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Dear Sirs

Response to Regulatory Accounts Paper (CP 5/2010)

We are pleased to have the opportunity to respond to the Commission's consultation paper on Regulatory Accounts dated 30 November 2010.

As we consider that the nature and format of information sought by the Commission in order to fulfil its statutory obligations is a matter for it to determine in consultation with the entities it regulates and other interested parties, we do not propose to comment on the different options for the future form of regulated accounts as set out in the consultation paper. We would however note that assessing which is the most appropriate form of regulatory accounts and the extent of independent assurance required from auditors thereon requires consideration of the cost to the regulated entities of producing those regulatory accounts and of the independent assurance required.

The consultation paper also asks whether there is a role for auditors in regulatory reporting and, if so, what and who should the auditors represent.

Audit assurance can add value by validating information required for the regulatory process or compliance with regulatory requirements - for example, in a different sector, auditors of certain types of financial institutions report on the compliance of those institutions with Client Assets Requirements of the Central Bank. Hence there may be a continued role for auditors in connection with regulatory accounts and that role may assist the efficiency of the regulatory process by allowing the Commission to rely, for regulatory purposes, on the information contained in them. However, we do not believe that involvement of auditors is an absolute necessity: again, this is ultimately a matter for the Commission to determine within the confines of its legal powers.

Since the current form and content of regulatory accounts was determined, there has been considerable development in the structure of audit and assurance reporting, and we therefore recommend that the future role for auditors in providing assurance on the regulatory accounts is

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designed having regard to the current International Framework for Assurance Engagements issued by the International Audit and Assurance Standards Board of IFAC, a copy of which is attached. This framework covers both audit of financial statements and equivalent assurance on other information and therefore would allow the design of auditor reporting that is responsive and proportionate to the Commission's needs. Its use would also assist the Commission in achieving an appropriate balance of cost and benefit. Additionally, guidance for auditor involvement in regulatory accounts has been developed by the Institute of Chartered Accountants in England and Wales and applies to accounts prepared for the Commission's UK counterpart, and Chartered Accountants Ireland is in the process of developing guidance for regulatory accounts required by ComReg based on the ICAEW guidance. We believe that both the IAASB framework and the ICAEW guidance should be taken into account as the Commission takes its review further.

Finally, we wish to note that an important element of the value provided by any assurance report is derived from the independence of the auditor. Ethical Standards require that we act objectively and do not represent any of the parties with an interest in the financial statements or other information on which we report. Consequently we consider that the appropriate structure for providing assurance is for the Commission is either to require the entities it regulates to obtain independent auditors' reports addressed to the directors of the regulated entities to accompany information they provide to the Commission or for the Commission to engage directly with the auditor to agree terms and conditions for the required form of assurance issued directly to it. In this case, it would be necessary to have regard to Miscellaneous Technical Statement M39 "Reporting to Third Parties" issued by the Institute of Chartered Accountants in Ireland.

We would be very happy to discuss the Framework and design of audit assurance reports with the Commission further should you find that helpful. If you have any queries or wish to clarify any of the comments above at this stage, please contact me at (01) 4101986.

Yours faithfully



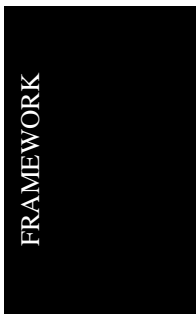
Shelagh McAlpine
Director

INTERNATIONAL FRAMEWORK FOR ASSURANCE ENGAGEMENTS

(Effective for assurance reports issued on or after January 1, 2005)

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Introduction

1. This Framework defines and describes the elements and objectives of an assurance engagement, and identifies engagements to which International Standards on Auditing (ISAs), International Standards on Review Engagements (ISREs) and International Standards on Assurance Engagements (ISAEs) apply. It provides a frame of reference for:
 - (a) Professional accountants in public practice (“practitioners”) when performing assurance engagements. Professional accountants in the public sector refer to the Public Sector Perspective at the end of the Framework. Professional accountants who are neither in public practice nor in the public sector are encouraged to consider the Framework when performing assurance engagements;¹
 - (b) Others involved with assurance engagements, including the intended users of an assurance report and the responsible party; and
 - (c) The International Auditing and Assurance Standards Board (IAASB) in its development of ISAs, ISREs and ISAEs.
2. This Framework does not itself establish standards or provide procedural requirements for the performance of assurance engagements. ISAs, ISREs and ISAEs contain basic principles, essential procedures and related guidance, consistent with the concepts in this Framework, for the performance of assurance engagements. The relationship between the Framework and the ISAs, ISREs and ISAEs is illustrated in the “Structure of Pronouncements Issued by the IAASB” section of the *Handbook of International Auditing, Assurance, and Ethics Pronouncements*.
3. The following is an overview of this Framework:
 - *Introduction:* This Framework deals with assurance engagements performed by practitioners. It provides a frame of reference for practitioners and others involved with assurance engagements, such as those engaging a practitioner (the “engaging party”).
 - *Definition and objective of an assurance engagement:* This section defines assurance engagements and identifies the objectives of the two types of assurance engagement a practitioner is permitted to perform.

