

June 2016

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# International Standard on Auditing (UK) 250 (Revised June 2016)

Section B—The Auditor’s Statutory Right and  
Duty to Report to Regulators of Public Interest  
Entities and Regulators of Other Entities in the  
Financial Sector

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Registered in England number 2486368. Registered Office:

8th Floor, 125 London Wall, London EC2Y 5AS

**INTERNATIONAL STANDARD ON AUDITING (UK) 250  
(REVISED JUNE 2016)**

**SECTION B—THE AUDITOR’S STATUTORY RIGHT AND DUTY TO  
REPORT TO REGULATORS OF PUBLIC INTEREST ENTITIES AND  
REGULATORS OF OTHER ENTITIES IN THE FINANCIAL SECTOR**

(Effective for audits of financial statements for periods commencing on or after 17 June 2016)

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International Standard on Auditing (UK) (ISA (UK)) 250 (Revised June 2016), *Section B—The Auditor’s Statutory Right and Duty to Report to Regulators of Public Interest Entities and Regulators of Other Entities in the Financial Sector*, should be read in conjunction with ISA (UK) 200 (Revised June 2016), *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with International Standards on Auditing (UK)*.

## Introduction

### Scope of this Section

1. This Section of ISA (UK) 250 deals with the circumstances in which the auditor of an entity subject to statutory regulation (a “regulated entity”) is required to report direct to a regulator information which comes to the auditor’s attention in the course of the work undertaken in the auditor’s capacity as auditor of the regulated entity. This may include work undertaken to express an opinion on the entity’s financial statements, other financial information or on other matters specified by legislation or by a regulator.

### The Auditor’s Responsibilities (Ref: Para. A1–A8)

2. The auditor of a regulated entity generally has special reporting responsibilities in addition to the responsibility to report on financial statements. These special reporting responsibilities take two forms:
  - (a) *A responsibility to provide a report on matters specified in legislation or by a regulator.* This form of report is often made on an annual or other routine basis and does not derive from another set of reporting responsibilities. The auditor is required to carry out appropriate procedures sufficient to form an opinion on the matters concerned. These procedures may be in addition to those carried out to form an opinion on the financial statements; and
  - (b) *A statutory duty to report certain information, relevant to the regulators’ functions, that come to the auditor’s attention in the course of the audit work.* The auditor has no responsibility to carry out procedures to search out the information relevant to the regulator. This form of report is derivative in nature, arising only in the context of another set of reporting responsibilities, and is initiated by the auditor on discovery of a reportable matter.
3. This Section of ISA (UK) 250 deals with both forms of direct reports. Guidance on the auditor’s responsibility to provide special reports on a routine basis on other matters specified in legislation or by a regulator is given in the Practice Notes dealing with regulated business, for example banks, building societies, investment businesses and insurers.
4. The statutory duty to report to a regulator applies to information which comes to the attention of the auditor in the auditor’s capacity as auditor. In determining whether information is obtained in that capacity, two criteria in particular need to be considered: first, whether the person who obtained the information also undertook the audit work; and if so, whether it was obtained in the course of or as a result of undertaking the audit work. Appendix 2 to this Section of ISA (UK) 250 sets out guidance on the application of these criteria.
5. The auditor may have a statutory right to bring information to the attention of the regulator in particular circumstances which lie outside those giving rise to a statutory duty to initiate a direct report. Where this is so, the auditor may use that right to make a direct report relevant to the regulator on a specific matter which comes to the auditor’s attention when the auditor concludes that doing so is necessary to protect the interests of those for whose benefit the regulator is required to act.
6. The requirements and explanatory material in this Section of ISA (UK) 250 complement but do not replace the legal and regulatory requirements applicable to each regulated entity. Where the application of those legal and regulatory requirements, taking into

account any published interpretations, is insufficiently clear for the auditor to determine whether a particular circumstance results in a legal duty to make a report to a regulator, or a right to make such a report, it may be appropriate to take legal advice.

### Effective Date

7. This Section of ISA (UK) 250 is effective for audits of financial statements for periods commencing on or after 17 June 2016. Earlier adoption is permitted.

### Objective

8. The objective of the auditor of a regulated entity is to bring information of which the auditor has become aware in the ordinary course of performing work undertaken to fulfil the auditor's audit responsibilities to the attention of the appropriate regulator as soon as practicable when:
  - (a) The auditor concludes that it is relevant to the regulator's functions having regard to such matters as may be specified in statute or any related regulations; and
  - (b) In the auditor's opinion there is reasonable cause to believe it is or may be of material significance to the regulator.

### Definitions

9. For purposes of this Section of ISA (UK) 250, the following terms have the meanings attributed below:
  - (a) **The Act(s)** – Means those Acts that give rise to a duty to report to a regulator. For example, in the UK, this includes the Audit Regulation,<sup>1</sup> the Financial Services and Markets Act 2000, the Financial Services Act 2012 and regulations made under those Acts, and any future legislation including provisions relating to the duties of auditors similar to those contained in that statute.
  - (b) **Audit** – For the purpose of this Section of ISA (UK) 250, the term “audit” refers both to an engagement to report on the financial statements of a regulated entity and to an engagement to provide a report on other matters specified by statute or by a regulator undertaken in the capacity of auditor.
  - (c) **Auditor** – The term “auditor” should be interpreted in accordance with the requirements of the Acts. Guidance on its interpretation is contained in Practice Notes relating to each area of the financial sector to which the duty applies.
  - (d) **Material significance** – The term “material significance” requires interpretation in the context of the specific legislation applicable to the regulated entity. A matter or group of matters is normally of material significance to a regulator's functions when, due either to its nature or its potential financial impact, it is likely of itself to require investigation by the regulator. Further guidance on the interpretation of the term in the context of specific legislation is contained in Practice Notes dealing with the rights and duties of auditors of regulated entities to report direct to regulators.
  - (e) **Regulated entity** – An individual, company or other type of entity which is:
    - (i) Authorized to carry on business in the financial sector which is subject to statutory regulation; or

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<sup>1</sup> Regulation (EU) No 537/2014 of the European Parliament and of the Council of 16 April 2014.

