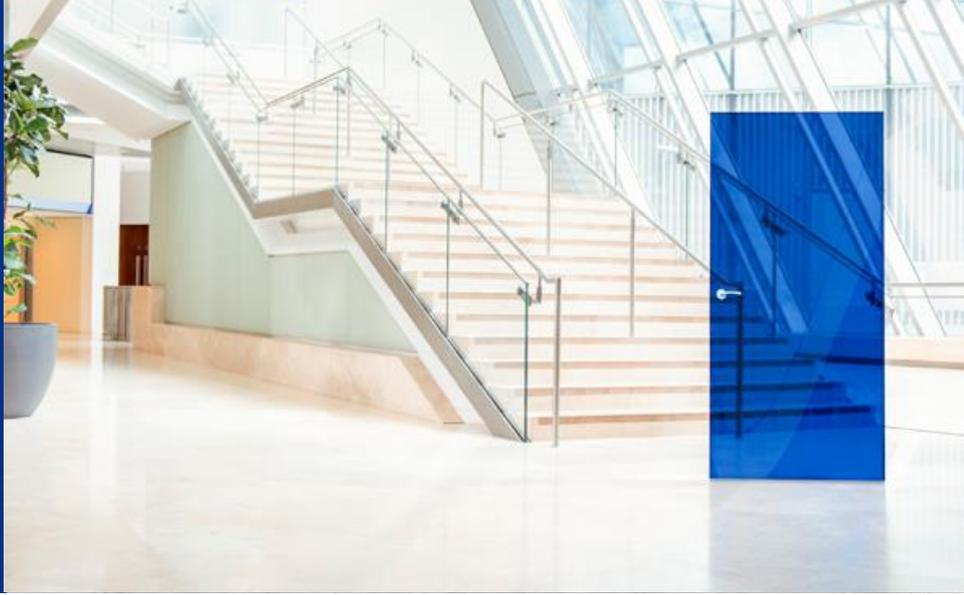




The Audit and Assurance Policy

KPMG Board Leadership Centre



Following the recommendation first made by Sir Donald Brydon in his [Independent review into the quality and effectiveness of audit](#), the recent BEIS Consultation [Restoring trust in audit and corporate governance](#) proposes that directors of public interest entities prepare an Audit and Assurance Policy, describing their approach (over a rolling three year forward look) to seeking internal and external assurance of the information they report to shareholders, including any external assurance planned beyond the scope of the annual statutory audit. The Government intends that the Audit and Assurance Policy would only be required initially of premium listed companies; other listed and unlisted PIEs should have a further two years to prepare and publish their Audit and Assurance Policy

The aim of the Audit and Assurance Policy is to provide the opportunity for companies to show how they are assuring the integrity of reporting – including, but not limited to the financial statements – and handling of risk; and by publishing the policy, increase the dialogue with investors and focus boards and audit committees towards greater clarity on the issues involved. The Government proposes that, as a minimum, the policy should cover the following:

- An explanation of what independent assurance, if any, the company intends to obtain in the next three years in relation to the annual report and other company disclosures beyond that required by statutory audit. This should include an explanation of what independent assurance, if any, the company plans to obtain in relation to:
 - the company’s Resilience Statement in whole or part, and other disclosures related to risk;
 - the effectiveness of the company’s internal controls framework.
- A description of the company’s internal auditing and assurance processes. This might include how management conclusions and judgements in the annual report and accounts can be challenged and verified internally, and whether, and if so how, the company is proposing to strengthen its internal audit and assurance capabilities over the next three years.
- A description of what policies the company may have in relation to the tendering of external audit services.
- An explanation of whether, and if so how, shareholder and employee views have been taken into account in the formulation of the Audit and Assurance Policy.

Risk and viability reporting, and the effectiveness of a company’s internal control framework, should be routinely considered for additional assurance since the consequences of inadequate reporting or processes in these areas could be particularly significant.

Having articulated the board’s approach to obtaining assurance over the range of reporting for which it has responsibility; and the assurance processes around risk and internal controls - it would then be for shareholders to challenge this approach through an advisory shareholder vote.

What matters should be considered when setting an Audit and Assurance Policy?

We encourage boards to think deeply about what their Audit and Assurance Policy might look like based on their current activities – and the guidance on the following pages is designed to help with that process. However, while we see some merit in publishing such policies for consultation with shareholders at the earliest possible opportunity, we urge audit committees to favour proper consideration of their risk assessment and associated assurance needs - and produce policies that are meaningfully linked to risk and resilience – over and above the desire to be seen to be the first to adopt.