¹ If a professional accountant not in public practice, for example an internal auditor, applies this Framework, and (a) this Framework, the ISAs, ISREs or the ISAEs are referred to in the professional accountant’s report; and (b) the professional accountant or other members of the assurance team and, when applicable, the professional accountant’s employer, are not independent of the entity in respect of which the assurance engagement is being performed, the lack of independence and the nature of the relationship(s) with the entity are prominently disclosed in the professional accountant’s report. Also, that report does not include the word “independent” in its title, and the purpose and users of the report are restricted.

This Framework calls these two types reasonable assurance engagements and limited assurance engagements.²

- *Scope of the Framework:* This section distinguishes assurance engagements from other engagements, such as consulting engagements.
- *Engagement acceptance:* This section sets out characteristics that must be exhibited before a practitioner can accept an assurance engagement.
- *Elements of an assurance engagement:* This section identifies and discusses five elements assurance engagements performed by practitioners exhibit: a three party relationship, a subject matter, criteria, evidence and an assurance report. It explains important distinctions between reasonable assurance engagements and limited assurance engagements (also outlined in the Appendix). This section also discusses, for example, the significant variation in the subject matters of assurance engagements, the required characteristics of suitable criteria, the role of risk and materiality in assurance engagements, and how conclusions are expressed in each of the two types of assurance engagement.
- *Inappropriate use of the practitioner's name:* This section discusses implications of a practitioner's association with a subject matter.

Ethical Principles and Quality Control Standards

4. In addition to this Framework and ISAs, ISREs and ISAEs, practitioners who perform assurance engagements are governed by:
 - (a) The IFAC *Code of Ethics for Professional Accountants* (the Code), which establishes fundamental ethical principles for professional accountants; and
 - (b) International Standards on Quality Control (ISQCs), which establish standards and provide guidance on a firm's system of quality control.³
5. Part A of the Code sets out the fundamental ethical principles that all professional accountants are required to observe, including:
 - (a) Integrity;
 - (b) Objectivity;
 - (c) Professional competence and due care;
 - (d) Confidentiality; and

² For assurance engagements regarding historical financial information in particular, reasonable assurance engagements are called audits, and limited assurance engagements are called reviews.

³ Additional standards and guidance on quality control procedures for specific types of assurance engagement are set out in ISAs, ISREs and ISAEs.

- (e) Professional behavior.
6. Part B of the Code, which applies only to professional accountants in public practice (“practitioners”), includes a conceptual approach to independence that takes into account, for each assurance engagement, threats to independence, accepted safeguards and the public interest. It requires firms and members of assurance teams to identify and evaluate circumstances and relationships that create threats to independence and to take appropriate action to eliminate these threats or to reduce them to an acceptable level by the application of safeguards.

Definition and Objective of an Assurance Engagement

7. “Assurance engagement” means an engagement in which a practitioner expresses a conclusion designed to enhance the degree of confidence of the intended users other than the responsible party about the outcome of the evaluation or measurement of a subject matter against criteria.
8. The outcome of the evaluation or measurement of a subject matter is the information that results from applying the criteria to the subject matter. For example:
- The recognition, measurement, presentation and disclosure represented in the financial statements (outcome) result from applying a financial reporting framework for recognition, measurement, presentation and disclosure, such as International Financial Reporting Standards, (criteria) to an entity’s financial position, financial performance and cash flows (subject matter).
 - An assertion about the effectiveness of internal control (outcome) results from applying a framework for evaluating the effectiveness of internal control, such as COSO⁴ or CoCo,⁵ (criteria) to internal control, a process (subject matter).