- (ii) A public interest entity.<sup>2</sup>
- (f) **Regulator** – Such persons as are empowered by the Act(s) to regulate the entity. The term includes the Financial Conduct Authority, the Prudential Regulation Authority, and such other bodies as may be so empowered in future legislation.
- (g) **“Tipping off”** – Involves a disclosure that is likely to prejudice any investigation into suspected money laundering which might arise from a report being made to a regulatory authority.<sup>3</sup> Money laundering involves an act which conceals, disguises, converts, transfers, removes, uses, acquires or possesses property which constitutes or represents a benefit from criminal conduct.

## Requirements

### Conduct of the Audit

#### *Planning*

10. When obtaining an understanding of the business for the purpose of the audit, the auditor of a regulated entity shall obtain an understanding of its current activities, the scope of its authorization and the effectiveness of its control environment. (Ref: Para. A9–A16)

#### *Supervision and Control*

11. The auditor shall ensure that all staff involved in the audit of a regulated entity have an understanding of:
  - (a) The provisions of applicable legislation;
  - (b) The regulator's rules and any guidance issued by the regulator; and
  - (c) Any specific requirements which apply to the particular regulated entity, appropriate to their role in the audit and sufficient (in the context of that role) to enable them to identify situations which may give reasonable cause to believe that a matter should be reported to the regulator. (Ref: Para. A17–A23)

#### *Identifying Matters Requiring a Report Direct to Regulators*

12. Where an apparent breach of statutory or regulatory requirements comes to the auditor's attention, the auditor shall:
  - (a) Obtain such evidence as is available to assess its implications for the auditor's reporting responsibilities;
  - (b) Determine whether, in the auditor's opinion, there is reasonable cause to believe that the breach is of material significance to the regulator; and
  - (c) Consider whether the apparent breach is criminal conduct that gives rise to criminal property and, as such, should be reported to the specified authorities. (Ref: Para. A24–A30)

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<sup>2</sup> ISA (UK) 220 (Revised June 2016), *Quality Control for an Audit of Financial Statements*, paragraph 7(m)-1 defines public interest entity.

<sup>3</sup> More detail is provided in the definition contained in Section A of ISA (UK) 250 (Revised December 2017).

## **Reporting** (Ref: Para. A31–A46)

### *The Auditor's Statutory Duty to Report Direct to Regulators*

13. When the auditor concludes, after appropriate discussion and investigations, that a matter which has come to the auditor's attention gives rise to a statutory duty to make a report the auditor shall<sup>4</sup> bring the matter to the attention of the regulator as soon as practicable in a form and manner which will facilitate appropriate action by the regulator. When the initial report is made orally, the auditor shall make a contemporaneous written record of the oral report and shall confirm the matter in writing to the regulator. (Ref: Para. A31–A35)

13R-1. For audits of financial statements of public interest entities, the auditor shall:

- (a) Report promptly to the regulator any information concerning that public interest entity of which the auditor has become aware while carrying out the audit and which may bring about any of the following:
  - (i) A material breach of the laws, regulations or administrative provisions which lay down, where appropriate, the conditions governing authorization or which specifically govern pursuit of the activities of such public interest entity; or
  - (ii) A material threat or doubt concerning the continuous functioning of the public interest entity; or
  - (iii) A refusal to issue an audit opinion on the financial statements or the issuing of an adverse or qualified opinion.
- (b) Report any information referred to in paragraph 13R-1(a)(i)–(iii) of which the auditor becomes aware in the course of carrying out the audit of an undertaking having close links<sup>5</sup> with the public interest entity for which they are also carrying out the audit.

14. When the matter giving rise to a statutory duty to make a report direct to a regulator casts doubt on the integrity of those charged with governance or their competence to conduct the business of the regulated entity, the auditor shall<sup>4</sup> make the report to the regulator as soon as practicable and without informing those charged with governance in advance. (Ref: Para. A35)

### *The Auditor's Right to Report Direct to Regulators*

15. When a matter comes to the auditor's attention which the auditor concludes does not give rise to a statutory duty to report but nevertheless may be relevant to the regulator's exercise of its functions, the auditor shall:<sup>4</sup>

- (a) Consider whether the matter should be brought to the attention of the regulator under the terms of the appropriate legal provisions enabling the auditor to report direct to the regulator; and, if so
- (b) Advise those charged with governance that in the auditor's opinion the matter should be drawn to the regulators' attention.

<sup>4</sup> In the UK, subject to compliance with legislation relating to "tipping off".

<sup>5</sup> "Close links" is defined in point (38) of Article 4(1) of Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013.

