



## Governance *in brief* FRC advises audit committees to take care with disclosure of AQR findings

### Headlines

- FRC cautions audit committees to take care if they wish to mention that an Audit Quality Review (AQR) inspection has taken place of the audit file of their company.
- In particular, the inspection grade must not be disclosed and care must be taken not to imply that the FRC endorses the financial statement judgements.
- The FRC will be consulting on the CMA's request to address disclosure of audit inspection findings during 2015 and 2016 with a view to introducing relevant Code changes in 2016.

As part of its investigation of the Statutory Audit Services Market, the Competition & Markets Authority (CMA) recommended that audit committees of FTSE 350 companies whose audit had been reviewed by the FRC's AQR should disclose the principal findings and grade assigned to it in the annual report and accounts together with how they and the auditors were responding to the issues raised. In response to this, the FRC has announced that it will consult on the CMA's recommendation in time for updates to the UK Corporate Governance Code to be made in 2016.

Some audit committees have indicated that they may wish to implement aspects of the CMA's recommendation in advance of any changes to the Code in 2016. The FRC is supportive of investors having additional and better information about the quality of an audit, but suggests audit committees proceed with a degree of circumspection.

### FRC advice to audit committees

In making disclosures on the results of AQR inspections, the FRC stresses that it is important that audit committees consider the following:

- AQRs' work is focussed on the audit, and not designed to comment on the contents of the report and accounts;
- inspections cover only selected aspects of the audit and are not designed to confirm the audit opinion; and
- in considering how to report on an inspection it is important that companies do not give false assurance to investors or raise unnecessary concerns.

Effectiveness of the audit process	In accordance with the Code, audit committees should continue to report how they have made their own assessment of the effectiveness of the external audit process.
Write in own words and focus on planned actions arising	<p>Where a company's audit has been reviewed by the AQR, the FRC would expect audit committees to discuss the findings with their auditors and consider whether any of those findings are significant for these purposes and, if so, to make appropriate disclosures. Such disclosures should be in the audit committee's own words and deal with what action they and the auditors plan to take. It is important that investors understand what the company itself believes to be important and how it has applied its judgement.</p> <p>The audit committee must also remember the Code's expectation of annual reports being fair, balanced and understandable.</p>
The inspection grade	<p>The FRC states that in making their report audit committees should not disclose the inspection grade.</p> <p>The current grading system was designed to help audit committees understand the significance of the issues identified and their implications. The grades are not intended to provide an assessment of the reliability of the financial statements as a whole or the audit opinion. The FRC is concerned that the publication of a 'single figure' grade could mislead and distract attention from the key issues identified by the audit committee.</p> <p>The question of whether these grades should be published will be considered more fully through the consultation in 2015 and 2016.</p>
FRC confidentiality	AQR reports are confidential and currently shared only with the audit committee and auditor. The FRC will waive its confidentiality rights to the information, <b>other than the grade awarded to the audit</b> , contained in its reports for the sole purpose of allowing the company and its auditor (who also has confidentiality rights) to determine how and what information arising from the inspection is reported to shareholders.

### Further reading

To read the full press release please go to [www.frc.org.uk](http://www.frc.org.uk)

Deloitte's publication "Governance in focus: Effectiveness of the external audit process" provides a framework for assessing the effectiveness of the external audit process and is available from [www.deloitte.co.uk](http://www.deloitte.co.uk)

### Deloitte view

- We acknowledge that investors may find information on the quality of audit of their investee companies interesting and we will work with audit committees to develop meaningful disclosures around inspection results and actions arising where they wish to make such disclosures.
- We share the FRC's concerns that care should be taken in the wording of these disclosures, so as not to imply either that the annual report and accounts are "perfect" or "endorsed" by the FRC, or indeed the contrary, that they are flawed. An audit where improvements to the audit file have been recommended does not mean that the financial statements are flawed.
- Audit committees should also bear in mind the time lag between the period to which the AQR inspection relates and the current period on which the committee is reporting.
- Audit committees are obliged to explain how they have assessed the effectiveness of the external audit process on an annual basis, and need to develop their own framework to fulfil this obligation which should be tailored to their company's circumstances. As we have noted before in Deloitte's suggested framework for assessing the effectiveness of the external audit process, there are many factors which contribute to audit effectiveness.

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