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# *Looking ahead:* What you need to know Autumn 2018

*The 100 Group briefing*

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# The 100 Group briefing

Dear members of The 100 Group,

Welcome to the fourth edition of The 100 Group Briefing for 2018. In the run up to Autumn, it may seem like there aren't as many updates included in this edition – but fewer doesn't mean less important.

The Financial Reporting Council ('FRC') has issued the final version of its revised guidance on the strategic report (the 'FRC Guidance' or 'Guidance'). The revised Guidance is an important element of the overall framework of measures connected with the Government's corporate governance reform agenda, and it would be easy to see the specific changes to the Code as limited and packing few surprises. But we think this underestimates the significance of the changes to the overall context that are embedded in the 2018 Code, including the need to think again about familiar areas and to enhance the meaningfulness of reporting in many cases.

There are also two reporting updates Group members should be aware of – the final version of the FRC's revised guidance on the strategic report, and The Department for Business, Energy and Industrial Strategy ('BEIS') publishing new reporting regulations under the Companies Act ('the Act') for 2019. Both are board-level issues, and responses will require careful thought.

We've set out in the Executive summary the other topics included in this edition. I hope you find the briefing useful – please do let me know what you'd like to see more of and how we can improve the publication.

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# Looking ahead

The 100 Group briefing, *Looking ahead*, is a quarterly briefing commissioned by the 100 Group of Finance Directors. Its aim is to brief the Group on key developments in the capital markets and proposed changes in regulation and standards that might require response, lobbying, or which are important for general awareness.

For further information, please contact Gilly Lord.

# Executive summary

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**Key: M – Monitor R – Respond/React L – Lobby**

# Reporting

## FRC issues revised Guidance on the strategic report

*PwC's John Patterson looks at the FRC's revised guidance, which has been some time in the making.*

The Financial Reporting Council ('FRC') has issued the final version of its revised guidance on the strategic report (the 'FRC Guidance' or 'Guidance').

The revised Guidance is an important element of the overall framework of measures connected with the Government's corporate governance reform agenda and, as such, a major focus is how the strategic report should set out the relevance of stakeholders for businesses, as well as dealing with the other matters set out in section 172 of the Companies Act. The Guidance also addresses the non-financial information statement which EU Public Interest Entities ('EU PIEs') with more than 500 employees are required to make. The content of that statement is also often closely related to the stakeholder agenda.

The FRC initially consulted on the revised Guidance in August 2017 but held off from publishing the final version until the revised UK Corporate Governance Code and section 172 reporting regulations were available.

The Guidance has persuasive rather than mandatory force, so companies do not need to follow it or explain where they have not done so. The FRC does expect companies to have regard to it where applicable, however. There is no specific applicable date but companies can clearly use the Guidance immediately where they are addressing the related reporting requirement.

### Content

The areas addressed in the revised Guidance are consistent with the existing Guidance for the most part.

In relation to the strategic report generally, the document continues to be structured around the following topics: purpose; materiality; communication principles; and content elements. It is important to bear in mind that much of the Guidance is focused on matters such as placement, integration, linkage and cross-referencing rather than specific disclosures.

The new text around stakeholders and section 172 and non-financial reporting is largely in the content elements section, which sets out each of the Companies Act reporting requirements and provides commentary on them.

The Guidance as a whole is relatively conceptual and technical, but it does include some practical examples to illustrate the points being made, as well as a number of questions for boards to consider in relation to the areas covered by the non-financial information statement.

*It will be important for boards to consider this new Guidance when planning their overall response to the governance reform and stakeholder agenda for the next annual reporting season.*

# BEIS issues new reporting regulations

*PwC's John Patterson looks at the new requirements to report on how boards have had regard to the matters in section 172 of the Companies Act and related issues.*

The Department for Business, Energy and Industrial Strategy ('BEIS') has published new reporting regulations under the Companies Act ('the Act') for 2019 in relation to how companies and boards implement section 172 and engage with their stakeholders, and also introducing mandatory reporting on corporate governance for certain large private companies. BEIS has also published a set of FAQs on the statutory instrument.

The new regulations form part of the Government's response to the 2016 Green Paper on corporate governance reform. Other actions requested by the Government at that time included a review of the UK Corporate Governance Code for premium listed companies, which is discussed here.

