



CORPORATE
FINANCE
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REPORTING ACCOUNTANTS' WORK ON FINANCIAL REPORTING PROCEDURES

CONSULTATION PAPER

Financing Change initiative



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INTRODUCTION

In the UK, directors of a company that is seeking to have its shares listed on the Main Market, or admitted to trading on AIM or PLUS, have to establish procedures that provide a reasonable basis for them to make proper judgements about the company's financial position and prospects. In this consultation paper, such procedures are referred to as financial reporting procedures.

As a result of that requirement, sponsors or nominated advisers of a company preparing to float usually require reporting accountants to be appointed to carry out due diligence on the company's financial reporting procedures.

In 1995, ICAEW published technical guidance for reporting accountants working in this area. The guidance has promoted transparency and generally accepted market standards and it is influential in determining the contractual terms between reporting accountants and those who appoint them.

Since 1995, there have been a number of changes to regulation that have given rise to changes in market practice, as set out in more detail in Section 3.2. These changes mean that FRAG 10/95 is in some respects outdated.

Through this consultation paper ICAEW is seeking views on how the guidance should be updated to bring it into line with current regulations and market practice. It provides an opportunity for market participants to share their understanding of what is meant by financial reporting procedures and, in that context, to identify the issues that should be addressed in new guidance for reporting accountants. The Financial Services Authority (FSA) has supported the principle of updating the guidance.

Any new guidance in this area will draw on the results of this consultation process.

Background

In 1994, the London Stock Exchange introduced a requirement in relation to financial reporting procedures through paragraph 2.11 of the Listing Rules. In 1995, ICAEW published Technical Release FRAG 10/95, *The London Stock Exchange Listing Rules Paragraphs 2.11 and 2.8* to provide guidance on the reporting accountant role in relation to the obligations of directors and sponsors. It also set out guidance on how to prepare certain comfort letters specific to the sponsor regime in force at the time for UK primary listings on the Main Market.

The 1995 guidance still forms the basis of what many reporting accountants do today in respect of financial reporting procedures of Main Market applicants even though the Listing Rules to which FRAG 10/95 refers have been superseded and the guidance does not address present regulatory requirements.

Although not drafted for this purpose, FRAG 10/95 is also used in relation to companies applying for admission to AIM. The AIM Rules require an issuer, in its application for shares to be admitted to AIM, to confirm that it has established procedures for the directors to make proper judgements as to the financial position and prospects of the issuer. Therefore reporting accountants are usually engaged by the AIM applicant and its nominated adviser to perform due diligence on the company's financial reporting procedures.

Our approach

ICAEW, through its Corporate Finance Faculty, has established a working group, whose members are listed in Appendix 1, to help review the need for new guidance for reporting accountants' work on financial reporting procedures and on the comfort letters they provide to sponsors and nominated advisers.

We are aware that issuing new guidance for reporting accountants will affect many other market participants and, therefore, we are keen to consult widely and understand how they may be impacted by new guidance for reporting accountants.

Ahead of developing draft new guidance we believe that there is a need for broad agreement on what financial reporting procedures encompass, what reporting on them is trying to achieve and the respective responsibilities of the various parties involved. We are proposing a two-stage consultation approach:

- this consultation will obtain views on our working assumptions for updating the current guidance and the principal issues that are involved; and
- the second consultation will obtain views on updated draft guidance prepared in the light of the results of the first consultation.

Section 1 of this consultation paper summarises the consultation questions and how to respond to them. Section 2 sets out the principal issues to be addressed while Section 3 contains supplementary briefing information to give respondents a better understanding of the background to the principal issues.

Anticipated benefits

In the context of a legal and regulatory regime, guidance can provide clear benefits. Up-to-date guidance for reporting accountants on financial reporting procedures would:

- provide transparency about what to expect from the work done by reporting accountants;
- improve efficiency and clarity by establishing agreement on an appropriate framework and accepted market practice that reduce the risk of disputes arising from different interpretations of regulatory requirements;
- assist access to the market by providers of services and thus enhance issuers' choice;
- help those with regulatory responsibilities to discharge them;
- help market entrants to understand what is expected of them, in the context of financial reporting procedures, under regulatory requirements and market practice; and
- underpin investor confidence in companies' ability to keep markets informed.

Another benefit of up-to-date guidance is that it will promote a better understanding internationally of how UK markets establish whether companies are fit to become publicly listed.

Invitation to comment

Guidance for reporting accountants that is trusted by the market requires broad agreement on some basic principles of what the financial reporting procedures regime is trying to achieve and how the respective responsibilities of various parties are appropriately discharged. The consultation process initiated by this paper will help ICAEW to develop guidance that is fit for purpose and which takes into account the views of all stakeholders.

The aim of the consultation paper is to set out working assumptions that might underpin our development of new guidance. These cover market practice, issues for companies and other market participants, and the role of reporting accountants.

We encourage contributions from all those who are involved with, or interested in, listing requirements for companies and the regulatory obligations of issuers and advisers.

1. CONSULTATION QUESTIONS AND HOW TO RESPOND

The Financial Reporting Procedures Working Group is seeking responses from interested parties to any or all of the following questions.

It would be helpful, where appropriate, to provide reasons to support your answers.

Directors' responsibilities for financial reporting procedures

1. Do you agree with our interpretation of the scope of financial reporting procedures?
2. Do you believe that the illustrative list of issues set out in FRAG 10/95 (and reproduced as Appendix 2) remain key issues and should other areas be covered?
3. Do you agree with our interpretation of the meaning of established procedures?

Responsibilities of others

4. Do you agree with our characterisation of the responsibilities of sponsors in relation to financial reporting procedures and our proposition that sponsors have responsibilities in relation to financial reporting procedures beyond engaging reporting accountants to perform due diligence work?
5. How, if at all, might differences between the nominated adviser and sponsor regimes influence our proposal to address the requirements of AIM in new guidance?
6. Should new guidance cover the PLUS market as well as the Main Market and AIM?

Involvement of reporting accountants

7. Should the form of the reporting accountant's comfort letter reflect ISAE 3000 or should market practice be used to justify a departure from the IAASB framework?
8. If IAASB pronouncements are followed, should the reporting accountant's work result in a comfort letter expressing a positive reasonable assurance opinion or a negative limited assurance opinion or a factual report of findings from performing agreed-upon procedures?
9. If the reporting accountant's involvement is to result in a comfort letter, what would be suitable criteria for providing such comfort?
10. Do you agree with our view that changes to the Listing Rules introduced since 2005 have not led to a need for additional involvement of reporting accountants and, if not, what do you consider such involvement should entail?

Purpose and role of market guidance

11. How should the development of new guidance for reporting accountants take account of the impact of such guidance on other parties?
12. Do you agree that ICAEW guidance is the appropriate means of enhancing market practice in this area?

How to respond

Comment letters should be received by 31 October 2010 and be sent either by email as a Word file to robert.hodgkinson@icaew.com, or by post to:

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It would help in the analysis of responses if organisations could provide information on their size and activities and if individual commentators could describe their background and experience.

Respondents should indicate specifically whether their comments are to be treated as confidential. Standard disclaimers in responses received by e-mail will be disregarded for this purpose. Unless otherwise stated, responses will be regarded as being on the public record.

2. CONSULTATION ISSUES

2.1 Directors' responsibilities for financial reporting procedures

A requirement regarding financial reporting procedures was first introduced in the Listing Rules of the London Stock Exchange in 1994. Paragraph 2.11(a) required the sponsor of a new applicant to the Main Market (the issuer) to confirm prior to flotation that it was satisfied that a written confirmation from the directors of the applicant that they had established procedures which provided a reasonable basis for them to make proper judgements as to the financial position and prospects of the issuers and its group had been given after due and careful enquiry.

The AIM Rules for Companies follow the original Main Market wording in respect of financial reporting procedures. However, it is the issuer's responsibility to make the confirmation to the London Stock Exchange in its application for shares to be admitted to AIM.

Directors of companies preparing to float have usually been required by their sponsors or nominated advisers to engage a firm of reporting accountants to perform due diligence on, amongst other matters, the basis for the directors' statement concerning the company's financial reporting procedures. In performing this work, reporting accountants follow the guidance in FRAG 10/95 issued by ICAEW. Further information on FRAG 10/95 and paragraph 2.11 is given in Section 3.1.

2.1.1 Scope of financial reporting procedures

1. Do you agree with our interpretation of the scope of financial reporting procedures?

FRAG 10/95 states that a reasonable interpretation of paragraph 2.11 is that the directors of the issuer have given due and careful consideration to the financial reporting procedures that need to be in place if the board is to be informed on a regular basis as to:

- the financial position of the issuer, including assets and liabilities, profits and losses and the amount of and reason for any significant change in either share capital or reserves since the last audited accounts;
- the implications of any such change on the prospects of the issuer; and
- projected profitability, cash flows and funding requirements based on realistic assumptions about the internal and external factors that might reasonably be expected to have a material impact on operations.

Since 1995 there have been changes in regulatory requirements and sources of guidance for a UK listed company and its directors relevant to financial reporting and internal control. The main changes are summarised in Sections 3.2 and 3.6 and are contained in the Listing Rules and Listing Principles, the Companies Act and the UK Corporate Governance Code. For example:

- Listing Rule 8.4.2(4) changed the terms of the declaration that is provided by the sponsor from a declaration regarding **process** (that the directors' confirmation in relation to financial reporting procedures has been given after due and careful enquiry) to a declaration regarding **outcome** (that the directors have established procedures which provide a reasonable basis for them to make proper judgements on an ongoing basis as to the financial position and prospects of the issuer). This change does not alter the scope of what is meant by financial reporting procedures.