Boards should focus on the drive for genuine improvements, both in the transparency of reporting and in the delivery of value-adding audit and assurance. Policies should provide transparency on what companies really do without boiler-plate descriptions. This year, companies might prepare for the new requirements by prioritising their understanding of their current arrangements, identifying practical improvements, building capability and addressing gaps in their underlying audit and assurance framework.

- **Responsibility** – The board must be clearly accountable for the Audit and Assurance Policy whilst delegating the implementation in practical terms to the audit committee. In developing the Audit and Assurance Policy, we would expect the audit committee to work closely with the executive team and consult with the risk committee and any other oversight committees as appropriate.
- **Assurance sources** – Consider the different sources of assurance and the degree of assurance provided. What role do the three lines of defence play? Do assurance activities provide high, moderate or limited assurance? When was the assurance received? What is the role of external assurance providers versus internal assurance providers?
- **Mapping assurance** – Do you have appropriate assurance over all the areas of interest to key stakeholders? Some areas may be immature and require preparatory work before assurance can be provided. Articulate the assurance journey and when you expect to report on new areas.
- **Consultation** – How will you engage with your investors and other key stakeholders. Brydon anticipates publishing the statement of risk and uncertainties sufficiently in advance of the Audit and Assurance Policy to allow the board to seek shareholder and other views on the appropriate emphasis. How does the board ensure this is not a tick-box exercise? How can the board encourage proactive engagement with shareholders in order to get meaningful input?
- **Publication** – Where will you publish the Policy? On the company’s website, in the Annual Report or both? How will you ensure alignment with the audit committee report and the risk disclosures within the Annual Report?
- **AGM** – How will you use the AGM to communicate to shareholders (and other stakeholders)? We recommend that the Audit committee chair be available to answer any questions in relation to the policy.
- **Rolling updates** – What processes will be put in place to keep the policy up to date – particularly if hosted on the company’s website? Think about the needs of the board, changes to the strategy and business model and the evolving needs of stakeholders.

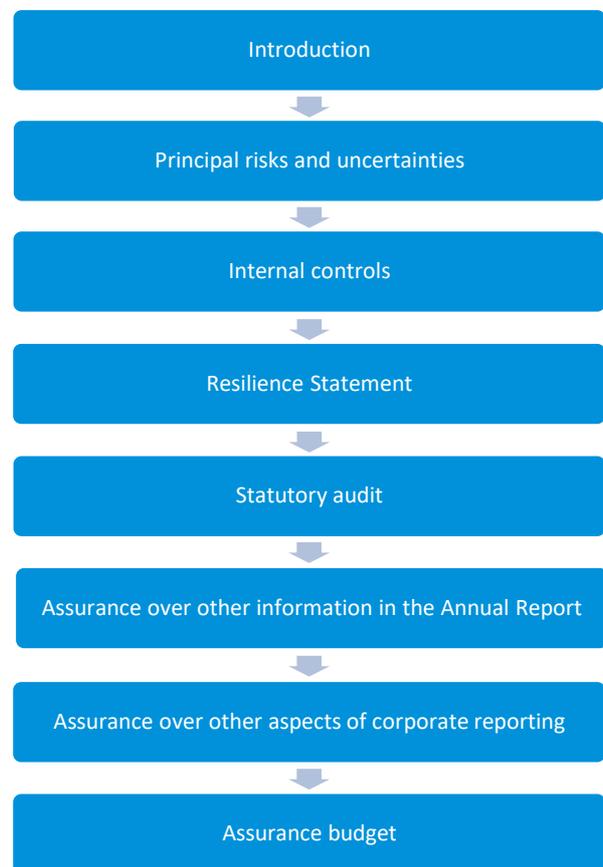
How should the Audit and Assurance Policy be structured?

The BEIS consultation sets out the fundamentals to be included within the Audit and Assurance policy and Brydon suggest other things such as the assurance budget including external fees and the cost of internal audit and any other forms of assurance the company obtains.

However, the precise structure will necessarily reflect the nature, scale and complexity of the company. In our view, a good Audit and Assurance policy should be communication focussed and seek to create an active dialogue between the company and its stakeholders. Continuous reflection on how well the Policy facilitates meaningful engagement should, in turn, invite continuous improvement and practice-led innovation.