## *Relevance for FTSE 100 companies*

It is tempting to see these new regulations as of limited relevance to FTSE 100 boards. Although there is no exemption from the section 172 and stakeholder engagement reporting in the regulations for premium listed companies, the revised UK Corporate Governance Code covers the same ground so little additional disclosure is likely to be needed. And premium listed companies are of course exempt from the new governance reporting requirements for very large private companies.

We have included details of all aspects of the new regulations here partly for awareness but principally because they will be relevant to the UK subsidiaries of premium listed companies, and it seems reasonable to expect plc boards to be interested in what their subsidiaries are saying about matters such as section 172, stakeholder engagement and indeed corporate governance in general. This will reflect back on the premium listed company and its governance reporting, potentially to a significant extent.

## *Reporting on section 172*

### ***Scope and applicable date***

This reporting will apply for periods beginning on or after 1 January 2019 to any company (including private and AIM) that qualifies as large under the Companies Act, so exceeds two of the following three thresholds (subject to smoothing arrangements where circumstances change): £36 million turnover; £18 million total balance sheet assets; 250 UK employees.

There is no exemption for subsidiaries, as noted above. Whatever subsidiaries say in connection with section 172 will therefore need to be consistent with the group level disclosures. In some cases, it may be a matter of cross referring to the parent company's disclosures but these will need to address the subsidiary in sufficient detail if this is to be appropriate.

### *Content*

The regulations state that a company's strategic report "must include a statement (a 'section 172(1) statement') which describes how the directors have had regard to the matters set out in section 172(1)(a) to (f) when performing their duty under section 172".

Companies who might not otherwise publish their annual/strategic report on a website, must also make the section 172(1) statement available in that form "as soon as reasonably practicable". In the FAQs published with the statutory instrument BEIS makes it clear that this can be a group website rather than the website of the particular company.

BEIS is also clear in its FAQs that the section 172(1) statement must be separately identifiable within the strategic report. We expect that this could take the form of an index table or similar method of cross-referring to where relevant information can be found.

## *Reporting on stakeholder engagement*

### *Scope and applicable date*

The requirements for reporting on stakeholder engagement are split between engagement with employees and engagement with "suppliers, customers and others in a business relationship with the company". The scope differs between the two: companies with more than 250 UK employees (i.e. excluding those "employed to work wholly or mainly outside the United Kingdom") must report on their engagement with those employees, regardless of any financial thresholds; for reporting on engagement with other stakeholders the tests are those set out above for section 172 reporting.

Again, it is intended that the new reporting will be required for periods beginning on or after 1 January 2019.

### *Content*

Unlike the section 172 reporting requirements, the stakeholder engagement requirements must be addressed in the directors' report (though cross-references could be used to allow related matters to be dealt with together).

BEIS explains in its FAQs that this "ensure[s] that company reports include information about these important aspects of the section 172(1) duty even where the directors do not judge the information to be of sufficient strategic importance to be included in the strategic report that year".

The requirements in relation to **employee engagement** build on the existing Companies Act disclosure requirements on employees and are relatively detailed and prescriptive. The directors' report must now include a statement:

"(a) describing the action that has been taken during the financial year to introduce, maintain or develop arrangements aimed at -

(i) providing employees systematically with information on matters of concern to them as employees,

(ii) consulting employees or their representatives on a regular basis so that the views of employees can be taken into account in making decisions which are likely to affect their interests,

(iii) encouraging the involvement of employees in the company's performance through an employees' share scheme or by some other means, and

(iv) achieving a common awareness on the part of all employees of the financial and economic factors affecting the performance of the company, and

(b) summarising -

(i) how the directors have engaged with employees, and

(ii) how the directors have had regard to employee interests, and the effect of that regard, including on the principal decisions taken by the company during the financial year."

The requirements for reporting on **other stakeholder engagement** are more high level, reflecting the variety of possible interested parties. In this case the statement must summarise "how the directors have had regard to the need to foster the company's business relationships with suppliers, customers and others, and the effect of that regard, including on the principal decisions taken by the company during the financial year".

In both cases there is an exemption from disclosing certain matters that might be 'seriously prejudicial' to the interests of the company.

