the auditor considers that there is not proper disclosure of a departure from a provision of the Combined Code specified for the auditor's review the auditor reports this in the auditor's report on the financial statements. Paragraph 55 describes the way in which such a matter (which does not give rise to a qualified opinion on the financial statements) is reported and provides an example of such an opinion.

### **Auditor's association with company's corporate governance disclosures**

21. The auditor would not wish to be associated with either the statement of compliance or the company's narrative statement of how it has applied the Code principles if the auditor has reason to believe that they may be misleading. The auditor, therefore, reads both of these statements and considers whether any information in either of them is apparently misstated or materially inconsistent with other information of which the auditor has become aware in the course of either the review of the company's compliance statement (insofar as it relates to the nine provisions of the Combined Code that the auditor is required to review under the Listing Rules) or the audit of the financial statements.
22. The auditor is not expected actively to search for misstatements or inconsistencies. However, if the auditor becomes aware of such a matter the auditor discusses it with the directors in order to establish the significance of the lack of proper disclosure. If such lack of proper disclosure is considered significant by the auditor and the directors cannot be persuaded to amend the disclosure to the auditor's satisfaction, the auditor considers the

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<sup>11</sup> FSA LR 9.8.10R; ISE LR 6.8.9

implications for the auditor's reporting responsibilities and the auditor may need to take legal advice.

## **SPECIFIC PROCEDURES**

### **Responsibilities of the directors and the auditor**

**C.1.1 The directors should explain in the annual report their responsibility for preparing the accounts and there should be a statement by the auditors about their reporting responsibilities.**

#### ***Directors' responsibilities***

23. While the content of the statement of the directors' responsibilities is determined by the directors, the auditor establishes that the directors' responsibility for preparing the accounts is explained in the annual report.

#### ***Auditor's responsibilities***

24. The auditor has different responsibilities with respect to the various component parts of the annual report. For example, the auditor is required to "audit" the financial statements, "review" the company's compliance with certain aspects of the Combined Code and "read" all information in the annual report that is not subject to any other requirement. The auditor reads such "other information" because the credibility of the financial statements and the related auditor's report may be undermined by material inconsistencies between the financial statements and the "other information", or by apparent misstatements within the other information.
25. In some instances the auditor has to report positively the results of the work whereas in other instances the auditor only has to report by exception. The APB is of the view that users of annual reports will find it difficult to understand the scope of the auditor's involvement in the absence of a clear statement of the auditor's responsibilities towards the whole annual report.
26. The key elements of a statement of the auditor's responsibilities relate to the requirements of:
- (a) statute and Auditing Standards with respect to the audit of the financial statements;
  - (b) statute with respect to the auditor's opinion as to whether the information given in the directors report for the financial year for which the financial statements are prepared is consistent with those financial statements;
  - (c) statute and the Listing Rules where the auditor is only required to report by exception;
  - (d) the Listing Rules for the auditor to review the statement concerning the company's compliance with certain provisions of the Combined Code; and

- (e) Auditing Standards to read the “other information” in the annual report.
27. A description of the auditor’s responsibilities may either be included as a separate section of the auditor’s report on the financial statements or set out as a separate statement within the annual report. The APB encourages auditors to include a description of the auditor’s responsibilities within the auditor’s report on the financial statements. Illustrative examples of auditor’s reports containing descriptions of the auditor’s responsibilities are given in the most recent version of the APB Bulletin “Auditor’s Reports on Financial Statements”<sup>12</sup>.
28. The content of the statement of the auditor’s responsibilities ought to be determined by the auditor regardless of whether it is published as a separate statement, or incorporated into the auditor’s report on the financial statements.
29. Appendix 3 to this Bulletin includes illustrative paragraphs that may be included in the auditor’s engagement letter to describe the auditor’s responsibilities with respect to the company’s compliance with the Listing Rules<sup>13</sup>. In practice the auditor tailors the engagement letter to the specific circumstances of the engagement.

## Internal control

**C.2.1 The board should, at least annually, conduct a review of the effectiveness of the group’s system of internal controls and should report to shareholders that they have done so. The review should cover all material controls, including financial, operational and compliance controls and risk management systems.**

### ***The auditor’s responsibilities with respect to the directors’ narrative statement***

30. The annual report will contain a narrative statement of how the company has applied Code principle C.2. The Turnbull Guidance recommends that, “In its narrative statement of how the company has applied Code Principle C.2, the board should, as a minimum, disclose that there is an ongoing process for identifying, evaluating and managing the significant risks faced by the company, that it has been in place for the year under review and up to the date of approval of the annual report and accounts, that is regularly reviewed by the board...”<sup>14</sup> The Turnbull Guidance also states that “The annual report and accounts should include such meaningful, high-level information as the board considers necessary to assist shareholders’ understanding of the main features of the company’s risk management processes and system of internal control, and should not give a misleading impression”<sup>15</sup>. The content of such narrative statements is likely, therefore, to vary widely from company to company.