Where the auditor is unable to obtain, within a reasonable period, adequate evidence that those charged with governance have properly informed the regulator of the matter, the auditor shall<sup>4</sup> make a report direct to the regulator as soon as practicable. (Ref: Para. A36–A37)

#### *Contents of a Report Initiated by the Auditor*

16. When making or confirming in writing a report direct to a regulator, the auditor shall:
- (a) State the name of the regulated entity concerned;
  - (b) State the statutory power under which the report is made;
  - (c) State that the report has been prepared in accordance with ISA (UK) 250, *Section B—The Auditor’s Statutory Right and Duty to Report to Regulators of Public Interest Entities and Regulators of Other Entities in the Financial Sector*;
  - (d) Describe the context in which the report is given;
  - (e) Describe the matter giving rise to the report;
  - (f) Request the regulator to confirm that the report has been received; and
  - (g) State the name of the auditor, the date of the written report and, where appropriate, the date on which an oral report was made to the regulator and the name and title of the individual to whom the oral report was made.
- (Ref: Para. A38–A39)

#### *Relationship With Other Reporting Responsibilities*

17. When issuing a report expressing an opinion on a regulated entity's financial statements or on other matters specified by legislation or a regulator, the auditor:
- (a) Shall consider whether there are consequential reporting issues affecting the auditor’s opinion which arise from any report previously made direct to the regulator in the course of the auditor’s appointment; and
  - (b) Shall assess whether any matters encountered in the course of the audit indicate a need for a further direct report. (Ref: Para. A40–A43)

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## **Application and Other Explanatory Material**

### **The Auditor’s Responsibilities** (Ref: Para. 2–6)

- A1. Before accepting appointment, the auditor follows the procedures identified in the FRC’s Ethical Standard and the ethical pronouncements and Audit Regulations issued by the auditor’s relevant professional body.
- A2. In the case of regulated entities, the auditor would in particular obtain an understanding of the appropriate statutory and regulatory requirements and a preliminary knowledge of the management and operations of the entity, so as to enable the auditor to determine whether a level of knowledge of the business adequate to perform the audit can be obtained. The procedures carried out by the auditor in seeking to obtain this preliminary understanding may include discussion with the previous auditor and, in some circumstances, with the regulator.
- A3. On ceasing to hold office, the auditor may be required by statute or by regulation to make specific reports concerning the circumstances relating to that event, and would

also follow the procedures identified in the ethical guidance issued by the relevant professional body.

- A4. In addition, the auditor of a regulated entity would assess whether it is appropriate to bring any matters of which the auditor is then aware to the notice of the regulator. Under legislation in the UK, this may be done either before or after ceasing to hold office, as the auditor's statutory right to disclose to a regulator information obtained in the course of the auditor's appointment is not affected by the auditor's removal, resignation or otherwise ceasing to hold office.
- A5. The duty to make a report direct to a regulator does not impose upon the auditor a duty to carry out specific work: it arises solely in the context of work carried out to fulfil other reporting responsibilities. Accordingly, no auditing procedures in addition to those carried out in the normal course of auditing the financial statements, or for the purpose of making any other specified report, are necessary for the fulfilment of the auditor's responsibilities.
- A6. It will, however, be necessary for the auditor to take additional time in carrying out a financial statement audit or other engagement to assess whether matters which come to the auditor's attention should be included in a direct report and, where appropriate, to prepare and submit the report. These additional planning and follow-up procedures do not constitute an extension of the scope of the financial statement audit or of other work undertaken to provide a specified report relating to a regulated entity. They are necessary solely in order to understand and clarify the reporting responsibility and, where appropriate, to make a report.
- A7. The circumstances in which the auditor is required by statute to make a report direct to a regulator include matters which are not considered as part of the audit of financial statements or of work undertaken to discharge other routine responsibilities. For example, the duty to report would apply to information of which the auditor became aware in the course of the auditor's work which is relevant to the Financial Conduct Authority's criteria for approved persons, although the auditor is not otherwise required to express an opinion on such matters. However, legislation imposing a duty to make reports direct to regulators does not require the auditor to change the scope of the audit work, nor does it place on the auditor an obligation to conduct the audit work in such a way that there is reasonable certainty that the auditor will discover all matters which regulators might consider as being of material significance. Therefore, whilst the auditor of a regulated entity is required to be alert to matters which may require a report, the auditor is not expected to be aware of all circumstances which, had the auditor known of them, would have led the auditor to make such a report. It is only when the auditor becomes aware of such a matter during the conduct of the normal audit work that the auditor has an obligation to determine whether a report to the regulator is required by statute or appropriate for other reasons.
- A8. Similarly, the auditor is not responsible for reporting on a regulated entity's overall compliance with rules with which it is required to comply nor is the auditor required to conduct the audit work in such a way that there is reasonable certainty that the auditor will discover breaches. Nevertheless, breaches of rules with which a regulated entity is required to comply may have implications for the financial statements and, accordingly, the auditor of a regulated entity needs to consider whether any actual or contingent liabilities may have arisen from breaches of regulatory requirements. Breaches of a regulator's requirements may also have consequences for other matters

on which the auditor of a regulated entity is required to express an opinion and, if such breaches represent criminal conduct, could give rise to the need to report to specified authorities.