## *Reporting on governance of large private companies*

### ***Scope and applicable date***

The proposed thresholds for this reporting are much higher than those for the section 172 and stakeholder engagement reporting: EITHER a) more than 2,000 employees OR b) turnover of more than £200 million AND total assets on the balance sheet of more than £2 billion (all on a global basis).

There is no exemption for subsidiaries and BEIS has been clear that large subsidiary businesses are expected to provide this new reporting, including the major UK operating subsidiaries of a number of international groups.

Once again, this new reporting is intended to apply for periods beginning on or after 1 January 2019.

### ***Content***

The regulations require that:

"(1) … the directors' report must include a statement (a 'statement of corporate governance arrangements') which states —

(a) which corporate governance code, if any, the company applied in the financial year,

(b) how the company applied any corporate governance code reported under … (a), and

(c) if the company departed from any corporate governance code reported under … (a), the respects in which it did so, and its reasons for so departing.

(2) If the company has not applied any corporate governance code for the financial year, the statement of corporate governance arrangements must explain the reasons for that decision, and explain what arrangements for corporate governance were applied for that year".

The requirement, therefore, is not just to report when a company has departed from its chosen code, but also to explain how it has *applied* that code generally. The term 'code' is to be interpreted broadly in this context. It would be possible to use a framework that does not describe itself as a 'code' or which does not have structures similar to the FRC Code.

A 'coalition group' under James Wates, supported by the FRC, is currently developing a set of governance principles that private companies could use, and which would then form the basis for the new reporting.

It is equally possible that subsidiary boards will decide that it is not appropriate to apply a full-scale governance framework at their level, depending on the group operating structure. If they choose to do this they will need to explain their governance arrangements (as per (2) above), and boards in such situations will need to consider what message this reporting would send to stakeholders.

As with the section 172 reporting, unquoted companies must also make the statement of corporate governance arrangements available on their website.

*We expect and recommend that the boards of premium listed companies will take a close interest in the approach that their major subsidiaries take to these disclosures, particularly in year one.*

## *Annual review of FTSE 350 reporting trends released*

*PwC's Elaine Forrest summarises the latest research on narrative reporting trends in the FTSE 350.*

Each year PwC reviews the annual report of every company in the FTSE 350 as part of the judging process for the Building Public Trust Awards. We have summarised below the main findings from this year's review.

The corporate governance reform debate discussed elsewhere in this briefing has clearly been on the minds of companies and boards, and the most noticeable changes in this year's reports generally related to that agenda. Many companies looked again at how they communicated the significance of stakeholders for the business, and how the matters set out in section 172 of the Companies Act had been addressed (though few referred to this by name). The introduction of the new non-financial reporting regulations had limited effect, though we expect the areas that they address to become more significant as the regulatory changes arising from the stakeholder agenda kick in.

Against this background we looked closely this year at companies' disclosure of their 'purpose'. This is an area of emphasis in the upcoming UK Corporate Governance Code and provides the foundation for discussions of the stakeholder agenda and

section 172. We found that only 51% of companies explicitly stated a purpose and many of those that did failed to link it to the rest of their strategic report.

Away from the stakeholder agenda, we found a continued slow evolution in the quality of corporate reporting in the FTSE 350. Two of the major areas that we look at demonstrate this:

## *Forward-looking information*

We found that more companies were clear about the period over which they were explaining their strategy. This is still only 45%, however (up from 24% last year), and the additional clarity showed that most were discussing only the time until the next annual report. This is very different from the three and five year periods that are referred to in most viability statements.

We also think that many companies are missing an easy win in relation to future market trends. This is the least commercially sensitive type of forward-looking information and yet we found that only 34% of companies provided a clear quantitative overview of the expected future trends in their market. It's true that this information, particularly on macro market trends, can be available from a variety of other sources, but what investors really want to know is how a company is interpreting that insight and using it to help shape their strategic plans.

## *Linkage*

Good logical flow and a clear narrative are characteristics that make the really good reporters stand out, and readers really want to see the linkage between the information they are reading. We found that most FTSE 350 companies could do better on this: less than half linked risks (46%) or KPIs (41%) back to strategic priorities, and even fewer linked their strategy to their business model (31%) or market insights (5%). And even when cross-references are provided, for example, the 'links' are often not sufficiently specific to help the reader.

