



ICGN

International Corporate Governance Network

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By email: k.billing@frc-apb.org.uk

9 July 2012

Dear Mr. Billing,

Re: ICGN Comment Letter on April 2012 FRC Consultation Paper, Proposed revisions to International Standards on Auditing (UK and Ireland) to give effect to the FRC Effective Company Stewardship proposals (“FRC Proposal”)

Thank you for the opportunity to comment on the FRC Consultation Paper, Proposed revisions to International Standards on Auditing to give effect to the FRC Effective Company Stewardship proposals. We are writing on behalf of the International Corporate Governance Network (ICGN) which is a global membership organisation of institutional and private investors, corporations and advisors from 50 countries. Our investor members are responsible for global assets of U.S. \$18 trillion and our mission is to raise standards of corporate governance worldwide. Information about the ICGN, its members, and its activities is available on our website: www.icgn.org.

The purpose of the ICGN Accounting and Auditing Practices Committee (AAPC or the Committee) is to address and comment on accounting and auditing practices from an international investor and shareowner perspective. In doing so, the Committee, through collective comment and engagement, strives to help to ensure the quality and integrity of financial reporting around the world. More information about the Committee can be found via: http://www.icgn.org/policy_committees/accounting-and-auditing-practices-committee/

We applaud and fully support the FRC’s efforts to enhance the relevance and value of the audit for users and the public by stimulating greater transparency about the judgements made by management and auditors in the course of preparing and auditing financial statements. We believe that enhancing auditor communications by requiring the auditor to communicate to the audit committee, enhancing board reporting, and extending auditor reporting are key objectives that will further strengthen investor protection when using financial statements in making informed investment decisions.

As global investors, we believe the current debate on audit issues (transparency, independence, auditor scepticism, and rotation of auditors or audit firms) and over the dialogue with audit committees is important as they are key concepts that need improvement. We would like to express our continuing commitment to the concept of best practice in ensuring effective company stewardship that contributes to the effective operation of the capital markets. It is important to capital providers, such as our members, to have access to credible, high-quality financial reports which serve the needs of investors and other users of financial information.

Investors need to have confidence in financial statements in making investment decisions and holding management to account. The integrity and quality of financial reports is supported and strengthened by a robust external independent audit and an active vigilant audit committee.

The following are responses to questions in the consultation paper:

Q1 Is the scope of the proposed changes appropriate? If not, please explain the scope you consider would be appropriate.

Answer to Q1

Although we understand that most of the proposed changes are intended to be applicable only to UK reporting entities, we support the proposed changes to International Standards on Auditing (ISAs) (UK and Ireland) 720 Section A being applied to all audits internationally. We encourage the FRC and APB (UK) to work proactively with the IAASB to ensure global auditing standards are aligned with national standards and seek to ensure audits of the highest quality.

We support the FRC's objective to make this an explicit requirement and the Auditing Practices Board's (APB) belief that the FRC Proposal should be effective for all audits and not just those of the UK Code reporting entities (See page 6 of the FRC Proposal, paragraph 20).

Whilst it is noted that ISA 600 is applicable to group audits, we would like to stress that the auditor's communications concerning the group audit should also encompass communications regarding component parts of the group audit.

Q2 Is the proposed effective date, which is linked to the intended effective date of the FRC's proposed revisions of the UK Corporate Governance Code, appropriate? If not please give reasons for your view and indicate the effective date that you would consider appropriate.

Answer to Q2

We support the FRC's proposed effective date of October 1, 2012, and the intention that APB should have the same effective date.

Q3 Are the proposed changes to ISAs (UK and Ireland) 260 and 265 appropriate? If not, please give reasons and, if applicable, indicate how you believe they should be modified.

Answer to Q3

We fully support the proposed changes to ISAs - auditors should communicate to audit committees - and we specifically highlight the following points:

- The description of the work of the audit committee should include the significant issues that it considered in relation to the financial statements, including estimates and judgments, and how these were addressed. This description should appropriately address matters communicated to the audit committee by the auditor.
- The responsibilities of the audit committee should include advising the board whether the annual report is fair, balanced and understandable and provides

the information necessary for users to assess the entity's performance, business model, strategy, business risks, and to report to the board the basis for that advice. Though we stress, this should not undermine the operation of the unitary board.

- A report from the company's audit committee to the shareholders, investors and other users on its activities and communications with the auditor should complement the Auditor's Report and reflect the responsibilities of those charged with governance of the entity. The audit committee's role is to oversee the integrity of the company's financial reporting.

Q4 Are the proposed changes to ISAs (UK and Ireland) 700 (Revised) and 720 Section A appropriate? If not, please give us your reasons and, if applicable, indicate how you believe they should be modified.

Q5 Do you agree that it would be inappropriate to extend to all audits the reporting requirement to provide an explicit conclusion arising from the auditor's work under ISA (UK and Ireland) 720 Section A? If not, please give us your reasons.