## Conduct of the Audit

### Planning (Ref: Para. 10)

- A9. ISAs (UK) require the auditor to obtain an understanding of the entity and its environment.<sup>6</sup>
- A10. In the context of a regulated entity, the auditor's understanding of its environment needs to extend to the applicable statutory provisions, the rules of the regulator concerned and any guidance issued by the regulator on the interpretation of those rules, together with other guidance issued by relevant authorities, including the FRC.
- A11. The auditor is also required to identify and assess the risks of material misstatements to provide a basis for designing and performing further audit procedures.<sup>7</sup> In making such an assessment the auditor takes into account the control environment, including the entity's higher level procedures for complying with the requirements of its regulator. Such a review gives an indication of the extent to which the general atmosphere and controls in the regulated entity are conducive to compliance, for example through consideration of *inter alia*:
- The adequacy of procedures and training to inform staff of the requirements of relevant legislation and the rules or other regulations of the regulator.
  - The adequacy of procedures for authorization of transactions.
  - Procedures for internal review of the entity's compliance with regulatory or other requirements.
  - The authority of, and any resources available to, the compliance officer/Money Laundering Reporting Officer (MLRO).
  - Procedures to ensure that possible breaches of requirements are investigated by an appropriate person and are brought to the attention of senior management.
- A12. In some areas of the financial sector, conducting business outside the scope of the entity's authorization is a serious regulatory breach, and therefore of material significance to the regulator. In addition, it may result in fines, suspension or loss of authorization.
- A13. Where the auditor's review of the reporting entity's activities indicates that published guidance by the regulator may not be sufficiently precise to enable the auditor to identify circumstances in which it is necessary to initiate a report, the auditor would consider whether it is necessary to discuss the matters specified in legislation with the appropriate regulator with a view to reaching agreement on its interpretation.
- A14. Similarly, where a group includes two or more companies separately regulated by different regulators, there may be a need to clarify the regulators' requirements in any overlapping areas of activity. However, the statutory duty to make a report as presently defined arises only in respect of the legal entity subject to regulation. Therefore the

<sup>6</sup> ISA (UK) 315 (Revised June 2016), *Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and Its Environment*, paragraph 11.

<sup>7</sup> ISA (UK) 315 (Revised June 2016), paragraph 25.

auditor of an unregulated company in a group that includes one or more other companies which are authorized by regulators would not have a duty to report matters to the regulators of those companies.

- A15. When a regulated entity is subject to provisions of two or more regulators, the auditor needs to take account of the separate reporting requirements in planning and conducting the audit work. Arrangements may exist for one regulatory body to rely on financial monitoring being carried out by another body (the “lead regulator”) and where this is the case, routine reports by the regulated entity's auditor may be made to the lead regulator alone.
- A16. However, the auditor’s statutory duty to report cannot be discharged by reliance on the lead regulator informing others. Therefore, where the auditor concludes that a matter is of material significance to one regulator, the auditor needs to assess the need for separate reports informing each regulator of matters which the auditor concludes are or may be of material significance to it.

#### *Supervision and Control* (Ref: Para. 11)

- A17. ISAs (UK) require the engagement partner to take responsibility for the direction, supervision and performance of the audit engagement in compliance with professional standards and applicable legal and regulatory requirements.<sup>8</sup> Consequently, in planning and conducting the audit of a regulated entity the auditor needs to ensure that staff are alert to the possibility that a report to its regulator may be required.
- A18. Auditing firms also need to establish adequate procedures to ensure that any matters which are discovered in the course of or as a result of audit work and may give rise to a duty to report are brought to the attention of the engagement partner responsible for the audit on a timely basis.
- A19. The right and duty to report to a regulator applies to information of which the auditor becomes aware in the auditor’s capacity as such. They do not extend automatically to any information obtained by a firm regardless of its source. Consequently partners and staff undertaking work in another capacity are not required to have detailed knowledge of the regulator's requirements (unless necessary for that other work) nor to bring information to the attention of the engagement partner responsible for the audit on a routine basis.
- A20. However, as discussed further in Appendix 2, firms need to establish lines of communications, commensurate with their size and complexity, sufficient to ensure that non-audit work undertaken for a regulated entity which is likely to have an effect on the audit is brought to the attention of the engagement partner responsible for the audit, who will need to determine whether the results of non-audit work undertaken for a regulated entity ought to be assessed as part of the audit process.

#### *Use of the Work of Other Auditors*

- A21. An auditor with responsibilities for reporting on financial statements including financial information of one or more components audited by other auditors is required to obtain sufficient appropriate audit evidence that the work of the other auditors is adequate for the purposes of the audit. The same principle applies to using the work of another auditor in a different type of engagement. The auditor of a regulated entity who uses

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<sup>8</sup> ISA (UK) 220 (Revised June 2016), *Quality Control for an Audit of Financial Statements*, paragraph 15.

the work undertaken by other auditors needs to establish reporting arrangements such that the other auditors bring to the attention of the auditor of the regulated entity matters arising from their work which may give rise to a duty to report to a regulator.

- A22. The nature of the reporting arrangements will depend on the nature of the work undertaken by the other auditors. For example, the statutory duty to make a report relates to the legal entity subject to regulation rather than to the entire group to which that entity may belong. Consequently, the auditor of a holding company authorized by one regulator would not be expected to have knowledge of all matters which come to the attention of a component auditor. The auditor of the regulated entity would, however, have a duty to report, where appropriate, matters which arise from the audit of the regulated entity's own financial statements and of the consolidated group figures.
- A23. Where the audit of a regulated entity is undertaken by joint auditors, knowledge obtained by one firm is likely to be deemed to be known by the other. Care will therefore be needed in agreeing and implementing arrangements to exchange information relating to matters which may give rise to a duty to report to a regulator.

*Identifying Matters Requiring a Report Direct to Regulators (Ref: Para. 12)*

A24. The precise matters which give rise to a statutory duty on auditors to make a report to a regulator derive from the relevant Acts. Broadly, such matters fall into three general categories:

- (a) The financial position of the regulated entity;
- (b) Its compliance with requirements for the management of its business; and
- (c) The status of those charged with governance as fit and proper persons.