- The addition in LR 8.4.2(4) of the words 'on an ongoing basis' introduced to the rule the concept of ongoing use of the procedures. A similar concept to the effect that there should be a commitment from the directors to maintain the procedures subsequent to admission to listing was already reflected in FRAG 10/95.
- The Companies Act 2006 introduced the requirement for a Business Review, certain changes to the requirements for the Directors' Report and some changes to disclosure. While directors need to consider whether the review of the business given in the annual accounts satisfies the new requirements, this does not appear to change the scope of financial reporting procedures as such.
- Financial reporting procedures for companies admitted to AIM are the same in concept as those for the listed market. Although the obligations for the company are driven by the AIM Rules rather than the regulation applying to the Main Market, there is the same overall principle of having a reasonable basis to make proper judgements as to the financial position and prospects of the issuer.

In summary, we do not consider that these and other changes significantly impact the scope of financial reporting procedures as currently set out in FRAG 10/95.

2.1.2 Issues to be considered

2. Do you believe that the illustrative list of issues set out in FRAG 10/95 (and reproduced as Appendix 2) remain key issues and should other areas be covered?

Paragraph 13 of FRAG 10/95 sets out illustrative issues (which it recognises will vary from case to case) for reporting accountants to consider in a long form report on financial reporting procedures, being:

- high level financial controls;
- EDP environment;
- forecasting and budgeting;
- treasury operations;
- accounting policies;
- financial accounting procedures; and
- management reporting framework.

These issues are analysed in more detail in an appendix to FRAG 10/95 which is reproduced as Appendix 2 to this paper. The list may be viewed as somewhat dated (for example reference is more likely to be made to IT than to EDP nowadays), and there may well be other areas that could be included. For example, the ability of directors to obtain timely information about events with a material financial, and therefore potentially price sensitive, impact between internal periodic reporting dates, might need to be added.

2.1.3 Established procedures

3. Do you agree with our interpretation of the meaning of established procedures?

In certain circumstances the wording of the Listing Rules can create a tension between what is expected and what can reasonably be reported on because Listing Rule 8.4.2(4) refers to procedures that have been 'established'. There will almost always be a distinction between procedures which have operated historically for at least some time before the transaction, such as the accounting systems for the production of monthly management accounts, and additional procedures which will only be needed and therefore used once the company is listed.

Certain additional procedures may have been designed but cannot, by definition, be in established use. It is concluded therefore that procedures can be considered to be established, even though they may not yet have been brought into operation. Market practice in such cases is to focus on whether directors have considered, designed and committed themselves to relevant procedures. For example, in relation to the requirement in the Disclosure and Transparency Rules for interim management statements, the directors need to have an appropriate plan concerning how they intend to produce the information once the company is listed. However, the procedures will not typically be operated before the company's flotation.

This interpretation of established procedures is particularly relevant when dealing with scenarios such as:

- an investment company set up for the purpose of an IPO, where the procedures may be documented but will not have operated before the transaction; or
- an IPO involving the demerger of an existing business, where the systems of the demerged entity may need to be adapted as a consequence of dividing up resources previously shared with or provided by the remaining entity; or
- an entity that is a new applicant by virtue of a 'reverse takeover', where the transaction is likely to give rise to an integration of existing financial reporting systems of the parties to the transaction and where part of the focus of the directors will be on new systems; or
- a corporate restructuring, where the whole of the new structure may not be in place until the transaction has occurred.

While we advocate the above interpretation, we recognise that there may be other views on the issue of established procedures.

2.2 Responsibilities of others

The responsibility for an issuer's financial reporting procedures lies with its directors but regulators have recognised that other market participants, in particular the sponsor or nominated adviser or corporate adviser of the applicant, play a key role in ensuring that companies are fit for listing and have enshrined this role within the relevant rules to encourage such advisers' engagement with the listing process.

Here we set out our understanding of the responsibilities of sponsors, nominated advisers and corporate advisers in relation to an applicant company's financial reporting procedures. Section 3.2 describes in detail changes to the Listing Rules introduced since 1995 which have changed sponsors' responsibilities in relation to financial reporting procedures. It also summarises other developments which, although separate from financial reporting procedures requirements raise issues as to their relationship to those requirements. They are addressed in Section 2.3.3. Further information on the sponsor, nominated adviser and corporate adviser roles is provided in Sections 3.3, 3.4 and 3.5 respectively.

2.2.1 The sponsor's role

4. Do you agree with our characterisation of the responsibilities of sponsors in relation to financial reporting procedures and our proposition that sponsors have responsibilities in relation to financial reporting procedures beyond engaging reporting accountants to perform due diligence work?

The requirement to appoint a sponsor relates to a premium listing only, where the Listing Rules apply. A sponsor is not retained at all times but is appointed in connection with a specific transaction. The key elements of the sponsor role under the Listing Rules are to make a declaration to the FSA when required that the responsibilities of a listed company or new applicant for listing under the Listing Rules have been met, and to guide the listed company or new applicant for listing in understanding and meeting its responsibilities under the Listing Rules and the Disclosure and Transparency Rules.

Sponsors are best placed to determine what assistance and information they require in order to discharge their responsibilities and to support the judgement required to make the declarations. To inform that judgement the sponsor needs to consider all the information it has obtained in the context of the 'bigger picture' it has formed of the issuer's affairs.

Under Listing Rule 8.4.2(4) a sponsor must not submit an application to the FSA on behalf of an applicant, in accordance with Listing Rule 3, unless it has come to a reasonable opinion, after having made due and careful enquiry, that the directors of the applicant have established procedures which provide a reasonable basis for them to make proper judgements on an ongoing basis as to the financial position and prospects of the company applying for listing.

The sponsor will usually ask the directors of the company applying for listing to confirm to it in writing that they have established such procedures and will typically commission due diligence on financial reporting procedures and a comfort letter from a reporting accountant in connection with the financial reporting procedures of the company.

Sponsors also have obligations to make declarations in relation to other matters relating to the applicant as set out in Listing Rule 8.4.2. A reporting accountant's work on financial reporting procedures is not intended to, and does not, in our view, relate to any other declaration being made by the sponsor, including that given under Rule 8.4.2(3) to the effect that the company has established procedures which enable the company to comply with the Listing Rules and the Disclosure and Transparency Rules.

The purpose of financial reporting procedures is to provide a reasonable basis for the directors to make proper judgements as to the financial position and prospects of the company. This is different from procedures which enable a company to comply with the Listing Rules and the Disclosure and Transparency Rules and certain continuing obligations related to those rules.

In relation to sponsors' obligations generally, the FSA has commented in articles in its LIST! publication, in the context of the sponsor's declaration on an issuer's working capital statement, that a sponsor is expected to apply its judgement, experience, knowledge and expertise on the Listing Rules and Disclosure and Transparency Rules. In Issue 20, for example, the FSA stated:

'It is important to note that the sponsor's role is in addition to the part played directly by the directors of the issuer or by a reporting accountant appointed by the issuer in the working capital exercise. Specifically the sponsor must review and challenge the work done by the issuer and the reporting accountant and through their own knowledge and experience of the issuer and its operating environment, ensure that the conclusion reached on the issuer's working capital position is the right one under the circumstances.'

Although there are differences between the declaration provided by a sponsor in relation to working capital and that provided in relation to financial reporting procedures, we think that in both cases the sponsor is discharging obligations that go beyond the work of a reporting accountant.

2.2.2 The nominated adviser's role

5. How, if at all, might differences between the nominated adviser and sponsor regimes influence our proposal to address the requirements of AIM in new guidance?

In order to be admitted to trading on AIM, a company must retain a nominated adviser at all times whereas, for Main Market companies, a sponsor is only required to be retained in connection with a specific transaction for a premium listed company.

As part of the process for application for listing on AIM the company itself has to make a declaration on financial reporting procedures to the London Stock Exchange (LSE) that the directors have established procedures which provide them with a reasonable basis for making proper judgements as to the financial position and prospects of the issuer. There is no requirement for the nominated adviser to make a declaration to the LSE regarding the issuer's financial reporting procedures in contrast to a listed company, where responsibility for the declaration to the FSA lies with the sponsor.

The Admission Responsibilities in the AIM Rules for nominated advisers give the nominated adviser specified responsibilities including ensuring that the directors of the applicant have received advice and guidance (from the nominated adviser or other appropriate professional advisers) as to the applicant's responsibilities and obligations, to ensure compliance by the applicant on an ongoing basis. Additionally, the nominated adviser has to declare that it is satisfied that the applicant and its securities are appropriate to be admitted to AIM. How the nominated adviser fulfils its obligations varies but will frequently include requesting that a range of reviews be undertaken. Such reviews will frequently include a comfort letter from a reporting accountant in connection with the financial reporting procedures of the issuer.

Despite the differences noted above, we do not see any significant difficulties in combining guidance in relation to the Main Market and AIM in the same document, while recognising that guidance in respect of each market may differ in some respects.

2.2.3 PLUS market issues

6. Should new guidance cover the PLUS market as well the Main Market and AIM?

In order to be admitted to trading on PLUS, a company must retain a PLUS corporate adviser at all times. The role of PLUS corporate adviser is analogous to that of the AIM nominated adviser.

Under Rule 69 of the PLUS Rules for Issuers, PLUS companies are required to 'establish sufficient procedures to ensure a sound system of internal control and a reasonable basis for making informed decisions about its financial position and prospects'. PLUS Corporate Advisers routinely request a comfort letter from reporting accountants and, as in the case of AIM, reporting accountants tend to provide wording based on the sample form of opinion in FRAG 10/95 as reproduced in Appendix 3 to this consultation paper.

In view of the practice followed by PLUS corporate advisers and reporting accountants we do not see any significant difficulties in combining guidance in relation to PLUS with guidance for the Main Market and AIM.

2.3 Involvement of reporting accountants

2.3.1 Long form reports and comfort letters

FRAG 10/95 provides for the output of a financial reporting procedures assignment typically to be a long form report which provides commentary on 'important aspects of the issuer's financial reporting procedures' and a comfort letter 'as concerns the statement to be made by the sponsor' under the relevant provision of the Listing Rules.