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12 At the date of publication of this Bulletin the most recent version was Bulletin 2005/4

13 FSA LR 9.8.10R; ISE LR 6.8.9

14 Paragraph 34 of the Turnbull Guidance.

15 Paragraph 33 of the Turnbull Guidance

31. Although the Listing Rules do not require the auditor to review the narrative statement, there are requirements under Auditing Standards for the auditor to read the other information (of which the company's narrative statement forms a part) issued with the audited financial statements and to seek to resolve any apparent misstatements or material inconsistencies with the audited financial statements.

### **Auditor's review of compliance**

32. The Turnbull Guidance<sup>16</sup>, recommends that the company discloses a summary of the process the board (and where applicable, its committees) has adopted in reviewing the effectiveness of the system of internal control. The Turnbull Guidance<sup>17</sup> describes the directors' process for reviewing effectiveness and in particular states<sup>18</sup>: *"The board should define the process to be adopted for its review of the effectiveness of internal control. This should encompass both the scope and frequency of the reports it receives and reviews during the year, and also the process for its annual assessment, such that it will be provided with sound, appropriately documented, support for its statement on internal control in the company's annual report and accounts"*.
33. The objective of the auditor's review of compliance is to assess whether the company's summary of the process the board (and where applicable its committees) has adopted in reviewing the effectiveness of the system of internal control, is both supported by the documentation prepared by or for the directors and appropriately reflects that process.
34. To achieve this objective the auditor, in addition to the procedures outlined in paragraph 16;
- (a) obtains an understanding, through enquiry of the directors, of the process defined by the board for its review of the effectiveness of all material internal controls and compares that understanding to the statement made by the board in the annual report and accounts;
  - (b) reviews the documentation prepared by or for the directors to support their statement made in connection with Code provision C.2.1 and assesses whether or not it provides sound support for that statement; and
  - (c) relates the statement made by the directors to the auditor's knowledge of the company obtained during the audit of the financial statements. As explained in paragraph 36, the scope of the directors' review will be considerably broader in its scope than the knowledge the auditor can be expected to have based on their audit.

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16 Paragraphs 26-32 and 36 of the Turnbull Guidance.

17 Paragraphs 26-32 of the Turnbull Guidance.

18 Paragraph 27 of the Turnbull Guidance.

35. The auditor considers whether the directors' statement covers the year under review and the period to the date of approval of the annual report and accounts, as recommended by the Turnbull Guidance<sup>19</sup>.
36. In carrying out the review, the auditor will have regard to the knowledge of the company the auditor has obtained from the audit work. To enable the auditor to perform the audit and express an opinion on the financial statements, the auditor is required by Auditing Standards<sup>20</sup> to obtain an understanding of the entity and its environment, including its internal control, sufficient to identify and assess the risks of material misstatement of the financial statements. Consequently, the auditor's assessment required by Auditing Standards will be considerably narrower in scope than the review performed by the directors for the purpose of reporting on compliance with Code provision C.2.1.
37. The auditor, therefore, is not expected to assess whether all risks and controls have been addressed by the directors or that risks are satisfactorily addressed by internal controls. In order to communicate this fact to users of the annual report, the following sentence is included in the auditor's report on the financial statements.

*"We are not required to consider whether the board's statements on internal control cover all risks and controls, or form an opinion on the effectiveness of the company's corporate governance procedures or its risk and control procedures."*

38. However, ISA (UK and Ireland) 260 "Communication of audit matters with those charged with governance" requires, among other things, that the auditor communicates, on a timely basis, to those charged with governance material weaknesses in internal control identified during the audit. A material weakness in internal control is a deficiency in design or operation which could adversely affect the entity's ability to record, process, summarize and report financial and other relevant data so as to result in a material misstatement in the financial statements. A material weakness in control identified by the auditor will be considered by the directors, in the context of the reports they receive and review during the year as part of their overall process for undertaking an annual assessment of the effectiveness of the company's internal control procedures, and it may be considered by them to be a significant failing or weakness as described in the Turnbull Guidance.
39. In view of the obligations placed on directors by the Turnbull Guidance the APB recommends that any material weaknesses in internal control identified by the auditor be reported to those charged with governance as soon as is practicable. The auditor does not wait until the financial statement audit has been completed before reporting such

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<sup>19</sup> Paragraph 26 of the Turnbull Guidance.

<sup>20</sup> ISA (UK and Ireland) 315, "Obtaining an understanding of the entity and its environment and assessing the risks of material misstatement".

weaknesses. In this way, the directors will be aware of the weaknesses that the auditor has identified and be able to take account of them in making their statements on internal control<sup>21</sup>.