*To some extent this has been a transitional year (and next year will be another) before the outcomes of the governance reform and stakeholder debates become mandatory for periods beginning on or after 1 January 2019. We certainly expect their influence to grow for the 2018 reporting season, however. Interestingly, we also think that the increased focus on purpose, stakeholders, section 172 and so on will have a positive effect across the strategic and annual report generally, including in areas such as forward-looking information and linkage. If, that is, they are done well.*

# Corporate governance

## FRC issues revised UK Corporate Governance Code

*PwC's John Patterson looks at the final shape of the revised UK Corporate Governance Code, and urges companies not to underestimate the extent of change.*

The result of the FRC's consultation on a major review of the UK Corporate Governance Code ('the Code') has now been published, along with a significantly revised set of Guidance on board effectiveness ('the Guidance') which supplements the Code much more fully than the 2011 version.

The Code will apply for periods beginning on or after 1 January 2019, meaning that there is limited time for companies to consider any procedural changes they may need to make. The first reporting is not due until early 2020 but the FRC expects that some companies will adopt the new Code early.

### *A fundamental review but less fundamental change?*

Reflecting political pressure in the wake of corporate failures and concerns about the behaviour of some boards, the FRC was clear from the start of its consultation process that – notwithstanding the string of updates to the Code since the financial crisis – this was to be a 'fundamental review' of UK corporate governance. Not surprisingly, given how it had been positioned, the consultation drew a record number of responses, and few would argue that it wasn't an in-depth exercise.

And yet, despite this, in terms of headline changes in the final Code it's tempting to see the outcome of the review as being less far-reaching than the process itself. It would not be surprising if this was the case, as the UK Code and governance generally are still seen to lead the world in many respects, so it would be difficult for the FRC to step away from much of what has been seen as important and successful over the past 25 years. They have therefore not done that; what they have done instead is to put governance in its wider context. The key message, of course, is that business does not operate in a vacuum, so it needs to recognise its purpose in a way that is better-rounded, that takes a long-term view, has regard to the interests of its key stakeholders and considers its impact on the environment and on society. This has been addressed partly by adding specific new requirements around these issues, including on stakeholder engagement, but it will be equally important to look again at the largely carried forward (but often re-drafted and re-ordered) content in the same wider context.

So what we now have in the 2018 Code is a document that is intended to be shorter and sharper, with a reduction from 55 to 41 provisions and the removal of supporting principles (some of this content has moved to the revised Guidance on board effectiveness). But it is not and is not intended to be an 'easier' Code. We will look below at the specific changes, but it's important to recognise that when the more 'compressed' principles and provisions are analysed out, there are actually about 10% more elements to consider.

## *Governance reporting*

There is also much more focus on high quality reporting than ever before, including a specific section in the Introduction to the Code. Many companies will need to think carefully about how to adapt their reporting to focus on how governance has been *applied*, as opposed to listing out board and committee roles and responsibilities.

Provision one illustrates this particularly clearly, stating that "The board should assess the basis on which the company generates and preserves value over the long-term. It should describe in the annual report how opportunities and risks to the future success of the business have been considered and addressed, the sustainability of the company's business model and how its governance contributes to the delivery of its strategy".

Boards will need to break this down into a number of different elements, none of which is straightforward to address in reporting (as the provision requires). The phrase "how its governance contributes to the delivery of its strategy" reinforces the call to report on how governance has been applied, and the requirement to discuss the "sustainability of the company's business model" could drive the sort of disclosure that the viability statement has so far failed to do.

## *Specific areas of change in the 2018 Code*

### ***Workforce and other stakeholder engagement***

If the interests of stakeholders are the major focus of the revised Code, it's a company's employees that are at its heart. Companies are expected to use one of the three mechanisms suggested by the Government in its 2016 Green Paper on governance reform for workforce engagement (a director appointed from the workforce; a formal workforce advisory panel; or a designated non-executive director), but it is clear in the final version of the Code that either one of these methods or a combination of them can be used, and that other mechanisms are also possible (subject to being explained).

A new provision has also been included to have boards report on how they have had regard to the matters set out in section 172 of the Companies Act 2006, including how other stakeholders have been engaged with. This is broadly consistent with the new Companies Act reporting regulations (except that the Code refers to 'the workforce' as opposed to being restricted to UK employees). It's worth noting that, in referring to the UK Companies Act in the Code in this way, the FRC has effectively extended the concepts in section 172 to companies that are not UK incorporated.