The process of defining the scope for a long form report prepared by a reporting accountant is often an initial step in what is frequently an iterative process in which the issuer develops and refines its assessment of its procedures in the light of the financial reporting procedures requirements of the Listing Rules.

Although many prospective issuers will in the course of their development have put in place a range of financial reporting procedures, they will generally not initially have developed them for the purposes of the financial reporting procedures requirements of the Listing Rules, and they may well not have reconsidered those procedures in the context of those requirements.

The scope of the long form report is a matter for agreement between the reporting accountant, the issuer and the sponsor, and each scope will have its own unique features and emphases.

The typical key features of long form report are:

- descriptions of the procedures that the prospective issuer considers to be vital in meeting its financial reporting procedures obligations;
- findings from enquiries made of the directors by the reporting accountant; and
- comments relating to strengths and weaknesses and other matters to assist the directors and the sponsor to assess the procedures described.

Drafts of the long form report will normally be provided to the directors and sponsor for their review and comment, as a consequence of which the directors may reassess what is critical to them in relation to the financial reporting procedures, and identify further procedures that they have in place or refinements that they can introduce. Such matters will be likely to lead to changes in subsequent drafts of the report. The preparation of the long form report is accordingly not important merely as a record of findings and comments, but also as a process which assists the prospective issuer to refine and develop its thought process in relation to its financial reporting procedures.

FRAG 10/95 proposed that a comfort letter should provide an opinion, which effectively mirrored the statement to be made by the sponsor, that the directors have made the statement required under paragraph 2.11(a) after due and careful enquiry. FRAG 10/95 also sets out the need to highlight in the comfort letter the inherent limitations in such a review that all financial reporting procedures are dependent for their effectiveness on the diligence and propriety of those responsible for operating them and are capable of being overridden by persons holding a position of authority or trust. The reporting accountant is therefore not able to provide assurance as to the day to day operation of those procedures at some future date.

It is implicit in FRAG 10/95, although it is not expressly stated, that the nature of the due and careful enquiry to be performed by the directors is broadly as set out in FRAG 10/95, that is to say, that they have considered the information that is generated by their financial reporting procedures in the light of the judgements the directors are required to make and have developed and adopted formal documentation describing those financial reporting procedures.

2.3.2 Implications of the IAASB assurance framework

7. Should the form of the reporting accountant's comfort letter reflect ISAE 3000 or should market practice be used to justify a departure from the IAASB assurance framework?

8. If IAASB pronouncements are to be followed, should the reporting accountant's work result in a comfort letter expressing a positive reasonable assurance opinion or a negative limited assurance opinion or a factual report of findings from performing agreed-upon procedures?

9. If the reporting accountant's involvement is to result in a comfort letter, what would be the suitable criteria for providing such comfort?

A significant development since 1995 has been the introduction by the UK Auditing Practices Board (APB) of Standards for Investment Reporting (SIRs) and their application to engagements in connection with an investment circular. A financial reporting procedures engagement by definition falls within the scope of SIR 1000.

For public reporting, SIRs aim for compatibility with certain concepts contained in ISAE 3000, *Assurance Engagements* and the *International Framework for Assurance Engagements* issued by the International Auditing and Assurance Standards Board. These are summarised in Section 3.7. Under ISAE 3000 an opinion is only permitted where the reporting accountant has assessed the appropriateness of the 'subject matter' and the suitability of the 'criteria' to evaluate or measure the subject matter.

The SIRs do not apply these concepts in the context of private reporting, and, at the present time, comfort letters are provided in relation to financial reporting procedures on the basis of established practice which is influenced by the guidance in FRAG 10/95, without having regard to how such an approach might fit in with the IAASB assurance framework. For the purposes of this paper, the following discussion considers potential consequences of seeking to apply concepts from the IAASB assurance framework to the provision of comfort in relation to financial reporting procedures. However, we do not see the assurance framework as having any implications for the long form reports envisaged under FRAG 10/95.

The comfort letters envisaged by FRAG 10/95 report whether the directors have made the statement required under paragraph 2.11(a) after due and careful enquiry. The applicable criteria for such a report would be those that establish the benchmarks for due and careful enquiry in the context of a financial reporting procedures statement. If the report were to be worded in terms that reflect the current formulation for sponsors under the Listing Rules, to the effect that the 'directors have established procedures', the applicable criteria would be those that establish benchmarks for the establishment of procedures.

The assurance framework requires such criteria to be made available to intended users, either:

- publicly; or
- through inclusion in a clear manner in the presentation of the information itself; or
- through inclusion in a clear manner in the assurance report; or
- by general understanding.

It will be apparent that the form of reporting has a significant bearing on the relevant criteria. It will also be apparent that what might constitute 'due and careful enquiry' or 'established procedures' may vary considerably from case to case, and that criteria may need to incorporate an element of flexibility. The documentation of sufficiently detailed and relevant benchmarks would require input from market participants.

The IAASB assurance framework also recognises that assurance engagements can lead to 'reasonable assurance' or 'limited assurance' being given. Limited assurance entails less evidence gathering on the part of the accountant than reasonable assurance, and the conclusions from a limited assurance engagement are expressed in different terms ('negative assurance') from those for a reasonable assurance engagement ('positive assurance'). FRAG 10/95 assumes that it is possible to give an opinion in positive form. It would appear to follow from this that there are evidence gathering procedures that can be performed that are sufficient for the purposes of reasonable assurance, but views are sought on whether the procedures envisaged by FRAG 10/95 do in fact support such an opinion, and if not, whether they support limited assurance, or no assurance at all. If current procedures are not seen as supporting a positive opinion, additional procedures might be specified to enable such an opinion to be provided.

Consistent with the SIRs, there is no obligation to introduce the concepts of ISAE 3000 and the IAASB framework into revised guidance. However, such an approach would not significantly alter the need to determine a suitable formulation or formulations for reporting, and to provide guidance on the basis for reporting using such wording.

2.3.3 Other developments

10. Do you agree with our view that changes to the Listing Rules introduced since 2005 have not led to a need for additional involvement of reporting accountants and, if not, what do you consider such involvement should entail?

FRAG 10/95 is the only specific available guidance for reporting accountants on performing a financial reporting procedures engagement. However, the usefulness of the current guidance is limited not only because of changes in the framework for reporting accountants' services but also because of changes in regulation summarised in Section 3.2. Other factors limiting its usefulness are discussed below.

FRAG 10/95 provides specimen instructions which detail the respective responsibilities of the directors and sponsors and the role of the reporting accountant. The language and the tone of this guidance may not reflect current best practice. Today, given the lack of guidance on responsibilities, it is left to the discretion of the reporting accountant, in negotiation with the client (the issuer) and its advisers, to determine the scope of the work of a financial reporting procedures assignment.

As explained in Section 3.2.2, new Listing Rules issued in 2005 introduced additional requirements for sponsors, which although separate from the financial reporting procedures requirements have raised questions as to their relationship with those requirements. The principal changes are:

- LR 8.4.2(3) which states that the sponsor must not submit to the FSA an application on behalf of an applicant unless it has come to a reasonable opinion, after having made due and careful enquiry, that the directors of the applicant have established procedures which enable the applicant to comply with the listing rules and the disclosure rules and the transparency rules on an ongoing basis; and
- LR 8.4.12(2) which states that the sponsor must not submit to the FSA, on behalf of a listed company, an application for approval of a circular regarding a transaction set out in LR 8.4.11 R, unless the sponsor has come to a reasonable opinion, after having made due and careful enquiry, that the transaction will not have an adverse impact on the listed company's ability to comply with the listing rules or the disclosure rules and transparency rules.

Our view is that these other developments in relation to a sponsor's obligations under the Listing Rules (together with a further change related to a change of listing category introduced in 2010) have not led to a need for additional involvement of reporting accountants beyond that customarily commissioned in relation to a transaction. For example, there are certain matters falling within an issuer's obligations, such as those relating to the publication of annual financial reports and interim financial reports, where the knowledge and experience of the reporting accountant may be relevant. In relation to matters of this sort, reporting accountants may be able to play a role in assisting sponsors, for example by agreeing to undertake procedures in order to provide a long form report.

Nevertheless, the range of the matters falling within the Listing Rules and the Disclosure Transparency Rules is such that it is not apparent that reporting accountants are able to play a significant role in relation to these obligations in the manner that they are able to in relation to financial reporting procedures. Nor is there a general perception that sponsors have a common view on whether there are contributions that reporting accountants can make.

This paper concentrates on the role of the reporting accountant in relation to financial reporting procedures, and on updating guidance in relation to that role. Accordingly it is beyond the scope of the current exercise to address the role, if any, of the reporting accountant in relation to other obligations of sponsors. However, for the purposes of considering whether there is a consensus on the issue of what work a reporting accountant might be able to perform and accordingly whether there may be merit in a separate project to develop guidance, the views of interested parties on this matter would be welcome.

2.4 Purpose and role of market guidance

In the context of a legal and regulatory regime, up-to-date technical guidance for accountants is helpful if it:

- assists market entrants to understand in more detail what they are likely to need to consider with regard to financial reporting procedures in preparing for a transaction;
- assists all parties in achieving consensus on the relevant assurance framework for financial reporting procedures work thereby avoiding time-consuming and costly debates about scope and expectation gaps as to what is actually being provided; and
- promotes market access for providers of reporting accountant services and potential issuers.

2.4.1 The scope for new guidance and its indirect effects

11. How should the development of new guidance for reporting accountants take account of the impact of such guidance on other parties?

FRAG 10/95 was a response to a need for guidance as to what might comprise financial reporting procedures and ways in which an issuer could demonstrate it had considered financial reporting procedures at the time of admission to the market.

FRAG 10/95 still forms the basis of what many reporting accountants do today and for their interaction with advisers to issuers. It provides a useful point of reference in that it sets out the basic purpose behind financial reporting procedures work and directionally, the topics that it should cover.