Further detailed guidance on the interpretation of these matters in the context of specific legislation applicable to each type of regulated entity is contained in Practice Notes dealing with the rights and duties of auditors of regulated entities to report direct to regulators.

- A25. In assessing the effect of an apparent breach, the auditor takes into account the quantity and type of evidence concerning such a matter which may reasonably be expected to be available. If the auditor concludes that the auditor has been prevented from obtaining all such evidence concerning a matter which may give rise to a duty to report, the auditor would normally make a report direct to the regulator as soon as practicable.
- A26. An apparent breach of statutory or regulatory requirements may not of itself give rise to a statutory duty to make a report to a regulator. There will normally be a need for some further investigation and discussion of the circumstances surrounding the apparent breach with the directors in order to obtain sufficient information to determine whether it points to a matter which is or may be of material significance to the regulator. For example, a minor breach which has been corrected by the regulated entity and reported (if appropriate) to the regulator, and which from the evidence available to the auditor appears to be an isolated occurrence, would not normally give the auditor reasonable cause to believe that it is or may be of material significance to the regulator. However, a minor breach that results in a criminal offence that gave rise to the criminal property would be reportable to the specified authorities under the anti-money laundering legislation.

- A27. When determining whether a breach of statutory or regulatory requirements gives rise to a statutory duty to make a report direct to a regulator, the auditor considers factors such as:
- Whether the breach, though minor, is indicative of a general lack of compliance with the regulator's requirements or otherwise casts doubt on the status of those charged with governance as fit and proper persons.
  - Whether a breach which occurred before the auditor's visit to the regulated entity was reported by the entity itself and has since been corrected, such that, at the date of the auditor's discovery, no breach exists.
  - Whether the circumstances giving rise to a breach which occurred before the auditors visit to the regulated entity continue to exist, or those charged with governance have not taken corrective action, or the breach has re-occurred.
  - Whether the circumstances suggest that an immediate report to the regulator is necessary in order to protect the interests of depositors, investors, policyholders, clients of the entity or others in whose interests the regulator is required to act.
- A28. The auditor would normally seek evidence to assess the implications of a suspected breach before reporting a matter to the regulator. However, the auditor's responsibility to make a report does not require the auditor to determine the full implications of a matter before reporting: the auditor is required to exercise professional judgment as to whether or not there is reasonable cause to believe that a matter is or may be of material significance to the regulator. In forming that judgment, the auditor undertakes appropriate investigations to determine the circumstances but does not require the degree of evidence which would be a normal part of forming an opinion on financial statements. Such investigations would normally include:
- Enquiry of appropriate level of staff;
  - Review of correspondence and documents relating to the transaction or event concerned; and
  - Discussion with those charged with governance, or other senior management where appropriate.
- In the case of a life company, it would also be appropriate to consult with the appointed actuary, who also has various statutory duties under insurance companies legislation.
- A29. The potential gravity of some apparent breaches may be such that an immediate report to the regulator is essential in order to enable the regulator to take appropriate action: in particular, prompt reporting of a loss of client assets may be necessary to avoid further loss to investors or others in whose interests the regulator is required to act. The auditor is therefore required to balance the need for further investigation of the matter with the need for prompt reporting.
- A30. On completion of the auditor's investigations, the auditor needs to ensure that the facts and the basis for the auditor's decision (whether to report or not) is adequately documented such that the reasons for that decision may be clearly demonstrated should the need to do so arise in future.

## Reporting

### *The Auditor's Statutory Duty to Report Direct to Regulators* (Ref: Para. 13–14)

- A31. Except in the circumstances referred to in paragraph 14 the auditor seeks to reach agreement with those charged with governance on the circumstances giving rise to a report direct to the regulator. However, where a statutory duty to report arises, the auditor is required to make such a report regardless of:
- (a) Whether the matter has been referred to the regulator by other parties (including the company, whether by those charged with governance or otherwise); and
  - (b) Any duty owed to other parties, including those charged with governance of the regulated entity and its shareholders (or equivalent persons).
- A32. Except in the circumstances set out in paragraph 14, the auditor sends a copy of the auditor's written report to those charged with governance and (where appropriate) audit committee of the regulated entity.
- A33. In normal circumstances, the auditor would wish to communicate with the regulator with the knowledge and agreement of those charged with governance of the regulated entity. However, in some circumstances immediate notification of the discovery of a matter giving reasonable grounds to believe that a reportable matter exists will be necessary - for example, a phone call to alert the regulator followed by a meeting to discuss the circumstances.
- A34. Speed of reporting is essential where the circumstances cause the auditor no longer to have confidence in the integrity of those charged with governance. In such circumstances, there may be a serious and immediate threat to the interests of depositors or other persons for whose protection the regulator is required to act; for example where the auditor believes that a fraud or other irregularity may have been committed by, or with the knowledge of, those charged with governance, or have evidence of the intention of those charged with governance to commit or condone a suspected fraud or other irregularity.
- A35. In circumstances where the auditor no longer has confidence in the integrity of those charged with governance, it is not appropriate to provide those charged with governance with copies of the auditor's report. Since such circumstances will be exceptional and extreme, the auditor may wish to seek legal advice as to the auditor's responsibilities and the appropriate course of action.