### ***Director and chair independence (and tenure)***

#### *Independence of directors*

Under the existing Code there is a list of indicators that a director may no longer be independent (including having been on the board for nine years or more). If the board decides that a director is still independent despite breaching one or more of these indicators, they need to explain why in the annual report.

The FRC consulted on removing this ability for boards to make their own judgements, so that being on the board for nine years (for example) would automatically mean that a director could no longer be considered independent.

In the final version of the revised Code (Provision 10) has reverted to the existing basis (with some strengthening of the language around the criteria), so director independence remains a board judgement.

*Independence (and tenure) of the chair*

Under the existing Code the chair of the board is expected to be independent at the time of their appointment, but loses this independence immediately after appointment because of the nature of the role.

The FRC consulted on extending the same independence framework to the chair as for other directors. In response, many chairs made it clear that they do not believe it to be possible to carry out their role fully while remaining 'independent' in any meaningful sense.

In the final version of the revised Code the FRC has reverted to the existing Code position on the chair BUT has also introduced a new Provision on tenure stating that: "The chair should not remain in post beyond nine years from the date of their first appointment to the board. To facilitate effective succession planning and the development of a diverse board, this period can be extended for a limited time, particularly in those cases where the chair was an existing non-executive director on appointment. A clear explanation should be provided" [Provision 19].

## *Composition of the board and committees*

*Board composition*

Under the existing Code at least half the board, excluding the chair, should be independent directors. For companies outside the FTSE 350, only two independent directors are required.

The FRC consulted on amending the composition calculation to a majority of the board, including the chair, being independent – consistent with their proposals to include the chair as an independent director.

Because of the outcome on chair independence, the composition test has reverted in the final Code to at least half the board excluding the chair BUT the relaxation to allow only two independent directors on boards outside the FTSE 350 has not been reinstated.

*Committee composition*

Consistent with the final position on chair independence, the final version of the Code also allows companies outside the FTSE 350 to have only two independent directors on the audit committee. *However*, in a change from the existing Code, the chair of the board cannot be on the audit committee.

There is no change to the existing Code in relation to remuneration and nomination committee composition (though the proposal which the FRC consulted on for a remuneration committee chair to have at least twelve months experience on a remuneration committee before being appointed has been retained).

## *Remuneration, including 'significant dissent'*

A major concern during the consultation process was that the scope of the remuneration committee was being expanded beyond a non-executive role. This has been addressed in the final version of the Code, which clarifies that "oversight of

workforce policies and practices" is a whole board responsibility (this has also been moved to the first section of the Code on Board leadership and purpose).

The final version of the revised Code largely catches the Code up with existing good practice on remuneration matters. Specific headlines include share awards to be released for sale on a phased basis and subject to a total vesting and holding period of five years or more, and executive director pension contributions to be aligned with those of the workforce. Consistent with market pressure, there is an emphasis on remuneration policies and practices being clear, simple and predictable, taking into account the potential effect on reputational and behavioural risk and aligned to performance and company culture. The need for boards to be able to recover and/or withhold awards is emphasised as is the importance of explaining when discretion is used.

The FRC's proposals relating to 'significant dissent' against AGM resolutions (which of course often relates to remuneration) have been retained broadly unchanged in the final version of the Code, with 'significant dissent' defined as 20% or more voting against, consistent with the Investment Association's public register. The Code now expects companies to engage with shareholders in these circumstances and new reporting is required within six months of the vote on views received and actions taken as a result, with follow up at the time of the next annual report/AGM.

### *Other amendments*

Other notable aspects of the revised Code include:

- The incorporation into the Code of the concepts from the Hampton-Alexander reports on gender diversity, including the focus on the executive pipeline.
- The extension of annual re-election of all directors to companies outside the FTSE 350 (though externally facilitated board evaluations have not been extended outside the FTSE 350 in the same way).
- A new focus on avoiding 'overboarding' of non-executive directors and chairs in Provision 15 in particular.

