ACCIF
AUDIT COMMITTEE CHAIRS' INDEPENDENT FORUM

Internal controls over financial reporting – enhanced framework proposal

Status of feedback from ACCIF consultation on ICFR proposals

- 12 ACCIF member written responses
- 19 further Audit Committee Chairs via two roundtables organised with the Deloitte Academy and KPMG's Audit Committee Institute
- 16 stakeholder written responses, including the Hundred Group, Deloitte, PwC, EY, KPMG, Mazars, ICAEW, ICAS and the QCA
- Seeking further feedback from the investment community (event with the Investor Forum later this month)

Key themes arising from the feedback

"I really welcome the fact that your group is picking this up and giving serious thought in concrete terms to what could be done.   I still think there is a moment of opportunity here!"
Sir John Kingman

"I think the paper has caught the spirit of my recommendations very successfully and also acknowledges effectively the need for proportionality. Using 8.4.2 is a sensible way forward."
Sir Donald Brydon

Areas of broad support for our proposals

- Leverage of Listing Rule 8.4.2 (Financial Position and Prospects, with an emphasis on Financial Position)
- Focus on internal controls over financial reporting in the first instance, and leave other risk and control areas to separate exercises

Areas where further guidance/consideration recommended

- Guidance on documentation & evidence underpinning the attestation
- Guidance on classification and reporting of Deficiencies
- Appropriate framework to assess controls
- Accountability & enforcement of CFO and CEO
- Scope & content of the attestation

Areas with significant differences of view with no clear theme

- Which companies it should apply to
- Whether it needs to be subject to assurance: the firms and institutes have recommended mandatory assurance; the corporate view is to leave that decision in the hands of the board/audit committee.

Further detail regarding key themes

Documentation & evidence – there needs to be a clear requirement for companies to assemble sufficient internal evidence and documentation of how both the design and operating effectiveness of ICFR has been tested.

Deficiencies - guidance for companies should be provided in the framework as to what constitutes a reportable failure of ICFR and how any such failures should be evaluated and disclosed.

Appropriate framework – comments in relation to the appropriate framework to underpin the attestation included the following:

- Should provide a clear description of directors' responsibilities and accountability, and how these would be enforced
- The framework should address the more granular transaction level controls that most likely will always need to be in place, such as key account reconciliations of material balances
- The framework should define the need for a balanced set of controls that operate at process level (including relevant IT controls) as well as at an entity wide level
- Needs to be clear on what would constitute appropriate procedures and sufficient evidence
- The framework should be designed firstly for the CEOs and CFOs making the attestation, for audit committees and main boards, and after that for auditors, rather than the other way round

Accountability & enforcement – there was significant support for the concept of the unitary board and a desire to ensure that any process for attestation does not undermine that. So the general view was that it was appropriate the board as a whole should be providing the public reporting (as per the Brydon recommendation) with the CEO/CFO reporting to the board privately. It was noted that Sir John Kingman had suggested that the audit committee should also be taking some increased responsibility for the attestation process. Overall in relation to enforcement, it was felt that if this was going to have teeth, there should be some form of regulatory enforcement which holds the directors to account.

Scope of application – general view that this should apply to all entities deemed to be of public interest (acknowledging that the definition of PIE is under review) but that a phased implementation is likely to be necessary to allow smaller entities with less resource a lead time to prepare. The QCA has challenged whether companies outside the FTSE 350 are all really in the public interest and have raised this with the FRC. Recognising that investment trusts represent a significant part of the FTSE350, consideration would need to be given to how the attestation works where there is no CEO/CFO – perhaps delegate to investment manager? Comments were made that a key challenge in the UK is going to be the "patchwork" of regulation which exists over different types of bodies.

Assurance – mixed views depending on the responder. Some supported the view that this should be addressed as part of the Audit & Assurance Policy. Others felt that the desired improvements in internal control effectiveness would only come with mandated independent assurance.

Timing of implementation - it was noted that it is essential that the compliance burdens are kept proportionate at this economically challenging time. A phased approach depending on size with an appropriate lead time was the general consensus. Options included:

- 3 years with year one being design, year 2 being testing and year 3 being draft reporting
- 2 years – as anything longer could imply a lack of importance

Scope & content of the attestation – feedback included the following comments:

- the attestation should not exclude the prospects part of FPP [as background, the rationale for this exclusion was that going concern is covered by a separate Directors' statement on going concern. SOx also does not address going concern considerations, which is the essence of the "Prospects" part of FPP. It also would make the assurance process a very different exercise as the attestation would not be linked to the balances in the financial statements which is the essence of SOx and our proposal]
- it is important to include controls over budgeting and forecasting where those processes underpin key accounting judgements
- the determination of the relevant controls to be covered should start with a robust financial and fraud risk assessment
- the attestation should cover controls over the production of the notes to the financial statements in addition to each of the primary financial statements
- the attestation should confirm design and operational effectiveness of the controls
- would an attestation over continuous operating effectiveness drive more improvement than a point in time attestation?