### *The Auditor's Right to Report Direct to Regulators* (Ref: Para. 15)

- A36. The auditor may become aware of matters which the auditor concludes are relevant to the exercise of the regulator's functions even though they fall outside the statutory definition of matters which must be reported to a regulator. In such circumstances, the Acts in the UK provide the auditor with protection for making disclosure of the matter to the appropriate regulator.
- A37. Where the auditor considers that a matter which does not give rise to a statutory duty to report is nevertheless, in the auditor's professional judgment, such that it should be brought to the attention of the regulator, it is normally appropriate for the auditor to request those charged with governance of the regulated entity in writing to draw it to the attention of the regulator.

*Contents of a Report Initiated by the Auditor* (Ref: Para. 16)

- A38. Such a report is a by-product of other work undertaken by the auditor. As a result it is not possible for the auditor or the regulator to conclude that all matters relevant to the regulator were encountered in the course of the auditor's work. The auditor's report therefore sets out the context in which the information reported was identified and indicates the extent to which the matter has been investigated and discussed with those charged with governance.
- A39. Matters to which the auditor may wish to refer when describing the context in which a report is made direct to a regulator include:
- The nature of the appointment from which the report derives. For example, it may be appropriate to distinguish between a report made in the course of an audit of financial statements and one which arises in the course of a more limited engagement, such as an appointment to report on specified matters by the Financial Conduct Authority;
  - The applicable legislative requirements and interpretations of those requirements which have informed the auditor's judgment;
  - The extent to which the auditor has investigated the circumstances giving rise to the matter reported;
  - Whether the matter reported has been discussed with those charged with governance;
  - Whether steps to rectify the matter have been taken.

*Relationship With Other Reporting Responsibilities* (Ref: Para. 17)

- A40. The circumstances which give rise to a report direct to a regulator may involve an uncertainty or other matter which requires disclosure in the financial statements. The auditor will therefore need to consider whether the disclosures made in the financial statements are adequate for the purposes of giving a true and fair view of the regulated entity's state of affairs and profit or loss. Where the auditor considers it necessary to draw users' attention to a matter presented or disclosed in the financial statements that, in the auditor's judgment, is of such importance that it is fundamental to users' understanding of the financial statements, the auditor is required to include an Emphasis of Matter paragraph in the auditor's report.<sup>9</sup>
- A41. Similarly, circumstances giving rise to a report direct to a regulator may also require reflection in the auditor's reports on other matters required by legislation or another regulator.
- A42. In fulfilling the responsibility to report direct to a regulator, it is important that the auditor not only assess the significance of individual transactions or events but also consider whether a combination of such items over the course of the work undertaken for the auditor's primary reporting responsibilities may give the auditor reasonable grounds to believe that they constitute a matter of material significance to the regulator, and so give rise to a statutory duty to make a report.
- A43. As there is no requirement for the auditor to extend the scope of the audit work to search for matters which may give rise to a statutory duty to report, such an

<sup>9</sup> ISA (UK) 706 (Revised June 2016), *Emphasis of Matter Paragraphs and Other Matter Paragraphs in the Independent Auditor's Report*, paragraph 6.

assessment of the cumulative effect of evidence obtained in the course of an audit would be made when reviewing the evidence in support of the opinions to be expressed in the reports the auditor has been appointed to make. Where such a review leads to the conclusion that the cumulative effect of matters noted in the course of the audit is of material significance to the regulator, it will be appropriate for a report to be made as set out in paragraph 16. However, reports indicating a 'nil return' are not appropriate.

#### *Communication of Information by the Regulator*

- A44. The Acts provide that, in certain exceptional circumstances, regulators may pass confidential information to another party. The precise circumstances in which regulators may disclose information varies, but in general they may do so if considered necessary to fulfil their own obligations under the appropriate Act, or, in some cases, to enable the auditor to fulfil the auditor's duties either to the regulated entity or, in other cases, to the regulator. Confidential information remains confidential in the hands of the recipient.
- A45. In so far as the law permits, regulators have confirmed that they will consider taking the initiative in bringing a matter to the attention of the auditor of a regulated entity in circumstances where:
- (a) They believe the matter is of such importance that the auditor's knowledge of it could significantly affect the form of the auditor's report on the entity's financial statements or other matters on which the auditor is required to report, or the way in which the auditor discharges the auditor's reporting responsibilities; and
  - (b) The disclosure is for the purpose of enabling or assisting the regulator to discharge its functions under the Acts.
- A46. The auditor needs to be aware that there may be circumstances in which the regulators are unable to disclose such information. Where the auditor of a regulated entity is not informed by the regulator of any matter, therefore, the auditor cannot assume that there are no matters known to the regulator which could affect the auditor's judgment as to whether information is of material significance. However, in the absence of disclosure by the regulator, the auditor can only form a judgment in the light of evidence to which the auditor has access.
- A47. For audits of public interest entities, the Audit Regulation<sup>10</sup> requires an effective dialogue to be established between the supervising credit institutions and insurance undertakings, on the one hand, and the auditor carrying out the audit of those institutions and undertakings, on the other hand. The responsibility for compliance with this requirement of the Audit Regulation rests with both parties to the dialogue.

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<sup>10</sup> Regulation (EU) No 537/2014 of the European Parliament and of the Council of 16 April 2014.

**The Regulatory Framework in the Financial Sector**

1. In the UK, legislation exists in the principal areas of financial services to protect the interests of investors, depositors in banks and other users of financial services. Regulated entities operating in the financial sector are required to comply with legal and regulatory requirements concerning the way their business is conducted. Compliance with those rules is monitored in four principal ways:
  - Internal monitoring by those charged with governance of the regulated entity;
  - Submission of regular returns by the regulated entity to the regulator;
  - Monitoring and, in some cases, inspection of the entity by the regulator;
  - Reports<sup>4</sup> by the reporting entity's auditor on its financial statements and other specified matters required by legislation or by the regulator.