Shortcomings of the current guidance are identified in this consultation paper and we believe that new guidance is necessary for reporting accountants. The FSA also supports the principle of issuing updated guidance in this area. In addition to reflecting developments in market regulation, we propose that new guidance should address other areas described in this paper and reaffirm:

- what is meant by financial reporting procedures and put this in the context of current UK rules and guidance;
- address factors limiting the usefulness of FRAG 10/95;
- provide clarity in the market about the assurance framework for a financial reporting procedures engagement performed by a reporting accountant; and
- include example scope of work descriptions, terms of engagement and reports which are consistent with the current rules in the UK markets in the same way as FRAG 10/95 sets out an example scope of work description as well as specimen instructions which detail the respective responsibilities of directors, sponsors and reporting accountants and a specimen comfort letter.

New guidance will also:

- address another situation where a financial reporting procedures declaration is required: the new rule LR 8.4.15(4) referred to in Section 3.2.1, came into effect on 6 April 2010 and requires a sponsor of an issuer moving from standard listing to a premium listing, to give a declaration on financial reporting procedures; and
- promote better understanding internationally, on one key aspect, as to how UK markets establish whether companies are fit to become publicly listed and ensure that they promote investor confidence in their ability to keep markets informed.

Up to date guidance will be useful for market access, transparency and consistency in market practice. However, we recognise that, while aimed at reporting accountants alone, guidance for reporting accountants has indirect effects on other market participants. For example:

- the new guidance is likely to include an updated list of the issues set out in Appendix 2 to reflect current market practice and continuing obligations which will have an indirect impact on company directors; and
- new criteria for assessing financial reporting procedures would affect a wide range of market participants.

While we wish to address these issues through this consultation and a further consultation on updated draft guidance, we are also open to other suggestions as to how to secure appropriate support from market participants other than reporting accountants. It might for example be beneficial to prepare a separate document containing guidance for company directors, as ICAEW did in the case of pro forma and prospective financial information prepared in respect of investment circulars.

2.4.2 Status of guidance and enforcement

12. Do you agree that ICAEW guidance is the appropriate means of enhancing market practice in this area?

In issuing guidance, ICAEW has regard to its obligation to act in the public interest. Updated guidance on financial reporting procedures will assist members and others to understand their obligations in a complex area. Guidance also has the merit that it can be readily updated to deal with changes in the law or regulatory requirements. Guidance for ICAEW members, such as that in FRAG 10/95 or a proposed successor, is however, not intended to be prescriptive nor is it mandatory for members to follow it. It is, however, suggested that members wishing to adopt alternative interpretations should consider the need to take legal advice first.

While ICAEW guidance does not bind regulatory authorities such as the FSA for Main Market issuers, the London Stock Exchange for AIM companies, or PLUS for PLUS-Quoted companies, the Courts and regulators would be free to take ICAEW guidance into account in relation to the work of ICAEW members.

3. SUPPLEMENTARY BRIEFING INFORMATION

3.1 FRAG 10/95 and financial reporting procedures

FRAG 10/95 is a technical release issued in March 1995 by ICAEW. It provides guidance on the reporting accountant's role in relation to the obligations of directors and sponsors under paragraphs 2.11 and 2.8 of the Listing Rules in issue at the time. This summary does not address the requirements of paragraph 2.8.

FRAG 10/95 sets out the requirements of paragraph 2.11, namely that:

'In the case of a new applicant, the sponsor must, before the application for listing is made, report to the [The London Stock Exchange] Exchange in writing that:

- (a) it has obtained written confirmation from the issuer that the directors have established procedures which provide a reasonable basis for them to make proper judgements as to the financial position and prospects of the issuer and its group; and
- (b) it is satisfied that this confirmation has been given after due and careful enquiry by the issuer.'

FRAG 10/95 also summarises the responsibilities of the issuer, sponsor and reporting accountant arising from such requirements and provides guidance on how these responsibilities may be discharged.

As regards the responsibility of the **issuer**, FRAG 10/95 states that in providing the confirmation to the sponsor:

'A reasonable interpretation of the objective of paragraph 2.11 is to ensure that, inter alia, the directors of the issuer have given due and careful consideration to the financial reporting procedures that need to be in place if the Board is to be informed on a regular basis as to:-

- the financial position of the issuer and the group, including assets and liabilities, profits and losses and, in particular, as to the amount of and reasons for any significant change in either share capital or reserves since the last audited accounts are made up;
- the implications of any such change on the prospects of the issuer and in aggregate its group; and
- the projected profitability, cash flows and funding requirements, having regard to realistic assumptions about the internal and external factors that might reasonably be expected to have a material impact on operations.

In addressing the above issues the Board will necessarily have to consider progress against budgets and address factors affecting profitability and liquidity.'

FRAG 10/95 provides an example board minute that sets out the form for the issuer's confirmation which in turn supports the report required from the sponsor together with further guidance as to the purpose of such board minute and the information which the directors should consider in the preparation of such board minute. Information considered by directors might include:

- financial information from sources within the company available to the board;
- internal information indicative of problems with procedures, compliance or the accounting systems;

- comments made by the auditors in previous reports to management and actions taken thereon; and
- relevant comments in a long form report provided by a reporting accountant.

The responsibility of the **sponsor** is to be satisfied that the board has provided the confirmation under paragraph 2.11 after having made due and careful enquiry. While the reporting accountant neither has an explicit responsibility under paragraph 2.11, nor stands in the place of the sponsor as concerns its responsibility under the Listing Rules, FRAG 10/95 acknowledges that it is common practice for the sponsor to instruct the reporting accountant to:

- prepare a long form report with commentary on the issuer's financial reporting procedures and matters relevant to the confirmation required of the directors and sponsor under paragraph 2.11(a). The findings of the report will subsequently be discussed with the sponsor and issuer; and
- provide a comfort letter with a positive affirmation that the issuer's written confirmation has been given after due and careful enquiry.

FRAG 10/95 provides specimen instructions from a sponsor to a **reporting accountant** setting out the respective responsibilities of the directors and sponsors and the role of the reporting accountant. FRAG 10/95 also provides a specimen comfort letter which the reporting accountant may reasonably expect to provide and details illustrative issues for inclusion within the long form report under the headings of:

- high-level financial controls;
- EDP environment;
- forecasting and budgeting,
- treasury operations;
- accounting policies;
- financial accounting procedures; and
- management reporting framework.

In respect of the long form report, FRAG 10/95 provides guidance as to the inclusion of commentary which assists the reader to assess the strengths and weaknesses of an issuer's procedures, other implications of the issuer's financial reporting obligations, and the need for the board to review the relevant sections of the long form report for factual accuracy and provide a representation to the reporting accountant.

With regard to the comfort letter, FRAG 10/95 provides guidance as to the need to highlight the inherent limitations in such a review and sets out the content of a comfort letter which is reproduced in Appendix 3 to this consultation paper. FRAG 10/95 also deals with the timing of release of the comfort letter. It should only be released once the board has provided its written confirmation. A reporting accountant will be unable to issue a comfort letter in the absence of either:

- a long form report; or
- a specifically commissioned financial reporting procedures report where no long form report is prepared; or
- a report prepared by the applicant itself.

3.2 Relevant changes in UK Listing Rules since 1995

3.2.1 Evolution of the requirement for financial reporting procedures

FRAG 10/95, which was issued in March 1995, was based on the Listing Rules in force at that time. The requirements of paragraph 2.11 of the Listing Rules (LR 2.11) quoted in FRAG 10/95 are set out in Section 3.1.

In August 1995, the LSE, which at that time was the competent authority under the Financial Services Act 1986 and so responsible for issuing and maintaining the Listing Rules, issued a revised version of the Listing Rules in which LR 2.11 was slightly amended to read as follows:

'2.11 In the case of a new applicant, the sponsor must obtain written confirmation from the issuer that the directors have established procedures which provide a reasonable basis for them to make proper judgements as to the financial position and prospects of the issuer and its group and be satisfied that this confirmation has been given after due and careful enquiry by the issuer.'

The only difference was that the revised LR 2.11 no longer referred to the sponsor having to report to the LSE in writing that it had obtained written confirmation from the directors regarding the financial reporting procedures. However, the sponsor still had to make an equivalent assertion but in its declaration to the LSE rather than in a separate letter.

In January 1999, LR 2.11 was amended further but only to allow the LSE to require a confirmation from the sponsor in relation to an existing listed company 'in exceptional circumstances'. This meant that financial reporting procedures were no longer solely relevant in the context of a new applicant for listing.

In April 2002, the FSA issued revised Listing Rules after it became the United Kingdom Listing Authority (UKLA) under the Financial Services and Markets Act 2000 and replaced the LSE as the competent authority. The sponsor's responsibilities in relation to financial reporting procedures were moved from LR 2.11 to LR 2.15 but otherwise they were unchanged. They remained in that form until the next major revision of the Listing Rules in 2005.

On 1 July 2005, the regulatory framework relating to prospectuses and listings changed significantly on the implementation of the EU Prospectus Directive and the accompanying Prospectus Directive Regulation. There was also a significant amendment on 1 July 2005 affecting a sponsor's responsibilities in connection with financial reporting procedures. Old LR 2.15 was recast into the following form:

'LR 8.4.2 A sponsor must not submit to the FSA an application on behalf of an applicant, in accordance with LR 3, unless it has come to a reasonable opinion, after having made due and careful enquiry, that:

.....

(4) the directors of the applicant have established procedures which provide a reasonable basis for them to make proper judgements on an ongoing basis as to the financial position and prospects of the applicant and its group...'

The FSA indicated that the intention was not to make any substantive changes to the sponsor's responsibilities in relation to financial reporting procedures. However, while the mechanism for the sponsor's confirmation remains the same (through its declaration to the competent authority), the nature of the comfort that is provided changed from comfort regarding **process** to comfort regarding **outcome**. Whereas the old rules LR 2.11 and LR 2.15 required comfort that the directors' confirmation in relation to financial reporting procedures had been given after due and careful enquiry, the new rule LR 8.4.2(4) requires confirmation that the directors have established adequate financial reporting procedures. Moreover, the addition of the words 'on an ongoing basis' introduced the concept of ongoing compliance and can be seen as being related to the concept of continuing obligations.