**Actions taken by the directors to remedy significant failings or weaknesses**

40. A revision made to the Turnbull Guidance in October 2005 was to expand the existing recommendation regarding the board's statement on internal control in the annual report in relation to Code provision C2.1. The recommendation was expanded to say that the board should in its statement on internal control, "*confirm that necessary actions have been or are being taken to remedy any significant failings or weaknesses identified from that review*"<sup>22</sup> (The reference to "that review" relates to the board's annual review of the effectiveness of the system of internal control).
41. The auditor's review responsibility with respect to this recommendation includes:
- (a) reviewing the documentation prepared by or for the directors supporting their statement made in connection with Code provision C2.1 that discusses those failings or weaknesses, if any, in internal control that they have assessed as "significant" and assessing whether or not it provides sound support for that statement;
  - (b) discussing with the directors the actions they have already taken, or consider necessary to take, with respect to the identified significant failings or weaknesses; and
  - (c) relating the statement made by the directors to the auditor's knowledge of the company obtained during the audit of the financial statements.
42. With respect to 41(c) above, the auditor assesses whether the directors, in making their statement, have taken into consideration the material weaknesses in internal control reported to those charged with governance by the auditor in accordance with ISA (UK and Ireland) 260 (See paragraph 38 above).
43. However, the auditor is not required to assess either the directors' decision as to what constitutes a significant failing or weakness, or whether the actions, taken or to be taken by the directors, will in fact remedy the significant failings or weaknesses identified by the directors. The APB recommends that a statement to this effect be included in the engagement letter (see Appendix 3).

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21 The auditor has a responsibility under ISA (UK and Ireland) 260 to consider whether there is adequate two-way communication between the auditor and those charged with governance, such that an effective audit can take place. As part of this responsibility, amongst other things, the auditor will need to consider the appropriateness and timeliness of actions taken by those charged with governance in response to the recommendations made by the auditor including those regarding material weaknesses in internal control.

22 Paragraph 36 of the Turnbull Guidance

44. If the auditor:
- (a) considers that the documentation and discussions do not support the directors' confirmation that necessary actions have been, or are being, taken or
  - (b) based on its audit findings is aware of material weaknesses in internal control that have not been considered by the directors

it discusses the position with the directors. If the auditor is not satisfied with the directors' explanations it considers the consequences for its opinion (see paragraph 54).

***Internal control aspects of problems disclosed in the annual report***

45. The Turnbull Guidance<sup>23</sup> also recommends that the board discloses *“the process it has applied to deal with material internal control aspects of any significant problems disclosed in the annual report and accounts”*.
46. This may be a difficult recommendation for directors to satisfy, and for the auditor to review, because what is meant by “significant problems” is not defined and the word “problem” encompasses more than financial matters. A directors' description, for example, of difficulties obtaining raw materials at a remote overseas location may be seen as a significant problem by directors of some companies but not the directors of others. Even when the directors have identified a problem it may not always be clear whether the problem has material internal control aspects. A significant loss-making contract, for example, will necessitate an assessment of whether the problem is attributable to changes in circumstances that could not reasonably have been foreseen as opposed to weaknesses in internal control.
47. The auditor's review responsibility with respect to this recommendation includes:
- (a) discussing with the directors the steps the directors have taken to determine what “significant problems” are disclosed in the annual report and accounts; and
  - (b) assessing whether disclosures made by the board of the processes it has applied to deal with material internal control aspects of any significant problems disclosed in the annual report and accounts appropriately reflect those processes.
48. The auditor is not required to assess whether the processes described by the directors will, in fact, remedy the problem described in the annual report and accounts.
49. If the auditor is aware of a significant problem that is disclosed in the annual report and accounts for which the board has not disclosed the material internal control aspects it discusses the position with the directors of the company.

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<sup>23</sup> Paragraph 36 of the Turnbull Guidance.



50. If the auditor is not able to agree with the directors as to how the matter should be resolved it considers the consequences for its opinion (see paragraph 54).

**Failure to conduct a review**

51. The Listing Rules<sup>24</sup> require the company to disclose if the board has failed to conduct a review of the effectiveness of internal control. The Turnbull Guidance<sup>25</sup> recommends that where it has not made the required disclosures the board should state that fact and provide an explanation. The auditor considers whether this recommendation is met and whether the explanation is consistent with the auditor's understanding.

**Groups of companies**

52. The Turnbull Guidance establishes that, for groups of companies, the review of effectiveness should be from the perspective of the group as a whole<sup>26</sup>. Accordingly, the auditor's consideration of the board's description of its process for reviewing the effectiveness of internal control encompasses the group as a whole.
53. Where material joint ventures and associated companies have not been dealt with as part of the group for the purposes of applying the Turnbull Guidance, this fact should be disclosed by the board<sup>27</sup>. The auditor assesses, based on the auditor's knowledge of the group obtained during the audit of the financial statements, whether any material joint ventures or associated companies have not been dealt with and, therefore, if such a disclosure is necessary.