**Responsibility for Ensuring Compliance**

2. Ensuring compliance with the requirements with which a regulated entity is required to comply in carrying out its business is the responsibility of those charged with governance of a regulated entity. It requires adequate organization and systems of controls. The regulatory framework provides that adequate procedures for compliance must be established and maintained. Those charged with governance of a regulated entity are also normally required to undertake regular reviews of compliance and to inform the regulator of any breach of the rules and regulations applicable to its regulated business. In addition, regulators may undertake compliance visits.
3. The auditor of a regulated entity normally has responsibilities for reporting<sup>4</sup> on particular aspects of its compliance with the regulator's requirements. However, the auditor has no direct responsibility for expressing an opinion on an entity's overall compliance with the requirements for the conduct of its business, nor does an audit provide any assurance that breaches of requirements which are not the subject of regular auditors' reports will be detected.

**The Role of Auditors**

4. Those charged with governance of regulated entities have primary responsibility for ensuring that all appropriate information is made available to regulators. Normal reporting procedures (including auditor's reports on records, systems and returns, and regular meetings with those charged with governance and/or management and auditors) supplemented by any inspection visits considered necessary by the regulators should provide the regulators with all the information they need to carry out their responsibilities under the relevant Act.

**Routine Reporting by Auditors**

5. Regulators' requirements for reports by auditors vary. In general terms, however, such reports may include opinions on:
  - The regulated entity's annual financial statements;
  - The regulated entity's compliance with requirements for financial resources; and

- The adequacy of the regulated entity's system of controls over its transactions and in particular over its clients' money and other property.
6. As a result of performing the work necessary to discharge their routine reporting responsibilities, or those arising from an appointment to provide a special report required by the regulator, the auditor of a regulated entity may become aware of matters which the auditor considers need to be brought to the regulator's attention sooner than would be achieved by routine reports by the entity or its auditor.
  7. The auditor of a regulated entity normally has a right to communicate in good faith<sup>4</sup> information the auditor considers is relevant to the regulators' functions.

### **The Auditor's Statutory Duty to Report to the Regulator**

8. In addition, the auditor is required by law to report<sup>4</sup> direct to a regulator when the auditor concludes that there is reasonable cause to believe that a matter is or may be of material significance to the regulator. The precise matters which result in a statutory duty to make such a report vary, depending upon the specific requirements of relevant legislation and the regulator's rules. In general, however, a duty to report to a regulator arises when the auditor becomes aware that:
  - The regulated entity is in serious breach of:
    - Requirements to maintain adequate financial resources; or
    - Requirements for those charged with governance to conduct its business in a sound and prudent manner (including the maintenance of systems of control over transactions and over any clients' assets held by the business); or
  - There are circumstances which give reason to doubt the status of those charged with governance or senior management as fit and proper persons.

### **Confidentiality**

9. Confidentiality is an implied term of the auditor's contracts with client entities. However, in the circumstances leading to a right or duty to report,<sup>4</sup> the auditor is entitled to communicate to regulators in good faith information or opinions relating to the business or affairs of the entity or any associated body without contravening the duty of confidence owed to the entity and, in the case of a bank, building society and friendly society, its associated bodies.
10. The statutory provisions permitting the auditor to communicate information to regulators relate to information obtained in the auditor's capacity as auditor of the regulated entity concerned. Auditors and regulators therefore should be aware that confidential information obtained in other capacities may not normally be disclosed to another party.

## **Appendix 2**

(Ref: Para. 4)

# The Application of the Statutory Duty to Report to Regulators

## Introduction

1. The statutory duty to report to a regulator<sup>4</sup> applies to information which comes to the attention of the auditor in the auditor's capacity as auditor. However, neither the term 'auditor' nor the phrase "in the capacity of auditor" are defined in the legislation, nor has the court determined how these expressions should be construed.
2. As a result, it is not always clearly apparent when a firm should regard itself as having a duty to report to a regulator. For example, information about a regulated entity may be obtained when partners or staff of the firm which is appointed as its auditor carry out work for another client entity; or when the firm undertakes other work for the regulated entity. Auditors, regulated entities and regulators need to be clear as to when the normal duty of confidentiality will be overridden by the auditor's statutory duty to report to the regulator.
3. In order to clarify whether or not a firm should regard itself as bound by the duty, the FRC developed, in conjunction with HM Treasury and the regulators, guidance on the interpretation of the key conditions for the existence of that duty, namely that the firm is to be regarded as auditor of a regulated entity and that information is obtained in the capacity of auditor.
4. Guidance on the interpretation of the term 'auditor' in the context of each Act is contained in the separate Practice Notes dealing with each area affected by the legislation.
5. This appendix sets out guidance on the interpretation of the phrase "in the capacity of auditor". The Board nevertheless continues to hold the view that the meaning of the phrase should be clarified in legislation in the longer term.

## In the Capacity of Auditor

6. In determining whether information is obtained in the capacity of auditor, two criteria in particular should be considered:
  - (a) Whether the person who obtained the information also undertook the audit work; and if so
  - (b) Whether it was obtained in the course of or as a result of undertaking the audit work.
7. It is then necessary to apply these criteria to information about a regulated entity which may become known from a number of sources, and by a number of different individuals within a firm. Within a large firm, for example, information may come to the attention of the partner responsible for the audit of a regulated entity, a partner in another office who undertakes a different type of work, or members of the firm's staff at any level. In the case of a sole practitioner who is the auditor of a regulated entity, information about a regulated entity may also be obtained by the practitioner in the course of work other than its audit.