As explained in Section 3.8.2, from 6 April 2010, certain companies have been allowed to transfer their equity securities from one listing category to another (eg, from standard listing to premium listing) without first cancelling their listing. At the same time the role of the sponsor of a company applying for a transfer between listing categories includes LR 8.4.15 which states that the sponsor must not submit to the FSA on behalf of an issuer a sponsor's declaration for a transfer, unless it has come to a reasonable opinion, after having made due and careful enquiry, that:

(4) the directors of the issuer have established procedures which provide a reasonable basis for them to make proper judgments on an ongoing basis as to the financial position and prospects of the issuer and its group....'

The effect of this was to extend the circumstances in which a sponsor is required to make a declaration regarding financial reporting procedures.

3.2.2 Other related requirements

The Listing Rules of 1 July 2005 included other requirements which although separate from financial reporting procedures requirements have raised questions as to their relationship with those requirements. For example, Listing Principle 2 requires that:

'A listed company must take reasonable steps to establish and maintain adequate procedures, systems and controls to enable it to comply with its obligations.'

The FSA's Guidance Notes to Listing Principle 2 say that it is intended to ensure that listed companies have adequate procedures, systems and controls to enable them to comply with their obligations under the Listing Rules and the Disclosure and Transparency Rules (DTR). The DTR implement the requirements of the EU Transparency Directive and contain requirements for communicating with shareholders such as publishing and distributing annual financial reports and for periodic financial reporting such as half-yearly financial reports and interim management statements.

The Listing Rules of 1 July 2005 also included LR 8.4.2(3) which stated that the sponsor must not submit to the FSA an application on behalf of an applicant unless it has come to a reasonable opinion, after having made due and careful enquiry, that:

'(3) the directors of the applicant have established procedures which enable the applicant to comply with the listing rules and the disclosure rules and the transparency rules on an ongoing basis'

LR 8.4.2(3) is very widely drawn; it essentially covers all of the procedures, systems and controls required for the issuer to be able to comply with its obligations as required by Listing Principle 2. Reporting accountants have not considered it appropriate to give comfort on LR 8.4.2(3) which is far more wide ranging than LR 8.4.2(4).

A further significant amendment of 1 July 2005 was the introduction of an entirely new obligation on sponsors in connection with Class 1 circulars and circulars for reconstructions or refinancings or for the purchase of a company's own shares, as follows:

'LR 8.4.12 A sponsor must not submit to the FSA, on behalf of a listed company, an application for approval of a circular regarding a transaction set out in LR 8.4.11 R, unless the sponsor has come to a reasonable opinion, after having made due and careful enquiry, that:

...

(2) the transaction will not have an adverse impact on the listed company's ability to comply with the listing rules or the disclosure rules and transparency rules...'

Finally, under the changes of 6 April 2010 referred to above, LR 8.4.15 also states that a sponsor must not submit a sponsor's declaration for a transfer from one listing category to another unless it has come to a reasonable opinion, after making due and careful enquiry, that:

'(3) the directors of the issuer have established procedures which enable the issuer to comply with the listing rules, the disclosure rules and the transparency rules on an ongoing basis;

LR 8.4.12(2) and LR 8.4.15(3) are all-encompassing rules similar to LR 8.4.2(3) above and reporting accountants are unlikely to give comfort on the totality of LR 8.4.12(2) and LR 8.4.15(3) for the same reasons.

3.3 Responsibilities of sponsors

The sponsor regime has its origins in the days when a member firm of the LSE took:

- regulatory responsibility for assessing the suitability of new applicants for listing; and
- in a market facing role, acted as the company's 'sponsor' in introducing the company to the market and made a market in the company's shares.

The regulatory nature of the role continued to be refined through changes in the Listing Rules over a number of years and, in 1993, the eligibility criteria for appointment as sponsor were revised so that the role no longer needed to be performed by a member firm of the LSE. At that point, the population of sponsors was opened up to include suitable applicants who were authorised under the Financial Services Act 1986 to carry on investment business. This included corporate finance advisory firms, accountants and lawyers. The market facing role can still involve the same firm that acts as sponsor. It was in this environment that the requirement under paragraph 2.11 of the Listing Rules was introduced.

In 2001, the LSE's regulatory responsibilities under the Listing Rules were transferred to the FSA, and with them the supervision and regulation of sponsors. In accordance with its remit, the FSA has embarked on a number of consultations concerning the nature of and the basis for the continuation of the sponsor regime. In the context of EU requirements, it remains one of the key elements of the UK's 'super-equivalent' regime for premium listings, and is considered to represent a major factor in maintaining the quality and reputation of the UK's Main Market. In the current Listing Rules, sponsors' responsibilities are set out in Listing Rule 8 and include the requirements in LR 8.4.2(3) and (4) referred to in Section 3.2.

The key elements of the sponsor role under the current Listing Rules are to:

- provide assurance to the FSA when required that the responsibilities of a listed company or new applicant for listing under the Listing Rules have been met; and
- guide the listed company or new applicant for listing in understanding and meeting its responsibilities under the Listing Rules and the Disclosure and Transparency Rules.

An issuer is not required to retain the services of a sponsor at all times, but must appoint a sponsor for:

- applications for listing which involve the preparation of a prospectus (and in certain other cases);
- transactions involving the preparation of a Class 1 circular, proposed reconstructions, refinancings and purchases of own shares that require the preparation of a circular;
- the transfer of its category of equity securities to a premium listing and
- other situations where the FSA requires their appointment.

In relation to applications for listing and circulars as referred to above the sponsor has an obligation to provide a sponsor's declaration relating to the discharge of its obligations under the Listing Rules. The different types of sponsor declarations are available to download from the sponsor page on the UKLA's website.

3.4 Relevant AIM Rules and requirements

Rule 1 of the AIM Rules for Companies states that, in order to be eligible for AIM, an applicant must appoint a nominated adviser and once admitted to AIM, must retain a nominated adviser at all times. The AIM Rules for Companies state that a nominated adviser must be approved by the LSE and included on the current register maintained by the LSE.

The AIM Rules for Nominated Advisers set out eligibility criteria, ongoing obligations and certain disciplinary matters in relation to nominated advisers.

An **issuer** is required, in its application for its shares to be admitted to AIM, to confirm that procedures have been established which provide a reasonable basis for the directors to make proper judgements as to the financial position and prospects of the issuer.

The **nominated adviser** is responsible to the LSE for:

- assessing the appropriateness of an applicant for AIM, or the appropriateness for AIM of an existing AIM company when appointed as its nominated adviser; and
- for advising and guiding an AIM company on its responsibilities under the AIM Rules for Companies both in respect of its admission and its continuing obligations on an ongoing basis.

A nominated adviser is required to make a declaration to the LSE where securities of an applicant are being admitted to AIM pursuant to an admission in the following form:

'This nominated adviser confirms that:

SECTION A:

to the best of its knowledge and belief having made due and careful enquiry and considered all relevant matters under the AIM Rules for Companies and AIM Rules for Nominated Advisers in relation to this application for admission, all applicable requirements of the AIM Rules for Companies and AIM Rules for Nominated Advisers have been complied with and, in particular, (i) the admission document complies with Schedule Two of the current AIM Rules for Companies, or (ii) (in the case of a quoted applicant only) the requirements of Schedule One and its supplement have been complied with; and

SECTION B:

(a) it is satisfied that the applicant and its securities are appropriate to be admitted to AIM, having made due and careful enquiry and considered all relevant matters set out in the AIM Rules for Companies and the AIM Rules for Nominated Advisers and:

(b) the directors of the applicant have received advice and guidance (from this nominated adviser and other appropriate professional advisers) as to the applicant's responsibilities and obligations under the AIM Rules for Companies in order to facilitate due compliance by the applicant on an ongoing basis; and

(c) it will comply with the AIM Rules for Companies and AIM Rules for Nominated Advisers as applicable to it in its role as nominated adviser to this applicant.'

A nominated adviser must be available at all times to advise and guide AIM companies for which it acts.

In deciding whether a nominated adviser has complied with the AIM Rules for Nominated Advisers and the undertakings it has provided to the LSE in its nominated adviser's declaration, the LSE will have regard to the matters set out in Schedule Three to the AIM Rules for Nominated Advisers, which are divided into the following three categories:

- admission responsibilities that apply to a nominated adviser that is acting for an applicant in respect of its admission to AIM;
- ongoing responsibilities that apply on an ongoing basis in respect of any nominated adviser who acts for an AIM company; and
- engagement responsibilities that apply when a nominated adviser is being engaged as a nominated adviser to an existing AIM company.

These responsibilities consist of numbered principles in bold followed by a list of actions. The numbered principles must be satisfied in all cases. The actions which follow each principle represent a non-exhaustive list of tasks that the LSE would usually expect a nominated adviser to fulfil in satisfying that principle. Where a nominated adviser is expected to consider or satisfy itself of a particular matter, this is expected to be after due and careful enquiry and after exercising due skill and care.

There is no requirement for the nominated adviser to make a declaration to the LSE regarding the issuer's financial reporting procedures in the manner required of a sponsor by the Listing Rules. However, the nominated adviser has an overall responsibility to the LSE regarding the suitability of a company applying for admission to AIM and the assessment of an applicant company's suitability would cover its financial reporting procedures.

Admission responsibility AR3 states the following principle in bold and a related non-exhaustive list of tasks expected of the nominated adviser by the LSE:

'The nominated adviser should oversee the due diligence process, satisfying itself that it is appropriate to the applicant and transaction and that any material issues arising from it are dealt with or otherwise do not affect the appropriateness of the applicant for AIM.'