Use plain language with well defined terms, avoid unnecessary words and complexity, use consistent terminology and work around an easy to follow structure.

One possible structure might be:



Introduction

Explain the context for the Audit and Assurance Policy including the:

- purpose, periods covered and when it will be updated;
- process for developing, reviewing and approving the policy;
- process for seeking shareholder and other stakeholder input; and
- state of maturity and any future plans, including whether, and if so how, the company is proposing to strengthen its internal audit and assurance capabilities over the next three years

Principal risks and uncertainties

Discuss how the approach to assurance relates to the company's principal risks and uncertainties.

Provision 28 of the UK Corporate Governance Code recommends that the board carry out a robust assessment of the company's emerging and principal risks; and confirm in the Annual Report that it has completed such an assessment, including a description of its principal risks, what procedures are in place to identify emerging risks, and an explanation of how these are being managed or mitigated.

- How does the board determine the nature and extent of the principal risks the company is willing to take in order to achieve its long-term strategic objectives?
- How does the board ensure that appropriate assurance is received in respect of all the principal risks and uncertainties?
- Is there an assurance map in place (see later)?
- What defence mechanisms are in place? How do the 'three lines of defence' operate within the company?
- How are new and emerging risks identified and assessed?

Internal controls

Discuss the board's approach to assurance in relation to the system of internal controls. This should cover all material controls including financial, operational and compliance controls, including the role of internal audit.

Provision 29 of the UK Corporate Governance Code recommends that the board should monitor the company's internal control systems and, at least annually, carry out a review of its effectiveness and report on that review in the annual report.

- How are material internal controls defined?
- What processes are in place to determine what is in scope?
- What processes are in place for the board's on-going monitoring of the design and operating effectiveness of material internal controls?
- Against which control framework is the effectiveness of the system of internal controls assessed?
- How are significant failings or weaknesses defined?
- What processes are in place for the annual review of the effectiveness of internal controls? How has the board drawn on the results of its on-going process?
- How has the board satisfied itself that it has sound, appropriately documented, evidence to support its statement in the company's annual report and accounts?

Resilience Statement

Discuss the board's approach to assurance in relation to the new Resilience Statement (or the existing Going Concern and longer-term Viability Statements) – including the internal review approach and the extent to which the auditors have been engaged.

- How has the board assured itself over the robustness of the Resilience Statement?
- What, if any, external forms of assurance have been provided?
- What additional assurance, if any, has been provided by the external auditor?

Statutory audit

- What was the approach taken to the appointment or reappointment of the external auditor – including audit tenders?
- What role did the audit committee play in negotiating the audit fee? On what basis was it set?
- How was the scope of the audit determined (geography, risk profile, etc.)? Did the audit committee arrange for additional work to be undertaken?
- What was the framework for determining materiality?
- How did the audit committee assess the effectiveness of the audit – including the role played by management?

Assurance over other information in the Annual Report

Discuss the board's approach to determining whether the Annual Report is fair, balanced and understandable and provides the information necessary for shareholders to assess the company's position, performance, business model and strategy.

Clarify the external auditor's responsibilities (under ISA720) in relation to the other information presented with the financial statements; including the role of internal audit.

Explain the board's approach and reasoning in determining any specific assurance received in respect of the other information included within the Annual Report – including the independence, qualifications and approach taken to appointment of the assurance provider; and the degree of assurance received.

Areas for consideration might include *inter alia*:

- The Strategic Report (or aspects of it)
- Key Performance Indicators (KPIs)
- Alternative Performance Measures (APMs)

- The Directors’ Fraud Statement
- The Public Interest Statement
- The Remuneration Report
- Other corporate governance statements
- ESG or Sustainability Report and/or any ESG metrics
- The Section 172(1) Statement
- The corporate culture disclosures

Where no additional assurance is commissioned, set out the reasons why and whether this will be reviewed in the future.

Assurance over other aspects of corporate reporting

The UK Corporate Governance Code extends the board’s responsibility to present a fair, balanced and understandable assessment to interim and other price-sensitive public records and reports to regulators, as well as to information required to be presented by statutory instruments. As such, the Audit and assurance policy should address the board’s approach to assurance over inter alia: interim reports; gender and ethnicity pay gap disclosures; the modern slavery statement; and analyst presentations and market announcements

Assurance budget

Disclose the company’s assurance budget divided by the broad categories of expenditure planned for the first year of the rolling three-year period covered, including:

- external fees (including the statutory audit fee);
- the cost of internal audit; and
- any other forms of assurance the company obtains.