In the remainder of this Framework, the term “subject matter information” will be used to mean the outcome of the evaluation or measurement of a subject matter. It is the subject matter information about which the practitioner gathers sufficient appropriate evidence to provide a reasonable basis for expressing a conclusion in an assurance report.

9. Subject matter information can fail to be properly expressed in the context of the subject matter and the criteria, and can therefore be misstated, potentially to a material extent. This occurs when the subject matter information does not

⁴ “Internal Control – Integrated Framework,” The Committee of Sponsoring Organizations of the Treadway Commission.

⁵ “Guidance on Assessing Control – The CoCo Principles,” Criteria of Control Board, The Canadian Institute of Chartered Accountants.

properly reflect the application of the criteria to the subject matter, for example, when an entity's financial statements do not give a true and fair view of (or present fairly, in all material respects) its financial position, financial performance and cash flows in accordance with International Financial Reporting Standards, or when an entity's assertion that its internal control is effective is not fairly stated, in all material respects, based on COSO or CoCo.

10. In some assurance engagements, the evaluation or measurement of the subject matter is performed by the responsible party, and the subject matter information is in the form of an assertion by the responsible party that is made available to the intended users. These engagements are called "assertion-based engagements." In other assurance engagements, the practitioner either directly performs the evaluation or measurement of the subject matter, or obtains a representation from the responsible party that has performed the evaluation or measurement that is not available to the intended users. The subject matter information is provided to the intended users in the assurance report. These engagements are called "direct reporting engagements."
11. Under this Framework, there are two types of assurance engagement a practitioner is permitted to perform: a reasonable assurance engagement and a limited assurance engagement. The objective of a reasonable assurance engagement is a reduction in assurance engagement risk to an acceptably low level in the circumstances of the engagement⁶ as the basis for a positive form of expression of the practitioner's conclusion. The objective of a limited assurance engagement is a reduction in assurance engagement risk to a level that is acceptable in the circumstances of the engagement, but where that risk is greater than for a reasonable assurance engagement, as the basis for a negative form of expression of the practitioner's conclusion.

Scope of the Framework

12. Not all engagements performed by practitioners are assurance engagements. Other frequently performed engagements that do not meet the above definition (and therefore are not covered by this Framework) include:
 - Engagements covered by International Standards for Related Services, such as agreed-upon procedures engagements and compilations of financial or other information.
 - The preparation of tax returns where no conclusion conveying assurance is expressed.

⁶ Engagement circumstances include the terms of the engagement, including whether it is a reasonable assurance engagement or a limited assurance engagement, the characteristics of the subject matter, the criteria to be used, the needs of the intended users, relevant characteristics of the responsible party and its environment, and other matters, for example events, transactions, conditions and practices, that may have a significant effect on the engagement.

- Consulting (or advisory) engagements,⁷ such as management and tax consulting.
13. An assurance engagement may be part of a larger engagement, for example, when a business acquisition consulting engagement includes a requirement to convey assurance regarding historical or prospective financial information. In such circumstances, this Framework is relevant only to the assurance portion of the engagement.
 14. The following engagements, which may meet the definition in paragraph 7, need not be performed in accordance with this Framework:
 - (a) Engagements to testify in legal proceedings regarding accounting, auditing, taxation or other matters; and
 - (b) Engagements that include professional opinions, views or wording from which a user may derive some assurance, if all of the following apply:
 - (i) Those opinions, views or wording are merely incidental to the overall engagement;
 - (ii) Any written report issued is expressly restricted for use by only the intended users specified in the report;
 - (iii) Under a written understanding with the specified intended users, the engagement is not intended to be an assurance engagement; and
 - (iv) The engagement is not represented as an assurance engagement in the professional accountant's report.

Reports on Non-Assurance Engagements

15. A practitioner reporting on an engagement that is not an assurance engagement within the scope of this Framework, clearly distinguishes that report from an assurance report. So as not to confuse users, a report that is not an assurance report avoids, for example:
 - Implying compliance with this Framework, ISAs, ISREs or ISAEs.
 - Inappropriately using the words “assurance,” “audit” or “review.”

⁷ Consulting engagements employ a professional accountant's technical skills, education, observations, experiences, and knowledge of the consulting process. The consulting process is an analytical process that typically involves some combination of activities relating to: objective-setting, fact-finding, definition of problems or opportunities, evaluation of alternatives, development of recommendations including actions, communication of results, and sometimes implementation and follow-up. Reports (if issued) are generally written in a narrative (or “long form”) style. Generally the work performed is only for the use and benefit of the client. The nature and scope of work is determined by agreement between the professional accountant and the client. Any service that meets the definition of an assurance engagement is not a consulting engagement but an assurance engagement.