In meeting this, the nominated adviser should usually:

- be satisfied that appropriate financial and legal due diligence is undertaken by an appropriate professional firm(s)
- be satisfied that appropriate working capital and financial reporting systems and controls reviews are undertaken (usually including reports or letters from accountants to the applicant)
- consider whether commercial, specialist (e.g. intellectual property) and/or technical due diligence is required and be satisfied that it is undertaken where required
- agree the scope of all such due diligence and reports (including, in relation to the working capital report, assumptions and sensitivities)

- review and assess the above due diligence, reports and adviser comfort letters, considering any material issues, recommended actions or adverse analysis raised and be satisfied that appropriate actions have been undertaken to resolve such matters or otherwise be satisfied that such matters do not affect the appropriateness of the applicant for AIM.'

The first, fourth and fifth bullet points above deal generally with the nominated adviser's responsibility to oversee the due diligence process. The second bullet point captures the nominated adviser's responsibility to oversee the due diligence on the issuer's financial reporting procedures. With regard to financial reporting procedures, in order to carry out the tasks expected by the LSE as set out above, the nominated adviser usually requests that the reporting accountant reports to it regarding the company's financial reporting procedures. FRAG 10/95 is used as a basis for such work.

3.5 Relevant PLUS Rules and requirements

Rule 1 of the PLUS Rules for Issuers states that an issuer must appoint a PLUS corporate adviser for admission to the PLUS-Quoted market. The *PLUS Corporate Advisers Handbook* sets out eligibility criteria, ongoing obligations and certain disciplinary matters in relation to corporate advisers.

The PLUS corporate adviser is responsible for ensuring that:

- the issuer and the securities to which the application relates meet the eligibility criteria and are otherwise suitable for admission to the PLUS market;
- satisfactory guidance has been provided to the directors of the issuer to ensure proper understanding of their responsibilities under the Rules; and
- due enquiries have been made to ensure that the information provided to PLUS on behalf of the issuer for the purpose of the application is accurate and complete.

There is no requirement for the corporate adviser to make a declaration to PLUS regarding the issuer's financial reporting procedures in the manner required of a sponsor by the Listing Rules. However, corporate advisers, as part of their obligations, are responsible to PLUS for determining the suitability of prospective companies for admission to the PLUS-Quoted market. The *Corporate Advisers Handbook* sets out factors to be taken into account in determining such suitability, including that PLUS would expect enquires to be made in respect of the issuer's 'internal controls to ensure continuing compliance with the PLUS Regulations'. Rule 69 states that:

'An issuer must establish sufficient procedures to ensure a sound system of internal control and a reasonable basis for making informed decisions about its financial position and prospects.'

In fulfilling its responsibilities under the Handbook, the corporate adviser usually requests that the reporting accountant reports to it regarding the company's financial reporting procedures. FRAG 10/95 is used as a basis for such work.

3.6 Financial reporting and internal control requirements

3.6.1 Related but distinct regulatory requirements

This consultation paper is primarily about requirements related to financial reporting procedures under LR 8.4.2(4) and the need for specific guidance to help companies affected by those requirements to comply with them. This section summarises related but distinct regulatory requirements.

As discussed in Section 3.1, it was the requirement of paragraph 2.11 of the Listing Rules issued in 1994 related to financial reporting procedures that led to the issuance of the ICAEW guidance FRAG 10/95. Section 3.2 explains how this requirement has evolved into LR 8.4.2(4) and 8.4.15(4) in the current Listing Rules. In both its current and original form this requirement is about procedures that provide a reasonable basis for directors to reach proper judgements about financial position and prospects. Section 3.2 also contrasts this financial reporting procedures requirement with:

- the wider requirement in LR 8.4.2(3), 8.4.12(2) and 8.4.15(3) relating to policies enabling a company to comply with the Listing Rules and the Disclosure and Transparency Rules; and
- the broader objective in Listing Principle 2 of procedures, systems and controls to enable compliance with a listed company's obligations.

The remainder of this section identifies and summarises other sets of requirements broadly related to internal control under the UK Corporate Governance Code and the US Sarbanes-Oxley Act.

3.6.2 The UK Corporate Governance Code and internal control

The UK Corporate Governance Code of June 2010, published by the Financial Reporting Council, is designed to contribute to better company performance and encourage wealth creation by helping directors discharge their responsibilities to shareholders and promote confidence in corporate reporting and governance.

The Code is not a rigid set of rules but a best practice guide for boards distilled from consultation and experience since the Cadbury Code was first published in 1992. It sets out a range of principles and supporting provisions. The Listing Rules require UK companies listed on the Main Market of the London Stock Exchange to make annual report disclosures about corporate governance from two points of view, the first dealing with their application of the Code's principles and the second explaining specifically any non-compliance with the Code's provisions. Together these descriptions should give shareholders a clear and comprehensive picture of a company's governance arrangements in relation to the Code.

While it is expected that companies will comply with all, or substantially all, the Code's provisions, it is recognised that non-compliance may be justified in particular circumstances if good governance can be achieved by other means. A condition of non-compliance is that the reasons for it should be explained to shareholders, who may wish to discuss the position with the company and change their voting intentions as a result. This 'comply or explain' approach is valued by boards and investors because of the flexibility it offers in pursuing good corporate governance. However, it does rely on appropriate dialogue between shareholders and listed company boards.

While Code Principle C.1 is framed in similar terms to LR 8.4.2(4) in that it calls for the presentation of a balanced and understandable assessment of a company's 'position and prospects', it makes no reference to underlying systems, procedures and controls. Rather, it is Code Principle C.2 which states that:

'The board should maintain sound risk management and internal control systems.'

Supporting Code Principle C.2. is Code Provision C.2.1 which states that:

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

These parts of the Code have evolved from paragraph 4.5 of the Cadbury Code which was in force when FRAG 10/95 was issued and which states that directors should report on the effectiveness of the company's system of internal control. FRAG 10/95 states that it must be recognised that paragraph 2.11 of the Listing Rules and the Cadbury Code requirements on internal controls are not the same. It goes on to say that there should not be any implication that written confirmation under paragraph 2.11 necessarily implies compliance with paragraph 4.5 of the Cadbury Code.

The FRC's 2005 publication *Internal Control: Revised Guidance for Directors on the Combined Code* which updated the original Turnbull Guidance of 1999 supports implementation of the Code's requirements relating to internal control and the related reporting to shareholders.

The 2005 Turnbull Guidance states that:

'An internal control system encompasses the policies, processes, tasks, behaviours and other aspects of a company that, taken together:

- facilitate its effective and efficient operation by enabling it to respond appropriately to significant business, operational, financial, compliance and other risks to achieving the company's objectives. This includes the safeguarding of assets from inappropriate use or from loss and fraud and ensuring that liabilities are identified and managed;

- help ensure the quality of internal and external reporting. This requires the maintenance of proper records and processes that generate a flow of timely, relevant and reliable information from within and outside the organisation;
- help ensure compliance with applicable laws and regulations, and also with internal policies with respect to the conduct of business.'

The Turnbull Guidance also provides a framework for reviewing the effectiveness of the system of internal control and states that a system of internal control:

'...will include:

- control activities;
- information and communication processes; and
- processes for monitoring the continuing effectiveness of the system of internal control.'

The Turnbull Guidance is clearly relevant to high quality financial reporting. An effective system of internal control helps ensure that management receives relevant and reliable information not only to support its decision making but also to put it in a position to make proper judgements as to the company's financial position and prospects and present a balanced and understandable assessment of these matters as required under Principle C.1 of the Code.

Therefore there will be overlap between the work done to satisfy LR 8.4.2(4) and 8.4.15(4) and the internal control requirements of the Code. In determining the procedures required to provide a reasonable basis for the board to make proper judgements on an ongoing basis as to financial position and prospects, directors will find it useful to consider the key elements of the framework provided by the Turnbull Guidance. However, the internal control requirements of the Code call for management to have established processes and procedures to help ensure not only the quality of internal and external reporting, but also effective and efficient operations and compliance with laws and regulations.

A further contrast between differing scopes of internal control requirements is evident when looking at the obligations of companies with US listings that are registered with the US Securities and Exchange Commission (SEC) and are subject to the Sarbanes-Oxley Act.

3.6.3 Internal control requirements of the Sarbanes-Oxley Act

In 2002, the US adopted the Sarbanes-Oxley Act. Section 404(a) of the Act directed the SEC to prescribe rules that require each annual report that a company, other than a registered investment company, files to contain an internal control report:

- stating management's responsibility for establishing and maintaining an adequate internal control structure and procedures for financial reporting; and
- containing an assessment, as of the end of the company's most recent fiscal year, of the effectiveness of the company's internal control structure and procedures for financial reporting.

In 2003, the SEC adopted rules implementing Section 404 with regard to management's obligations to report on its internal control structure and procedures and, in so doing, created the term 'internal control over financial reporting' (ICFR). Management is responsible for maintaining a system of ICFR that provides reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. Management is also responsible for maintaining evidential matter, including documentation, to provide reasonable support for its assessment. This evidence will also allow a third party, such as the company's external auditor, to consider the work performed by management.

The establishment and maintenance of internal accounting controls has been required of US public companies since the enactment of the Foreign Corrupt Practices Act of 1977. The significance of Section 404 of the Sarbanes-Oxley Act is that it re-emphasises the important relationship between the maintenance of effective ICFR and the preparation of reliable financial statements. Section 404 is specifically directed at evaluating the effectiveness of internal control over financial reporting. However, the UK requirement under the Code for an evaluation of the effectiveness of internal control and the supporting Turnbull Guidance do not focus specifically on financial reporting but cover the wider system of internal control. Nevertheless, the Turnbull

Guidance is identified by the SEC as a suitable framework against which to make judgements about the effectiveness of ICFR and FRC guidance published in 2004 explains how it can be used for this purpose.