**Reporting by exception**

54. If the auditor concludes:
- (a) that the board's summary of the process it has applied in reviewing the effectiveness of internal control is either not supported by or does not appropriately reflect the auditor's understanding of the process undertaken (paragraphs 32 to 39);
  - (b) that the documentation and discussions do not support the directors' confirmation that necessary actions have been, or are being taken; (paragraphs 40 to 44);
  - (c) that the processes disclosed to deal with material internal control aspects of significant problems disclosed in the annual report and accounts do not appropriately reflect the auditor's understanding of the process undertaken (paragraphs 45 to 50);
  - (d) that no disclosure has been made by the board that it has failed to conduct a review of the effectiveness of internal control (paragraph 51);

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24 FSA LR 9.8.6R(6)(b); ISE LR 6.8.6(7)(b)

25 Paragraph 37 of the Turnbull Guidance

26 Paragraph 13 of the Turnbull Guidance

27 Paragraph 38 of the Turnbull Guidance

- (e) where the board discloses that it has not reviewed the effectiveness of internal control, that its explanation is not consistent with the auditor's understanding (paragraph 51); or
- (f) that no disclosure has been made by the board that a material joint venture or associated company has not been dealt with as part of the group (paragraphs 52 to 53), they report this in their report on the financial statements.
55. However, as this does not give rise to a qualified audit opinion on the financial statements the APB recommends that the auditor's comments be included under the heading "Other matter" which would be included in the auditor's report below the auditor's opinion and any emphasis of matter related to the auditor's report on the financial statements as illustrated below:

**Opinion**

[Standard opinion wording for an auditor's report on group (not including parent company) financial statements of a publicly traded company incorporated in Great Britain<sup>28</sup>]

**Emphasis of matter**

Where applicable any emphasis of matter paragraph relating to the auditor's report on the financial statements.

**Other matter**

We have reviewed the board's description of its process for reviewing the effectiveness of internal control set out on page x of the annual report. In our opinion the board's comments concerning ... do not appropriately reflect our understanding of the process undertaken by the board because.....

**An audit committee of independent non-executive directors**

**C.3.1 The board should establish an audit committee of at least three, or in the case of smaller companies<sup>29</sup> two, members, who should all be independent non-executive directors. The board should satisfy itself that at least one member of the audit committee has recent and relevant financial experience.**

**Auditor's review of compliance**

56. When reviewing the company's compliance with this provision of the Combined Code the APB recommends that the auditor performs the following procedures:

<sup>28</sup> See Example 7 in Bulletin 2005/4

<sup>29</sup> In the UK a smaller company is one that is below the FTSE 350 throughout the year immediately prior to the reporting year. The Irish Stock Exchange considers a smaller company to be one that is included in the ISEQ Small Cap Index throughout the year immediately prior to the reporting year.

- (a) Checking that the audit committee comprises at least three, or in the case of smaller companies two, members.
  - (b) Obtaining an understanding of the process adopted by the board for determining whether:
    - (i) the members of the audit committee are all independent non-executive directors (see paragraphs 57 to 58); and
    - (ii) at least one member of the audit committee has recent and relevant financial experience (see paragraph 59).
  - (c) Reviewing evidence such as minutes and other documentation supporting the board's view that the non-executive directors on the audit committee are independent and, where appropriate, have recent and relevant financial experience.
57. Provision A.3.1 of the Combined Code, requires the board to identify in the annual report each non-executive director it considers to be independent. This provision includes guidance on how independence might be interpreted by listing a number of relationships or circumstances that may indicate that a director is not independent<sup>30</sup>. The Code makes clear, however, that notwithstanding such relationships or circumstances the company is entitled to explain why a director is considered independent.
58. It is not the auditor's responsibility to satisfy itself whether directors are properly described as being "independent" non-executives. Nor does the auditor lay down more precise criteria with respect to the meaning of the term "independent" than those set out in the Combined Code. When reviewing the company's compliance with this provision of the Combined Code the APB recommends that the review procedures be limited to establishing that the audit committee is comprised of non-executive directors who are identified in the annual report as being, in the opinion of the board, independent. However, if the auditor doubts whether the directors are properly described as being "independent" non-executives the auditor communicates those concerns to the audit committee and the board of directors.
59. Similarly, it is not the auditor's responsibility to satisfy itself whether the company is correct in concluding that a particular audit committee member has "recent and relevant financial experience". Nor should the auditor lay down more precise criteria with respect to the meaning of the term "recent and relevant financial experience". When reviewing the company's compliance with this provision of the Combined Code the APB recommends that the review procedures be limited to considering the process adopted by the board for determining that at least one member of the audit committee has "recent

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30 A footnote to A.3.1 explains 'A.2.2 states that the chairman should on appointment meet the independence criteria set out in this provision, but thereafter the test of independence is not appropriate in relation to the chairman'.