- Including a statement that could reasonably be mistaken for a conclusion designed to enhance the degree of confidence of intended users about the outcome of the evaluation or measurement of a subject matter against criteria.
16. The practitioner and the responsible party may agree to apply the principles of this Framework to an engagement when there are no intended users other than the responsible party but where all other requirements of the ISAs, ISREs or ISAEs are met. In such cases, the practitioner's report includes a statement restricting the use of the report to the responsible party.

Engagement Acceptance

17. A practitioner accepts an assurance engagement only where the practitioner's preliminary knowledge of the engagement circumstances indicates that:
- (a) Relevant ethical requirements, such as independence and professional competence will be satisfied; and
 - (b) The engagement exhibits all of the following characteristics:
 - (i) The subject matter is appropriate;
 - (ii) The criteria to be used are suitable and are available to the intended users;
 - (iii) The practitioner has access to sufficient appropriate evidence to support the practitioner's conclusion;
 - (iv) The practitioner's conclusion, in the form appropriate to either a reasonable assurance engagement or a limited assurance engagement, is to be contained in a written report; and
 - (v) The practitioner is satisfied that there is a rational purpose for the engagement. If there is a significant limitation on the scope of the practitioner's work (see paragraph 55), it may be unlikely that the engagement has a rational purpose. Also, a practitioner may believe the engaging party intends to associate the practitioner's name with the subject matter in an inappropriate manner (see paragraph 61).

Specific ISAs, ISREs or ISAEs may include additional requirements that need to be satisfied prior to accepting an engagement.

18. When a potential engagement cannot be accepted as an assurance engagement because it does not exhibit all the characteristics in the previous paragraph, the engaging party may be able to identify a different engagement that will meet the needs of intended users. For example:
- (a) If the original criteria were not suitable, an assurance engagement may still be performed if:

- (i) The engaging party can identify an aspect of the original subject matter for which those criteria are suitable, and the practitioner could perform an assurance engagement with respect to that aspect as a subject matter in its own right. In such cases, the assurance report makes it clear that it does not relate to the original subject matter in its entirety; or
 - (ii) Alternative criteria suitable for the original subject matter can be selected or developed.
- (b) The engaging party may request an engagement that is not an assurance engagement, such as a consulting or an agreed-upon procedures engagement.
19. Having accepted an assurance engagement, a practitioner may not change that engagement to a non-assurance engagement, or from a reasonable assurance engagement to a limited assurance engagement without reasonable justification. A change in circumstances that affects the intended users' requirements, or a misunderstanding concerning the nature of the engagement, ordinarily will justify a request for a change in the engagement. If such a change is made, the practitioner does not disregard evidence that was obtained prior to the change.

Elements of an Assurance Engagement

20. The following elements of an assurance engagement are discussed in this section:
- (a) A three party relationship involving a practitioner, a responsible party, and intended users;
 - (b) An appropriate subject matter;
 - (c) Suitable criteria;
 - (d) Sufficient appropriate evidence; and
 - (e) A written assurance report in the form appropriate to a reasonable assurance engagement or a limited assurance engagement.

Three Party Relationship

21. Assurance engagements involve three separate parties: a practitioner, a responsible party and intended users.
22. The responsible party and the intended users may be from different entities or the same entity. As an example of the latter case, in a two-tier board structure, the supervisory board may seek assurance about information provided by the management board of that entity. The relationship between the responsible party and the intended users needs to be viewed within the context of a specific

engagement and may differ from more traditionally defined lines of responsibility. For example, an entity’s senior management (an intended user) may engage a practitioner to perform an assurance engagement on a particular aspect of the entity’s activities that is the immediate responsibility of a lower level of management (the responsible party), but for which senior management is ultimately responsible.

Practitioner

23. The term “practitioner” as used in this Framework is broader than the term “auditor” as used in ISAs and ISREs, which relates only to practitioners performing audit or review engagements with respect to historical financial information.
24. A practitioner may be requested to perform assurance engagements on a wide range of subject matters. Some subject matters may require specialized skills and knowledge beyond those ordinarily possessed by an individual practitioner. As noted in paragraph 17 (a), a practitioner does not accept an engagement if preliminary knowledge of the engagement circumstances indicates that ethical requirements regarding professional competence will not be satisfied. In some cases this requirement can be satisfied by the practitioner using the work of persons from other professional disciplines, referred to as experts. In such cases, the practitioner is satisfied that those persons carrying out the engagement collectively possess the requisite skills and knowledge, and that the practitioner has an adequate level of involvement in the engagement and understanding of the work for which any expert is used.