*As noted above, it would be easy to see the specific changes to the Code as limited and packing few surprises, so that relatively few board-level discussions might be needed - particularly where the changes around tenure of the chair are not an issue. We think this underestimates the significance of the changes to the overall context that are embedded in the 2018 Code, including the need to think again about familiar areas and to enhance the meaningfulness of reporting in many cases.*

# Investor engagement

## Shareholder rebellion rises in 2018 AGM season

*The 2018 Annual general meeting (AGM) season has seen rebellions rise around FTSE 100 pay and director re-election. PwC's Hilary Eastman looks at developments.*

New research from the Investment Association (IA), the body representing the UK's asset management industry, has found that shareholder rebellions rose by over a quarter in 2018, with 120 companies being added to the Investment Association's Public Register of shareholder votes.

The register was launched in August 2017 in response to the UK government's consultation on corporate governance reform, with the IA charged with establishing and maintaining a list of FTSE All-Share companies that have received more than 20% of votes against any resolution at an AGM or EGM. Its purpose is to bring attention to companies that have received a significant vote against motions and to track whether and how they are responding to shareholder concerns.

The IA's newest data shows 120 FTSE All-Share companies were added to the Register up to the end of July 2018, compared to 110 companies over the same period in 2017. In total, 237 individual resolutions were added to the Register in 2018, a jump of 25% from 2017. Significantly, in 2018, 29 repeat offenders appeared on the Register for the exact same resolution as last year (35 resolutions in total).

Opposition to individual director re-election was also a key theme this year, with the number of total resolutions more than doubling from 38 in 2017 to 80 in 2018. The rise was particularly stark in the FTSE 250, where rebellions more than doubled (106%) with 37 resolutions in 2018 compared to just 18 in 2017.

While executive pay declined overall as an issue in the FTSE All-Share, with the total number of remuneration resolutions dropping from 68 in 2017 to 61 in 2018, there was a sharp rise in objections to FTSE 100 pay this year. This year 18 pay resolutions attracted over 20% shareholder dissent among FTSE 100 companies, double the number (9) in 2017. This resulted in the near doubling of FTSE 100 companies on the Public Register because of pay, up from 8 in 2017 to 15 in 2018 (88%).

*With shareholders using their vote to take a stand about their concerns, Group members should consider engaging with their shareholders to understand how they may vote and why. In the event of a significant vote against a resolution, Group members should engage with their shareholders to understand their concerns and share their plans for addressing them.*

# Assurance

## FRC launches Consultation on revised auditing standard for estimates and related disclosures

*At the end of July the FRC launched a consultation on the proposed revision of its UK standard (ISA (UK) 540) - Auditing Accounting Estimates and Related Disclosures. PwC's Jamie Shannon looks at what's proposed.*

The FRC's changes reflect revisions made by the International Auditing and Assurance Standards Board (IAASB), and address challenges in auditing accounting estimates arising from evolving financial reporting frameworks. The revisions were initially prompted by consideration of the implementation of IFRS 9, which introduces an expected credit loss (ECL) approach to impairment provisions for financial assets, which is of particular significance for banks. The FRC has strongly supported the IAASB's work.

The FRC's proposals will ensure the quality of auditing of management estimates and disclosures in the UK keeps pace with developments in financial reporting, which has evolved to be more forward looking, leading to an increase in the volume and complexity of accounting judgements and related disclosures.

The revised standard requires enhanced risk assessment and introduces more granular, objective based, requirements to obtaining audit evidence, together with a greater focus on contradictory evidence and adequacy of disclosures. This will not only be important to financial services audits, when auditing expected credit losses, but also in dealing with new accounting standards for revenue recognition and insurance contracts, where applicable.

When finalised, the revised UK standard is proposed to be effective, in line with the international standard, for audits of financial statements for periods beginning on or after 15 December 2019. Early adoption of the revised standard will be permitted and is encouraged.

In issuing the revised ISA (UK) 540 for consultation, the FRC is not proposing to add any new UK requirements, given that the IAASB has addressed concerns raised by the FRC in its comment letter on the IAASB's Exposure Draft. However, the FRC has carried over additional material added to ISA (UK) 540 in June 2016, to comply with requirements in the EU Audit Regulation and Directive.

The FRC is requesting comments on this Consultation Paper by Friday 21 September 2018. Comments are invited in writing on all aspects of the Consultation Paper, and in particular, sought in relation to the three questions below:

1. Do you agree that ISA (UK) 540 (Revised June 2016) and other ISAs (UK) should be revised to adopt the revision to the underlying international standard and the related conforming amendments to other ISAs? If not, please give your reasons and explain what action, if any, you believe should be taken to update the ISAs (UK) in relation to auditing accounting estimates.