and relevant financial experience". However, if the auditor doubts whether the company is correct in concluding that a particular audit committee member has "recent and relevant financial experience" the auditor communicates those concerns to the audit committee and the board of directors.<sup>31</sup>

### **Role and responsibilities of the audit committee<sup>32</sup>**

**C.3.2 The main role and responsibilities of the audit committee should be set out in written terms of reference and should include:**

- **to monitor the integrity of the financial statements of the company, and any formal announcements relating to the company's financial performance, reviewing significant financial reporting judgements contained in them;**
- **to review the company's internal financial controls and, unless expressly addressed by a separate board risk committee composed of independent directors, or by the board itself, to review the company's internal control and risk management systems;**
- **to monitor and review the effectiveness of the company's internal audit function;**
- **to make recommendations to the board, for it to put to the shareholders for their approval in general meeting, in relation to the appointment, re-appointment and removal of the external auditor and to approve the remuneration and terms of engagement of the external auditor;**
- **to review and monitor the external auditor's independence and objectivity and the effectiveness of the audit process, taking into consideration relevant UK professional and regulatory requirements;**
- **to develop and implement policy on the engagement of the external auditor to supply non-audit services, taking into account relevant ethical guidance regarding the provision of non-audit services by the external audit firm; and to report to the board, identifying any matters in respect of which it considers that action or improvement is needed and making recommendations as to the steps to be taken.**

#### ***Auditor's review of compliance***

60. When reviewing the company's compliance with this provision of the Combined Code the APB recommends that the auditor obtains a copy of the terms of reference of the audit committee and reviews whether the roles and responsibilities of the audit committee

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31 The Combined Code recommends that the board should satisfy itself that at least one member of the audit committee has recent and relevant financial experience. Where this is not the case there is a need for an explanation such as the board has concluded that the audit committee "collectively" has recent and relevant financial experience.

32 In Ireland Section 42(2) of the Companies (Auditing and Accounting) Act 2003 requires the board of directors to establish an audit committee and sets out its responsibilities.

described in the terms of reference reflect the recommendations of Code provision C.3.2. It is not the auditor's responsibility to consider whether the audit committee has fulfilled its roles and responsibilities.

### Terms of reference of the audit committee

**C.3.3 The terms of reference of the audit committee, including its role and the authority delegated to it by the board, should be made available<sup>23</sup>. A separate section of the annual report should describe the work of the committee in discharging those responsibilities.**

#### *Auditor's review of compliance*

61. When reviewing the company's compliance with this provision of the Combined Code the APB recommends that the auditor performs the following procedures:

- (a) Reviewing whether the terms of reference of the audit committee are included on the company's website or that the terms of reference have been reasonably made available or communicated by another method.
- (b) Reviewing whether a description of the work performed by the audit committee in discharging its responsibilities, is included in a separate section of the annual report, and is not materially inconsistent with the information that the auditor has obtained in the course of the audit work on the financial statements.

### Arrangements by which company's staff may raise concerns

**C.3.4 The audit committee should review arrangements by which staff of the company may, in confidence, raise concerns about possible improprieties in matters of financial reporting or other matters. The audit committee's objective should be to ensure that arrangements are in place for the proportionate and independent investigation of such matters and for appropriate follow-up action.**

#### *Auditor's review of compliance*

62. When reviewing the company's compliance with this provision of the Combined Code the APB recommends that the auditor performs the following procedures:

- (a) Reviewing supporting documentation to determine whether there is evidence that the audit committee has reviewed the arrangements and, if necessary, discussing with members of the audit committee what review procedures they performed.
- (b) Reviewing documentation supporting the company's arrangements for the proportionate and independent investigation of concerns raised in confidence by staff relating to possible improprieties in matters of financial reporting or other matters and for appropriate follow-up action. It is not the responsibility of the auditor to consider whether such arrangements will facilitate "proportionate and

independent” investigation or “appropriate” follow-up action but the auditor reviews the process by which the audit committee satisfies itself that the recommendation of the Combined Code has been satisfied.

### **Monitoring and review of the effectiveness of the internal audit activities**

**C.3.5 The audit committee should monitor and review the effectiveness of the internal audit activities. Where there is no internal audit function, the audit committee should consider annually whether there is a need for an internal audit function and make a recommendation to the board, and the reasons for the absence of such a function should be explained in the relevant section of the annual report.**

#### ***Auditor’s review of compliance***

63. When reviewing the company’s compliance with this provision of the Combined Code the APB recommends that the auditor performs the following procedures:
- (a) Where there is an internal audit function discussing with the audit committee chairman and reviewing the supporting documentation to establish that the audit committee has monitored and reviewed the effectiveness of the internal audit activities. It is not the auditor’s responsibility to consider whether the internal audit activities are effective.
  - (b) Where there is no internal audit function, reviewing whether:
    - (i) the audit committee has considered whether there is a need for an internal audit function;
    - (ii) there is documentation that evidences the audit committee’s recommendation to the board;
    - (iii) the reasons for the absence of such a function are explained in the relevant section of the annual report. It is not the auditor’s responsibility to consider whether the reasons given are appropriate.