Finally, although in a UK context the requirements of LR 8.4.2(4) and 8.4.15(4) are described as relating to financial reporting procedures, there is no equivalence between this requirement and those imposed on SEC registrants under Section 404 even though these also refer exclusively to financial reporting. The two sets of requirements are framed in different legal environments and are supported by different regulatory and market expectations.

3.7 Framework for reporting accountants' services

3.7.1 Services provided under FRAG 10/95

FRAG 10/95 provides guidance to reporting accountants on the provision of the following:

- a commentary on financial reporting procedures in a long form report for the issuer and the sponsor; and
- a comfort letter to the issuer and the sponsor that the directors have exercised due and careful enquiry in making their confirmation that they have established procedures that provide a reasonable basis for them to make proper judgements as to financial position and prospects.

Section 3.1 summarises key contents of FRAG 10/95 in relation to a long form report and a comfort letter as reproduced in Appendix 3 to this consultation paper. It is also worth quoting further from FRAG 10/95 to appreciate the nature and limitations of the services provided by reporting accountants:

'Although the reporting accountants must exercise their own judgement as to the extent of their work, it will necessarily be limited to obtaining a description of the financial reporting procedures, to reviewing them on a selective basis and to obtaining information and representations from the issuer's management. The work of the reporting accountants will result in commentary in the long form report appropriate to the final scope of the instructions. In addition, all financial reporting procedures are dependent for their effectiveness on the diligence and propriety of those responsible for operating them and are capable of being overridden by persons holding positions of authority or trust. Consequently, the reporting accountants will not be in a position to provide assurance as to the day to day operation of those procedures and thus neither the directors nor the sponsors can rely on the long form report (or comfort letter) to provide such assurance.'

FRAG 10/95 is currently used as a starting point for work in relation to LR 8.4.2(4) by firms acting as reporting accountants. However, the actual approach adopted is affected by each firm's own processes and interpretations of how to take account of circumstances and developments not envisaged in 1995. Not only have regulation and market practice changed in the ways outlined in earlier sections. Professional standards applicable to reporting accountants have also changed, particularly in respect of the linkage between the work they perform and the assurance that they report.

3.7.2 Assurance services

In 2004, the International Auditing and Assurance Standards Board (IAASB) issued the *International Framework for Assurance Engagements* and the *International Standard on Assurance Engagements 3000, Assurance Engagements Other Than Audits or Reviews of Historical Financial Information*. The expression of a conclusion separates assurance engagements from other engagements, for example, to compile financial statements or to perform agreed-upon procedures. The pronouncements of the IAASB are important for reporting accountants in the UK because:

- its International Standards on Auditing (ISAs) are the basis of the auditing standards issued by the UK Auditing Practices Board;
- UK professional accountancy bodies including ICAEW have obligations to support its standards as a result of their membership of the International Federation of Accountants (IFAC); and
- most of the larger UK accounting firms have obligations to apply ISAs because they belong to networks that are members of IFAC's Forum of Firms.

With compilation engagements, a reporting accountant uses accounting expertise to collect, classify and summarise financial or other information, but expresses no conclusion on any assurance obtained on that information. When a reporting accountant performs agreed-upon procedures, the scope and amount of work are agreed in advance between the reporting accountant and the intended user of the information in question. The reporting accountant reports objectively on findings of fact arising from his work, including details of errors and exceptions found, rather than providing a subjective conclusion on the basis of that work. In neither case does a reporting accountant include such words as audit, assurance or review in any report that he provides.

In an assurance engagement, the reporting accountant expresses a conclusion in the form of a professional opinion that is designed to enhance the confidence of intended users of information on the basis that sufficient and appropriate evidence has been gathered and evaluated against criteria relevant to specific subject matter. An assurance engagement involves three separate parties:

- the reporting accountant;
- the party responsible for the subject matter and an assertion in relation to that subject matter; and
- intended users of the assurance opinion or conclusion.

There are two types of assurance engagement: reasonable assurance engagements and limited assurance engagements. In a reasonable assurance engagement, the reporting accountant seeks to obtain sufficient appropriate evidence that enables the expression of a positive conclusion on an assertion made, typically, by directors. The reporting accountant performs sufficient work procedures to reduce the risk of a material misstatement so as to support that positive conclusion.

In a limited assurance engagement, the reporting accountant seeks to gather evidence sufficient to obtain a level of assurance which provides the basis for a negative form of conclusion, such as '...nothing has come to our attention to refute the directors' assertion that...'. In contrast to reasonable assurance, a limited assurance engagement consists principally of making enquiries of management and directors and applying analytical procedures and does not include:

- a comprehensive assessment of the risks of material misstatement;
- consideration of fraud or of laws and regulations; or
- gathering of evidence in relation to all material areas or in respect of all relevant assertions.

3.7.3 Investment reporting standards

The APB issued its first Standard for Investment Reporting (SIR) 100, *Investment circulars and reporting accountants* in 1997. This was an overarching standard and subsequent SIRs covered related public reporting engagements on historical financial information, profit forecasts and pro forma financial information. However, the APB has not issued SIRs covering private reports such as comfort letters and long form reports issued by reporting accountants in connection with investment circulars and so FRAG 10/95 remains the only authoritative professional literature on reporting accountants' work on financial reporting procedures.

In 2005, the APB withdrew SIRs 100 to 400 and issued revised standards SIRs 1000 to 4000. In 2008, the APB issued a further standard, SIR 5000, on financial information reconciliations under the Listing Rules. The new SIRs reflect the influence of the IAASB's Framework and ISAE 3000.

SIR 1000 contains basic principles and essential procedures, with which a reporting accountant is required to comply in the conduct of all engagements in connection with an investment circular prepared for issue in connection with a securities transaction governed wholly or in part by the laws and regulations of the UK. SIR 1000 also requires compliance with the IAASB's International Standard on Quality Control (UK and Ireland) which, in turn, requires compliance with professional standards. SIR 1000 sets the scope for the subject matter, the criteria and the outcome for private as well as public reporting engagements.

3.7.4 Implications for financial reporting procedures

The application of the current international framework for reporting accountants' services would have major implications for market practice which has grown out of FRAG 10/95. In particular, it could be argued that the reporting accountants' services described in FRAG 10/95 contain elements of reasonable assurance and limited assurance engagements that require clarification.

As a starting point, in relation to assurance engagements it should be noted that subject matter may take a number of different forms and may comprise systems and processes such as an entity's financial reporting procedures. Different subject matters have different characteristics, including the degree to which information about them is qualitative or quantitative, objective or subjective, historical versus prospective and relates to a point in time or covers a period. Such characteristics affect whether the subject matter:

- is identifiable and capable of being consistently evaluated or measured against criteria;
- can be subjected to procedures for gathering sufficient appropriate evidence to support a reasonable assurance or limited assurance conclusion, as appropriate; and
- can be subjected to procedures to support a factual conclusion.

However, if the subject matter does not fall within the above parameters, it may not be appropriate for the reporting accountant to accept an engagement. Assertions as to future events, such as the effectiveness of financial reporting procedures yet to be established, and subject matter that is not documented are also unlikely to meet the above parameters.

Criteria are the benchmarks used by an entity to support an assertion typically made by its directors. In relation to historical financial information, the assertion might be that it has been prepared in accordance with applicable law or regulation, such as the detailed requirements of International Financial Reporting Standards and the Companies Act. In relation to financial reporting procedures, specific criteria could take the form of control objectives.

The reporting accountant assesses the suitability of criteria for a particular engagement by considering whether they reflect characteristics of relevance, completeness, reliability, neutrality and understandability. The relative importance of each characteristic to a particular engagement is a matter of judgement. Criteria also need to be available to the intended users to allow them to understand how the subject matter has been evaluated or measured. Without the frame of reference provided by suitable control objectives any conclusion would be open to individual interpretation and misunderstanding. If criteria do not exist, the reporting accountant may not be able to accept an engagement. The evaluation or measurement of a subject matter on the basis of the reporting accountant's own expectations, judgements and individual experience would not constitute suitable criteria.

Companies would also need to identify and record their control objectives; otherwise the reporting accountant may have no criteria against which to report. Requiring a reporting accountant to establish and document control objectives may be an acceptable compilation engagement. However, independence requirements would probably prevent a reporting accountant from performing a related assurance engagement because of the self-review threat to objectivity that would be involved.

Although criteria in the form of control objectives relevant to financial reporting procedures do not currently exist, it would be possible to develop such criteria. For example, the ICAEW Audit and Assurance Faculty developed a set of control objectives in conjunction with relevant stakeholders before publishing Technical Release AAF 01/06, *Assurance reports on internal controls of service organisations made available to third parties*. This replaced previous guidance in FRAG 21/94 which like FRAG 10/95 predated the current international framework for reporting accountants' services.

3.7.5 Market choices

Assuming that suitable criteria could be developed, market participants would still need to decide whether reporting accountants could best meet their needs in relation to financial reporting procedures by providing reasonable or limited assurance or performing agreed-upon procedures. The following considerations would need to be taken into account.

Reasonable or limited assurance engagements:

- The user is provided with a positive conclusion on compliance with criteria and there is no need for users to interpret the results, unless there is a qualified opinion.
- The user simply receives an opinion, rather than a detailed report, unless additional reporting is specified (eg, details of all exceptions identified).
- The user may set the materiality levels that a reporting accountant will use to determine the scope, nature and extent of the testing to reach a conclusion on the criteria.
- The reporting accountant determines the exact scope, nature and extent of testing required to support the required opinion.
- There may be differences between the work undertaken by different reporting accountants.
- Even where the exact scope of work has been agreed at the outset, this does not preclude the reporting accountants from performing other procedures in order to gather sufficient evidence to reach their conclusion.
- To reach a positive conclusion typically requires additional procedures to be undertaken by the reporting accountant. This type of reasonable assurance engagement can therefore be more expensive.
- In a limited assurance engagement the work consists, principally, of making enquiries of management and directors and applying analytical procedures rather than obtaining sufficient and appropriate evidence. It does not include a full assessment of the risks of fraud or material misstatement and does not involve gathering evidence in relation to all material areas or in respect of all relevant assertions.