2. If you agree that the ISAs (UK) should be revised to adopt the revised ISA 540 and conforming amendments, do you agree that the UK supplementary material can be limited to that shown in the exposure draft? If not, please give your reasons and explain what supplementary material, if any, you believe should be added.

3. Is the proposed effective date, which is consistent with the effective date of the IAASB's revised ISAs, appropriate? If not, please give reasons and indicate the effective date that you would consider appropriate.

*The consultation runs until 21 September 2018. Group members are advised to respond to the FRC with their thoughts on the proposals.*

## *FRC finds room for improvement in audits of pension obligations*

*Whilst highlighting good practice, the FRC found scope for improvement in the audit of pension balances and disclosures in company accounts according to a new report. PwC's Gillian Morrell has more.*

In December 2016, the FRC announced that one of the areas of focus in the 2017-18 audit quality monitoring cycle would be the audit of pension balances and disclosures. This audit inspection cycle identified both weaknesses and examples of good practice which the FRC felt would be of benefit to auditors, audit committees and investors to publish in a separate report.

Out of the 125 audits reviewed in 2017/18, the FRC reviewed the quality of audit of pension balances and related disclosures in 51. In 8 audits, no areas for improvement were identified; in a quarter of audits, good practice in aspects of the pensions audit work performed were identified; but in just under half of audits reviewed, the FRC found at least one aspect of the audit work performed over pensions where limited improvements were required. In two of these audits, the weaknesses identified in relation to aspects of the pensions audit work performed contributed to assessing the overall audit work as requiring more than limited improvement.

Overall, the FRC concluded that there was some scope for improvement in a number of aspects of the work that auditors and their experts carry out in this important area of the audit. They also suggested auditors can bring about improvement, by:

- assessing the sensitivity of the valuation to changes in assumptions
- clearly evidencing the work done by actuarial experts and the rationale for conclusions reached
- considering whether the source data used to calculate the valuation of the defined benefit obligation is materially accurate and complete
- identifying different categories of investment assets and obtaining sufficient audit evidence to support the valuation of each
- paying attention to evidence to support the allocation of the defined benefit obligation and pension scheme assets in multi-employer schemes
- focussing on the completeness and accuracy of the pensions related disclosures; not just the valuation
- considering whether given the material nature and risks, the audit work on pensions should be explained in the auditor's report.

*Where companies have significant pension scheme balances, the FRC expects Audit committees and auditors to discuss the findings of this report and consider how the audit approach could be enhanced.*

## *IAASB releases Exposure Draft of ISA 315 (Revised) Identifying and assessing the risks of material misstatement*

*The International Auditing and Assurance Standards Board (IAASB) is seeking public comment on its Exposure Draft, ISA 315 (Revised), Identifying and Assessing the Risks of Material Misstatement. PwC's Jamie Shannon has more.*

The IAASB received feedback from its monitoring work on implementation of the 2009 revised ISAs that suggested a reconsideration of ISA 315 (Revised) was needed as comments received indicated that several aspects of the standard were not being understood or implemented in a consistent manner.

To ensure that International Standards on Auditing continue to form the basis for high-quality, valuable and relevant global audits, the IAASB Exposure Draft, ISA 315 (Revised), *Identifying and Assessing the Risks of Material Misstatement*, proposes more robust requirements and clarified guidance to:

- Drive more consistent and effective identification and assessment of risks of material misstatement
- Modernize ISA 315 to reflect evolving business practices, including the use of information technology, and how auditors use automated tools and techniques (data analytics, for example) to perform audit procedures, including risk assessment
- Make clearer how the standard can be applied in a proportionate manner to entities of differing size and complexity
- Focus auditors on exercising professional scepticism throughout the risk identification and assessment process.

Through its targeted continuing stakeholder outreach, the IAASB has received significant stakeholder input as the proposed revisions have been developed. The Exposure Draft is a key element of the IAASB's work to address the fundamental elements of an audit and thereby enhance audit quality.

*Comments are requested by November 2, 2018. Group members are advised to respond to the IAASB providing their views.*

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