### **Appointment, reappointment and removal of the external auditor**

**C.3.6 The audit committee should have primary responsibility for making a recommendation on the appointment, reappointment and removal of the external auditors. If the board does not accept the audit committee’s recommendation, it should include in the annual report, and in any papers recommending appointment or re-appointment, a statement from the audit committee explaining the recommendation and should set out reasons why the board has taken a different position.**

#### ***Auditor’s review of compliance***

64. When reviewing the company’s compliance with this provision of the Combined Code the APB recommends that the auditor performs the following procedures:

- (a) Reviewing documentation, for example inclusion in the terms of reference of the audit committee, which explains that the audit committee has primary responsibility for making a recommendation on the appointment, reappointment and removal of the external auditors.
- (b) Reviewing documentation that evidences the audit committee's recommendation to the board.
- (c) Where the board has not accepted the audit committee's recommendation, reviewing whether there is included in the annual report and in any papers recommending appointment or re-appointment of the auditors:
  - (i) a statement from the audit committee explaining its recommendation; and
  - (ii) a statement from the board setting out reasons why the board has taken a different position from that recommended by the audit committee.

### Non-audit activities

**C.3.7 The annual report should explain to shareholders how, if the auditor provides non-audit services, auditor objectivity and independence is safeguarded.**

#### ***Auditor's review of compliance***

65. When reviewing the company's compliance with this provision of the Combined Code the APB recommends that the auditor establishes whether the annual report includes a statement explaining to shareholders how, if the auditor provides non-audit services, auditor objectivity and independence is safeguarded.
66. The auditor considers the explanation of how auditor objectivity and independence is safeguarded in the context of the information of which they are aware. While it is not the auditor's responsibility to establish that the audit committee has fulfilled its responsibilities as set out in the terms of reference recommended by the Combined Code (to review and monitor the independence and objectivity of the external auditor and to develop and implement policy on the engagement of the external auditor to supply non-audit services taking into account relevant ethical guidance regarding the provision of non-audit services by the external auditor<sup>24</sup>) the auditor will be aware of whether the audit committee has undertaken these responsibilities and:
- (a) notifies the audit committee and the board of directors if they believe these responsibilities have not been undertaken; and
  - (b) considers the requirements of Auditing Standards in relation to other information issued with audited financial statements if they believe the explanation is misleading.

67. APB Ethical Standards (“ESs”) 1 to 5 set out the integrity, objectivity and independence requirements for auditors in the audit of financial statements. ES1<sup>33</sup> requires the audit engagement partner to ensure that those charged with governance of the audit client are appropriately informed on a timely basis of all significant facts and matters that bear upon the auditors “objectivity and independence”. In relation to non-audit services, ES5<sup>34</sup> requires the audit engagement partner to ensure that those charged with governance are informed of any inconsistencies between APB Ethical Standards and the company’s policy for the supply of non-audit services by the audit firm and any apparent breach of that policy.

## DIRECTORS’ STATEMENT ON GOING CONCERN

**C.1.2 The directors should report that the business is a going concern, with supporting assumptions or qualifications as necessary.**

### **Auditor’s review of compliance**

68. The Listing Rules<sup>35</sup> require the directors of certain listed companies<sup>36</sup> to include in the annual report and accounts a statement that:

*“the business is a going concern, together with supporting assumptions or qualification as necessary, that has been prepared in accordance with “Going Concern and Financial Reporting: Guidance for directors of listed companies registered in the United Kingdom, published in November 1994<sup>37”</sup> .*

69. The Listing Rules<sup>38</sup> require a listed company to ensure that the auditor reviews the directors’ going concern statement. In order for the auditor to meet the review requirements of this rule the auditor:
- (a) assesses the consistency of the directors’ going concern statement with the knowledge obtained in the course of the audit of the financial statements. This knowledge will primarily have been obtained in meeting Auditing Standards<sup>39</sup> relating to going concern; and
  - (b) assesses whether the directors’ statement meets the disclosure requirements of the guidance for directors referred to in the Listing Rules<sup>40</sup>. Illustrative suggested disclosures for directors are set out in paragraphs 47 to 54 of that guidance.

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33 Paragraph 49

34 Paragraph 35

35 FSA LR 9.8.6R(3); ISE LR 6.8.6R(3)

36 In the case of the FSA the Listing Rule applies to companies incorporated in the United Kingdom and in the case of the ISE the Listing Rule applies to companies incorporated in the Republic of Ireland.

37 Going Concern and Financial Reporting: Guidance for directors of listed companies registered in the UK, ICAEW, November 1994. This guidance can be downloaded from the ICAEW web-site.