Consider reconciling the figures disclosed to the audit fee disclosures within the financial statements

Presentation

Companies should invest in creating a report that is compelling, clearly articulates the audit and assurance policy, and is visually engaging.

We encourage reporting formats that reflect the nature scale and complexity of the company and recommend the inclusion of:

- the full policy in an accessible location on the company’s website; and
- a succinct summary of the mandatory information within the Annual Report. Logically, this would be part of or appended to the Audit Committee Report though alternative approaches – such as extending the existing risk reporting – could be adopted.

Consider including a risk map and an assurance map to help illustrate:

- the significance of effective controls in reducing inherent risk to residual risk; and
- the areas over which assurance is received; and the source, degree and timing of the assurance obtained.

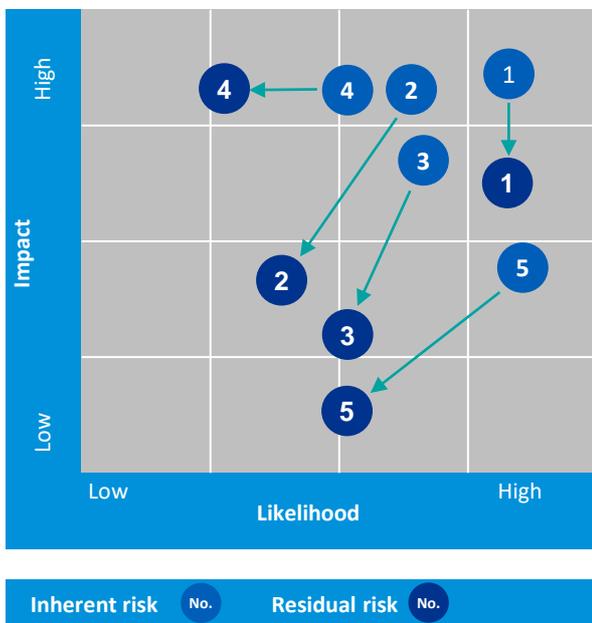


Fig 1: Example risk map

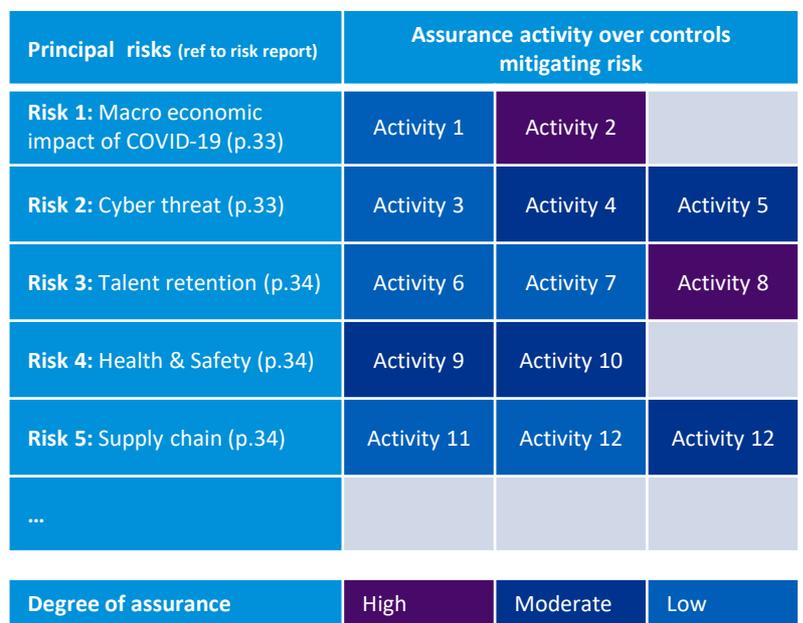


Fig 2: Example assurance map

The KPMG Board Leadership Centre

The KPMG Board Leadership Centre offers support and guidance to non-executive directors, whether managing a portfolio non-executive career or embarking on a first appointment. Membership offers you a place within a community of board-level peers with access to topical and relevant seminars, invaluable resources and thought leadership, as well as lively and engaging networking opportunities. We equip you with the tools you need to be highly effective in your role, enabling you to focus on the issues that really matter to you and your business.

Learn more at www.kpmg.com/uk/blc.

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