Agreed-upon procedures engagements:

- The scope, nature and extent of the testing are set by the user and agreed with the reporting accountant at the outset.
- In the absence of suitable criteria or control objectives, identifying and recording criteria can be limited to specific areas of concern or can take the form of a long form due diligence report covering the same scope as is normally provided in a financial reporting procedures assignment, but without an accompanying comfort letter.
- The report, being a factual accuracy report, makes a statement in absolutes rather than giving an opinion.
- Any errors or exceptions that are identified are set out in the report.
- The work can be directed to limited areas of concern and is likely to be cheaper than a reasonable assurance or limited assurance engagement.
- However, if the scope of work is set too widely, it may be more expensive than a reasonable assurance or limited assurance engagement.
- The user must make its own judgement whether the agreed work is sufficient.
- Time needs to be set aside to agree the scope, nature and extent of work upfront.
- Reporting accountants will only complete the required work and will not undertake additional procedures even if they identify errors unless this is required by the scope of work.
- No conclusion is given and therefore the user is left to interpret the results and make a judgement. The user may not have the time, skills or resources to do this.

3.8 Obligations of listed companies

3.8.1 Principal obligations of Main Market and AIM companies

This section summarises the principal obligations of companies that are on the Main Market or AIM. It is noted that the procedures that a company must have to enable it to comply with these obligations are broader than and in some ways different to its financial reporting procedures, the purpose of which is to provide a reasonable basis for the directors to make proper judgements as to the financial position and prospects of the company.

	Premium listing	Standard listing	AIM
Advisers and sponsors	A sponsor is required for certain transactions	A sponsor is not required	An exchange approved nominated advisor and broker must be retained at all times
Price-sensitive information	Must communicate information to holders and potential holders of its listed equity securities in such a way as to avoid the creation or continuation of a false market in such listed securities	Must communicate information to holders and potential holders of its listed equity securities in such a way as to avoid the creation or continuation of a false market in such listed securities	New developments which, if made public, would result in a substantial movement in the share price must be notified without delay
Annual report and accounts	The annual accounts must be signed and published within four months of the year end	The annual accounts must be signed and published within four months of the year end	The annual accounts must be signed and published within six months of the year end
Half-yearly reports (unaudited)	Half-yearly reports must be published within two months of the period end and contain primary statements with comparatives, as a minimum	Half-yearly reports must be published within two months of the period end and contain primary statements with comparatives, as a minimum	Half-yearly reports must be published within three months of the period end and contain primary statements with comparatives, as a minimum
Continuing obligations	Adherence to the continuing obligations of the UKLA's Listing and Disclosure and Transparency Rules	Adherence to Disclosure and Transparency Rules 4, 5 and 6	Adherence to the continuing obligation requirements of the AIM Rules
Corporate governance	UK premium listed companies must adhere to the UK Corporate Governance Code or explain why	Adherence to the UK Corporate Governance Code is on a voluntary basis Compliance with DTR 7.2	Adherence to the UK Corporate Governance Code is on a voluntary basis
Approval for transactions	Prior shareholder approval for certain transactions	Prior shareholder approval for transactions is not required	In most cases, no prior shareholder approval is required for transactions

3.8.2 Explanation of premium and standard listing

Previously, the primary listing category of the Main Market was open to UK and overseas companies while the secondary listing category was open only to overseas companies. The regime has now been restructured into two segments, premium and standard. The former denotes more stringent super equivalent standards and the latter, EU minimum standards. These segments have replaced the primary and secondary listing categories respectively.

From 6 October 2009, the standard listing category has been available to UK companies in order to provide a level playing field. This means that applicant UK companies are able to apply for a standard listing on the Main Market without appointing a sponsor and, by implication, without needing to go through the due diligence process for financial reporting procedures.

From 6 April 2010, the process for companies with an equity listing wishing to move from one segment to another was simplified so that a cancellation of their listing is not required. The sponsor of companies moving from standard to premium listing needs to give a declaration on financial reporting procedures under new LR 8.4.15(4) as explained in Section 3.2.1.

From 6 April 2010, overseas premium listed companies have faced the same corporate governance requirements as UK premium listed companies with the corporate governance standards for overseas companies being strengthened by requiring overseas premium listed companies to 'comply or explain' against the UK Corporate Governance Code. Therefore corporate governance considerations set out in section 3.6 also apply to overseas premium listed companies.

UK and overseas standard listed companies are also required to comply with the EU Company Reporting Directive which requires them, among other things, to provide a corporate governance statement and to describe the main features of their internal control and risk management systems, as required in DTR 7.2.

APPENDIX 1: WORKING GROUP MEMBERS

Members of the Financial Reporting Procedures Working Group

Robert Hodgkinson, Chairman	ICAEW
David Cattermole	KPMG
Philip Chamberlain	ICAEW
John Chapman	Baker Tilly
Victoria Charlton	Deloitte
Anna Gordon	PricewaterhouseCoopers
David Harris	Ernst & Young
Dudley Hilton	Deloitte
Katerina Joannou	ICAEW
Sue Nyman	Grant Thornton
Charles Romaine	BDO
Chris Searle	BDO

APPENDIX 2: LONG FORM REPORT ISSUES IN FRAG 10/95

Appendix 1

Illustrative issues for long form report as concerns paragraph 2.11 of listing rules

High level financial controls

- The 'tone at the top'.
- Risk identification and assessment undertaken by client.
- The effectiveness of the Audit Committee role.
- The extent to which high level financial controls are generally appropriate and potentially capable, if properly exercised, of achieving their objectives.
- Response to points reported to management arising from the audit.
- Internal audit procedures.
- Documentation of procedures.
- Adequacy of resources to support and develop appropriate procedures.

EDP environment

- General features of the computer systems for the present and planned future needs of the business.
- Where relevant, procedures for monitoring reliability and maintenance standards.
- Technical support for continuing development of the systems and controls.
- Disaster recovery.

Forecasting and budgeting

- Budgeting procedures and whether they appear adequate to meet the present and planned future needs of the business.
- Past experience in budgeting and whether it suggests that previous forecasts have been reasonably accurate.
- Budget and whether they are set so as to control the business or are merely targets.
- Budget holders' responsibilities for monitoring.
- Whether information on variances is meaningful.

Treasury operations

- Board authority for activities undertaken by treasury management.
- Suitability of treasury management to control cash and treasury instruments.
- Whether there is upwards reporting of the extent of commitments and contingencies, for example, in relation to foreign currency operations and exposure.

Accounting policies

- Compliance of policies with recognised accounting principles and company law requirements.
- Whether accounting policies are appropriate for the particular business and consistent with those used by the majority of other entities in the same industry.

Financial accounting procedures

- Extent to which accounting records are up to date.
- Procedures to enable financial statements to be prepared with the minimum of time and effort.
- Sufficiency of departmental staffing to provide an effective service.
- Whether the financial position on a statutory basis can be established and reconciled with the management accounts as and when required.

Management reporting framework

- Actual use of management information generated by the company by management (including the Board) to take decisions about the business.
- Acceptability of frequency, timeliness, quality and reliability of the management information by senior management (including the Board).
- Whether the commentary provided for the Board highlights the key financial data the Board might reasonably expect to enable it to understand the financial position and prospects.

APPENDIX 3: FRAG 10/95 COMFORT LETTER ON FINANCIAL REPORTING PROCEDURES

Appendix 2

Specimen comfort letter as concerns paragraph 2.11

[To the issuer]

[To the sponsor]

Dear Sirs

[the issuer]

This letter is provided under paragraph [] of our instructions dated []. We refer to the attached letter dated [] from the directors of [the issuer] to [the sponsor], given under paragraph 2.11(a) of the Listing Rules of the London Stock Exchange ("Listing Rules"), confirming that the directors of [the issuer] have established procedures which provide a reasonable basis for them to make proper judgements as to the financial position and prospects of [the issuer] and its group.

We also refer to our report dated [] ("long form report") which was prepared in accordance with our instructions dated []. The long form report contains, primarily in Section [], a description of and commentary on [the issuer]'s financial reporting procedures. This letter should be read in conjunction therewith.

All financial reporting procedures are dependent for their effectiveness on the diligence and propriety of those responsible for operating them and are capable of being overridden by persons holding positions of authority or trust. Although we can therefore provide no assurance as to the day to day operation of those procedures, we can confirm that in our opinions the directors have provided their written confirmation required by paragraph 2.11(a) of the Listing Rules after due and careful enquiry.

This letter is for your information only, solely as concerns the sponsor's declaration to the London Stock Exchange in relation to the issuer under paragraph 2.11(b) of the Listing Rules. It should not be referred to or quoted, in whole or in part, in any other context.

Yours faithfully

APPENDIX 4: LIST OF ABBREVIATIONS

APB	Auditing Practices Board
DTR	Disclosure and Transparency Rules
FRC	Financial Reporting Council
FSA	Financial Services Authority
IAASB	International Auditing and Assurance Standards Board
ICAEW	Institute of Chartered Accountants in England and Wales
ICFR	Internal Control over Financial Reporting
IFAC	International Federation of Accountants
IPO	initial public offering
ISA	International Standard on Auditing
ISAE 3000	International Standard on Assurance Engagements 3000, <i>Assurance Engagements Other Than Audits or Reviews of Historical Financial Information</i>
LR	Listing Rules
LSE	London Stock Exchange
SEC	Securities and Exchange Commission
SIR	Standard for Investment Reporting
UKLA	United Kingdom Listing Authority

APPENDIX 5: BIBLIOGRAPHY

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FSA, Disclosure and Transparency Rules, Chapter 4 Periodic Financial Reporting.

FSA, Sponsors, <http://www.fsa.gov.uk/Pages/Doing/UKLA/Sponsors/index.shtml>

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LSE, AIM Rules for Nominated Advisers.

UKLA, *LIST!*, 2005.

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