38 FSA LR 9.8.10R(1); ISE LR 6.8.9(1)

39 ISA (UK and Ireland) 570, “The going concern basis in financial statements”.

40 FSA 9.8.6R(3); ISE LR 6.8.6(3)



70. The auditor does not assess or report on whether the directors have complied with any other detailed requirements of the guidance for directors. In particular, as the auditor does not express an opinion on the ability of the company to continue in operational existence they do not undertake additional procedures that would support such an opinion.
71. Paragraph 49 of the guidance for directors (dealing with going concern) provides the following illustrative example of the basic disclosure that directors make when the going concern presumption is appropriate:

*“After making enquiries, the directors have a reasonable expectation that the company has adequate resources to continue in operational existence for the foreseeable future. For this reason, they continue to adopt the going concern basis in preparing the accounts”.*

72. It is particularly important that the directors’ statement on going concern is not inconsistent with any disclosures regarding going concern in either the financial statements or the auditor’s report thereon. Where going concern matters are discussed in the financial statements one method of achieving consistency is for the directors’ statement to include a cross reference to the relevant note to the financial statements.

## **REPORTING REQUIREMENTS DERIVED FROM OTHER AUDITING STANDARDS**

73. Auditing Standards set out the auditor’s responsibilities in relation to other information in documents containing audited financial statements. These responsibilities extend to the Combined Code disclosures where there is either a material misstatement of fact or a material inconsistency with the audited financial statements. Application of these Standards requires that:
- (a) Where the auditor identifies a material inconsistency between the audited financial statements and the Combined Code disclosures the auditor determines whether the audited financial statements or the Combined Code disclosures need to be amended and seeks to resolve the matter through discussion with those charged with governance:
    - (i) If an amendment is necessary in the audited financial statements and the entity refuses to make the amendment, the auditor expresses a qualified or adverse opinion on the financial statements.
    - (ii) If an amendment is necessary in the Combined Code disclosures and the entity refuses to make the amendment, the auditor considers including in the auditor’s report an emphasis of matter paragraph describing the material inconsistency<sup>41</sup> or taking other actions.

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41 As explained in paragraph 55, the APB recommends that the auditor’s comments be included under the heading ‘other matter’ which would be included in the auditor’s report below the auditor’s opinion.

(b) Where the auditor identifies a material misstatement of fact in the Combined Code disclosures the auditor discusses the matter with those charged with governance. Where, after discussion, the auditor still considers that there is an apparent misstatement of fact, the auditor requests those charged with governance to consult with a qualified third party, such as the entity's legal counsel, and considers the advice received.

If the auditor concludes that an amendment is necessary in the Combined Code disclosures, which the entity refuses to correct, the auditor considers taking further appropriate action and considers including in the auditor's report an emphasis of matter paragraph describing the material misstatement.

## APPENDIX 1

EXTRACTS FROM THE FSA LISTING RULES<sup>42</sup>**Additional information**

LR 9.8.6R

In the case of a *listed company* incorporated in the *United Kingdom*, the following additional items must be included in its annual report and accounts:

- (3) a statement made by the *directors* that the business is a going concern, together with supporting assumptions or qualifications as necessary, that has been prepared in accordance with “Going Concern and Financial Reporting: Guidance for Directors of listed companies registered in the United Kingdom”, published in November 1994;
- (5) a statement of how the *listed company* has applied the principles set out in Section 1 of the *Combined Code*, in a manner that would enable shareholders to evaluate how the principles have been applied;
- (6) a statement as to whether the *listed company* has;
  - (a) complied throughout the accounting period with all relevant provisions set out in Section 1 of the *Combined Code*; or
  - (b) not complied throughout the accounting period with all relevant provisions set out in Section 1 of the *Combined Code* and if so, setting out:
    - i. those provisions, if any, it has not complied with;
    - ii. in the case of provisions whose requirements are of a continuing nature, the period within which, if any, it did not comply with some or all of those provisions; and
    - iii. the *company’s* reasons for non-compliance; ...

LR 9.8.7R

An *overseas company* with a *primary listing* must disclose in its annual report and accounts:

- (1) whether or not it complies with the corporate governance regime of its country of incorporation;

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42 See Appendix 2 for references to equivalent Irish Stock Exchange Listing Rules

- (2) the significant ways in which its actual corporate governance practices differ from those set out in the *Combined Code*; and
- (3) the unexpired term of the service contract of any *director* proposed for election or re-election at the forthcoming annual general meeting and, if any *director* for election or re-election does not have a service contract, a statement to that effect.