## Non-Audit Work Carried out in Relation to a Regulated Entity

8. Where partners or staff involved in the audit of a regulated entity carry out work other than its audit (non-audit work) information about the regulated entity will be known to them as individuals. In circumstances which suggest that a matter would otherwise give rise to a statutory duty to report<sup>4</sup> if obtained in the capacity of auditor, it will be

prudent for them to make enquiries in the course of their audit work in order to establish whether this is the case from information obtained in that capacity.

9. However, where non-audit work is carried out by other partners or staff, neither of the criteria set out in paragraph 6 is met in respect of information which becomes known to them. Nevertheless the firm should take proper account of such information when it could affect the audit so that it is treated in a responsible manner, particularly since in partnership law the knowledge obtained by one partner in the course of the partnership business may be imputed to the entire partnership. In doing so, two types of work may be distinguished: first, work which could affect the firm's work as auditor and, secondly, work which is undertaken purely in an advisory capacity.
10. A firm appointed as auditor of a regulated entity needs to have in place appropriate procedures to ensure that the partner responsible for the audit function is made aware of any other relationship which exists between any department of the firm and the regulated entity when that relationship could affect the firm's work as auditor. Common examples of such work include accounting work, particularly for smaller entities, and provision of tax services to the regulated entity.
11. *Prima facie*, information obtained in the course of non-audit work is not covered by either the right or the duty to report to a regulator. However, the firm appointed as auditor needs to consider whether the results of other work undertaken for a regulated entity need to be assessed as part of the audit process. In principle, this is no different to seeking to review a report prepared by outside consultants on, say, the entity's accounting systems so as to ensure that the auditor makes a proper assessment of the risks of misstatement in the financial statements and of the work needed to form an opinion. Consequently, the partner responsible for the audit needs to make appropriate enquiries in the process of planning and completing the audit (see paragraph 17 of this Section of ISA (UK) 250). Such enquiries would be directed to those aspects of the non-audit work which might reasonably be expected to be relevant to the audit. When, as a result of such enquiries, those involved in the audit become aware of issues which may be of material significance to a regulator such issues should be considered, and if appropriate reported<sup>4</sup> following the requirements set out in this Section of this ISA (UK).
12. Work which is undertaken in an advisory capacity, for example to assist the directors of a regulated entity to determine effective and efficient methods of discharging their duties, would not normally affect the work undertaken for the audit. Nevertheless, in rare instances, the partner responsible for such advisory work may conclude that steps considered necessary in order to comply with the regulator's requirements have not been taken by the directors or that the directors intend in some respect not to comply with the regulator's requirements. Such circumstances would require consideration in the course of work undertaken for the audit, both to consider the effect on the auditor's routine reports and to determine whether the possible non-compliance is or is likely to be of material significance to the regulator.

### **Work Relating to a Separate Entity**

13. Information obtained in the course of work relating to another entity audited by the same firm (or the same practitioner) is confidential to that other entity. The auditor is not required, and has no right, to report to a regulator confidential information which arises from work undertaken by the same auditing firm for another client. However, as a matter of sound practice, individuals involved in the audit of a regulated entity who

become aware (in a capacity other than that of auditor of a regulated entity) of a matter which could otherwise give rise to a statutory duty to report would normally make enquiries in the course of their audit of the regulated entity to establish whether the information concerned is substantiated.

14. In carrying out the audit work, the auditor is required to have due regard to whether disclosure of non-compliance with laws and regulations to a proper authority is appropriate in the public interest.<sup>11</sup>

### **Conclusion**

15. The phrase “in his capacity as auditor” limits information subject to the duty to report to matters of which the auditor becomes aware in the auditor’s capacity as such. Consequently, it is unlikely that a partnership can be said to be acting in its capacity as auditor of a particular regulated entity whenever any apparently unrelated material comes to the attention of a partner or member of staff not engaged in that audit, particularly if that material is confidential to another client.
16. The statutory duty to report to a regulator<sup>4</sup> therefore does not extend automatically to any information obtained by a firm regardless of its source. Firms undertaking audits of regulated entities need, however, to establish lines of communication, commensurate with their size and organizational structure, sufficient to ensure that non-audit work undertaken for a regulated entity which is likely to have an effect on the audit is brought to the attention of the partner responsible for the audit and to establish procedures for the partner responsible for the audit to make appropriate enquiries of those conducting such other work as part of the process of planning and completing the audit.

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<sup>11</sup> See ISA (UK) 250 (Revised December 2017), *Section A—Consideration of Laws and Regulations in an Audit of Financial Statements*, paragraphs A33-1–A33-8.

## Appendix 3

### **Action by the Auditor on Discovery of a Breach of a Regulator's Requirements**

1. This appendix sets out in the form of a flowchart the steps involved in assessing whether a report to a regulator is required when a breach of the regulator's requirements comes to the attention of the auditor.
2. The flowchart is intended to provide guidance to readers in understanding this Section of ISA (UK) 250. It does not form part of the auditing standards contained in the ISA (UK).





**Financial Reporting Council**

8th Floor  
125 London Wall  
London  
EC2Y 5AS

+44 (0)20 7492 2300

[www.frc.org.uk](http://www.frc.org.uk)