Answers to Q4 & Q5

We fully support giving greater transparency to the work carried out by auditors in relation to the annual report as a whole. We agree with the FRC Proposal that auditors should be required to report whether the review they undertake of the annual report under ISA 720 has revealed any information which is incorrect or inconsistent with the information contained in the financial statements or obtained in the course of their audit.

We also support the objective of the proposed revision to ISA 700 (Revised) to introduce a requirement for auditors of UK Code reporting entities to report by exception if, when reading the other financial and non-financial information included in the annual report, they identify information that is materially inconsistent with the information in the audited financial statements or is apparently incorrect based on, or materially inconsistent with knowledge acquired by them in the course of performing the audit. The review of information (financial and non-financial) by the auditors should also include a review of any Audit Committee Report or statements on the work of that committee and on its deliberations as perceived by the auditor in the course of the audit.

As intended by FRC, the combined effect of these proposed requirements is to require auditors of UK Code reporting entities to provide an explicit conclusion on whether they have anything to report arising from their work under ISA (UK and Ireland) 720 Section A. For such entities this would require the auditor to provide an explicit conclusion as to whether:

- The board's statement in the annual report is inconsistent with the knowledge acquired by the auditor in the course of performing the audit; and/or
- The matters disclosed in the section of the annual report describing the work of the audit committee do not appropriately address the matters communicated by the auditor to the audit committee.

However, we disagree with APB and strongly believe this should be extended to all audits the requirement to provide an explicit conclusion on whether the auditors have anything to report arising from their work under ISA (UK and Ireland) 720 Section A.

We also point out the International Auditing and Assurance Standards Board (IAASB) recently released an exposure draft and consultation paper on “Improving the Auditor’s Report.” We suggest the FRC utilize the IAASB’s suggested improvements to auditor reporting. We believe the role of auditors needs to focus more on providing investors with improved confidence in the integrity of Financial Reporting.

To assist the audit committee, the standards governing the provision of reports by auditors to audit committees should be revised to ensure that auditors are required to provide audit committees with the information that they need to understand the rationale for, and the evidence relied upon in making, the auditor’s significant professional judgments in the course of the audit and in reaching their audit opinion. In particular these include:

- Key business, operational and audit risks which the auditor believes exist, and which the auditor has considered when conducting the audit;
- The auditor’s perspective on what are the key assumptions used in judgments that materially affect the financial statements, and whether those assumptions are at the low, most likely, or high end of the range of possible outcomes;
- The appropriateness of the accounting policies adopted;
- Changes to accounting policies that have a significant impact;
- The methods and judgments made in valuing assets and liabilities;
- Any unusual transactions;
- Accounting applications and practices that are uncommon to the industry;
- Identification of any matters in the Annual Report that the auditors believe are incorrect or inconsistent with the information contained in the financial statements or obtained in the course of their audit;
- Key audit issues and their resolution which the audit partner documents in a final summary audit memo;
- Quality and effectiveness of the governance structure and risk management (including internal controls);
- **Evaluation of whether there is a substantial doubt about the company’s ability to continue as a going concern for a reasonable period of time; and**
- A view on how the entity compares to its peers in the effectiveness of its internal controls and financial reporting practices.

Certain of our members believe that the auditor should provide this information through an enhanced audit report directly to shareholders. This type of reporting could be through an auditor’s discussion and analysis report (AD&A). The FRC should consider and discuss these options.

Q6 Do you agree that the associated costs of the proposed changes should not be significant compared to total audit costs? If not, please give reasons and your estimate of the level of impact.

Q7 Do you agree that the benefits of the proposed changes will outweigh any costs? If not, please give reasons.

Answers to Q6 & Q7

Yes, we agree that the enhanced transparency and other benefits of the proposed changes outweigh the costs. As stated by FRC, the proposed changes to the auditing standards do not require auditors to perform more verification work, but primarily

expand, and enhance, the auditor's communication and reporting responsibilities on the basis of work already undertaken.

Moreover, also as indicated in the FRC Proposal, the APB believes the associated costs, if any, will not be significant in relation to the total audit costs and will be outweighed by the benefits to audit committees complying with the proposed changes to the UK Corporate governance Code and the enhanced transparency of the audit that will benefit users of the financial statements.

We further support the APB's belief that there is a clear benefit for all audits in the auditors identifying any information that is apparently incorrect based on, or materially inconsistent with, the knowledge acquired by the auditor in the course of performing the audit.

We are also pleased to see that APB has proactively decided to move forward with these proposed changes in 2012 rather than waiting for developments to occur in other potentially relevant projects and, in the longer term, we encourage global alignment.

If you would like to discuss any of these points, please do not hesitate to contact Kerrie Waring, ICGN Chief Operating Officer, at +44 207 612 7079 or kerrie.waring@icgn.org. Thank you for your attention and we look forward to your response on the points above.

Yours sincerely,



Michelle Edkins
Chairman of the ICGN Board of Governors



Janine M. Guillot
Co-Chair, ICGN Accounting and
Auditing Practices Committee



Elizabeth Murrall
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