### **Auditors report**

LR 9.8.10R

A *listed company* must ensure that the auditors review each of the following before the annual report is published:

- (1) LR 9.8.6R (3) (statement by the directors that the business is a going concern); and
- (2) the parts of the statement required by LR9.8.6R (6) (corporate governance) that relate to the following provisions of the *Combined Code*:
  - a. C1.1;
  - b. C.2.1; and
  - c. C3.1 to C3.7

## APPENDIX 2

## EQUIVALENT IRISH STOCK EXCHANGE LISTING RULES

FSA Listing Rule	Equivalent Listing Rule of the Irish Stock Exchange
LR 9.8.6R	LR 6.8.6
LR 9.8.6R (3)	LR 6.8.6 (3)
LR 9.8.6R (5)	LR 6.8.6 (6)
LR 9.8.6R (6)	LR 6.8.6 (7)
LR 9.8.6R (7)	LR 6.8.6 (8)
LR 9.8.7R	LR 6.8.7
LR 9.8.8R	LR 6.8.8
LR 9.8.10R	LR 6.8.9
LR 9.8.10R(1)	LR 6.8.9(1)
LR 9.8.10R(2)	LR 6.8.9(2)

## EXAMPLE TERMS OF ENGAGEMENT PARAGRAPHS

*The following is an illustrative example of paragraphs that may be included in the auditor's engagement letter dealing with the auditor's responsibilities with respect to the company's compliance with FSA LR 9.8.10R or ISE LR 6.8.9. In practice the auditor tailors the engagement letter to the specific circumstances of the engagement.*

*The auditor may wish to include a statement in its engagement letter limiting the auditor's liability in respect of the engagement to review the directors' corporate governance disclosures. The auditor is recommended to take legal advice concerning the wording of such a statement and how it is communicated.*

### **Review of the company's disclosures relating to corporate governance and going concern.**

#### **Responsibilities of directors**

As directors of the company you are responsible for ensuring that the company complies with the Listing Rules of the [Financial Services Authority including rules LR 9.8.6R (3), (5) and (6) "Additional information" and LR 9.8.10R "Auditors report"] [Irish Stock Exchange including rules LR 6.8.6 (3), (6) and(7) "Additional information" and LR 6.8.9 "Auditors Report"].

#### **Responsibilities of the auditor**

Listing Rule [9.8.10R] [6.8.9] states that "A listed company must ensure that the auditors review each of the following before the annual report is published:

- (1) [LR9.8.6R (3)] [LR 6.8.6 (3)] (statement by the directors that the business is a going concern); and
- (2) the parts of the statement required by [LR 9.8.6R (6)] [LR 6.8.6(7) (corporate governance) that relate to the following provisions of the Combined Code:
  - (a) C1.1;
  - (b) C2.1; and
  - (c) C3.1 to C3.7.

As we have agreed, we will carry out the review required of us by the Listing Rules having regard to the guidance published in APB Bulletin 2006/5. We are not required to form an opinion on the company's corporate governance procedures.

Having finalised our review we expect to communicate and discuss with you the factual findings of our review.

**Scope of review**

You will provide us with such information and explanations as we consider necessary. We may request you to provide written confirmation of oral representations which you make to us during the course of our review. We shall request sight of all documents or statements which are due to be issued with either the statement of compliance or the going concern statement and all documentation prepared by or for the board in support of the company's statements.

As we have agreed we will attend the meeting of the audit committee [full board] at which the annual report and accounts, including the going concern statement and the statement of compliance, are considered and approved for submission to the board of directors.

**Internal control**

With respect to Code Provision C.2.1, our work will be restricted to:

- (a) assessing, based on enquiry of the directors, the supporting documentation prepared by or for the directors and our knowledge obtained during the audit of the financial statements, whether the company's summary of the process the board (and where applicable its committees) has adopted in reviewing the effectiveness of internal control appropriately reflects that process; and
- (b) assessing whether the company's disclosures of the processes it has applied to deal with material internal control aspects of any significant problems disclosed in the annual report and accounts appropriately reflects those processes.

As our work is not designed to:

- (a) consider whether the board's statements on internal control cover all risks and controls; or
- (b) form an opinion on the effectiveness of the company's risk and control procedures; or
- (c) assess either the directors' decision as to what constitutes a significant failing or weakness, or whether the actions, taken or to be taken, will in fact remedy the significant failings or weaknesses identified by the directors,

our work on internal control will not be sufficient to enable us to express any assurance as to whether or not your internal controls are effective. In addition our financial statement audit should not be relied upon to draw to your attention matters that may be relevant to your consideration as to whether or not your system of internal control is effective.

***Going concern***

With respect to the company's going concern statement our work will be restricted to a consideration of whether the statement provides the disclosures required by [LR 9.8.6R (3)] [LR 6.8.6 (3)] and is not inconsistent with the information of which we are aware from our audit work on the financial statements. We will not carry out the additional work necessary to give an opinion that the company has adequate resources to continue in operational existence.

***Statement of auditor's responsibilities***

Code provision C.1.1 recommends, among other things, that there should be a statement in the annual report about the auditor's reporting responsibilities. As we have agreed we will incorporate a description of our reporting responsibilities in our audit report on the financial statements.



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