Responsible Party

25. The responsible party is the person (or persons) who:
 - (a) In a direct reporting engagement, is responsible for the subject matter; or
 - (b) In an assertion-based engagement, is responsible for the subject matter information (the assertion), and may be responsible for the subject matter. An example of when the responsible party is responsible for both the subject matter information and the subject matter, is when an entity engages a practitioner to perform an assurance engagement regarding a report it has prepared about its own sustainability practices. An example of when the responsible party is responsible for the subject matter information but not the subject matter, is when a government organization engages a practitioner to perform an assurance engagement regarding a report about a private company’s sustainability practices that the organization has prepared and is to distribute to intended users.

The responsible party may or may not be the party who engages the practitioner (the engaging party).



26. The responsible party ordinarily provides the practitioner with a written representation that evaluates or measures the subject matter against the identified criteria, whether or not it is to be made available as an assertion to the intended users. In a direct reporting engagement, the practitioner may not be able to obtain such a representation when the engaging party is different from the responsible party.

Intended Users

27. The intended users are the person, persons or class of persons for whom the practitioner prepares the assurance report. The responsible party can be one of the intended users, but not the only one.
28. Whenever practical, the assurance report is addressed to all the intended users, but in some cases there may be other intended users. The practitioner may not be able to identify all those who will read the assurance report, particularly where there is a large number of people who have access to it. In such cases, particularly where possible readers are likely to have a broad range of interests in the subject matter, intended users may be limited to major stakeholders with significant and common interests. Intended users may be identified in different ways, for example, by agreement between the practitioner and the responsible party or engaging party, or by law.
29. Whenever practical, intended users or their representatives are involved with the practitioner and the responsible party (and the engaging party if different) in determining the requirements of the engagement. Regardless of the involvement of others however, and unlike an agreed-upon procedures engagement (which involves reporting findings based upon the procedures, rather than a conclusion):
- (a) The practitioner is responsible for determining the nature, timing and extent of procedures; and
 - (b) The practitioner is required to pursue any matter the practitioner becomes aware of that leads the practitioner to question whether a material modification should be made to the subject matter information.
30. In some cases, intended users (for example, bankers and regulators) impose a requirement on, or request the responsible party (or the engaging party if different) to arrange for, an assurance engagement to be performed for a specific purpose. When engagements are designed for specified intended users or a specific purpose, the practitioner considers including a restriction in the assurance report that limits its use to those users or that purpose.

Subject Matter

31. The subject matter, and subject matter information, of an assurance engagement can take many forms, such as:
- Financial performance or conditions (for example, historical or prospective financial position, financial performance and cash flows) for which the subject matter information may be the recognition, measurement, presentation and disclosure represented in financial statements.
 - Non-financial performance or conditions (for example, performance of an entity) for which the subject matter information may be key indicators of efficiency and effectiveness.
 - Physical characteristics (for example, capacity of a facility) for which the subject matter information may be a specifications document.
 - Systems and processes (for example, an entity's internal control or IT system) for which the subject matter information may be an assertion about effectiveness.
 - Behavior (for example, corporate governance, compliance with regulation, human resource practices) for which the subject matter information may be a statement of compliance or a statement of effectiveness.
32. Subject matters have different characteristics, including the degree to which information about them is qualitative versus quantitative, objective versus subjective, historical versus prospective, and relates to a point in time or covers a period. Such characteristics affect the:
- (a) Precision with which the subject matter can be evaluated or measured against criteria; and
 - (b) The persuasiveness of available evidence.
- The assurance report notes characteristics of particular relevance to the intended users.
33. An appropriate subject matter is:
- (a) Identifiable, and capable of consistent evaluation or measurement against the identified criteria; and
 - (b) Such that the information about it can be subjected to procedures for gathering sufficient appropriate evidence to support a reasonable assurance or limited assurance conclusion, as appropriate.



Criteria

34. Criteria are the benchmarks used to evaluate or measure the subject matter including, where relevant, benchmarks for presentation and disclosure. Criteria can be formal, for example in the preparation of financial statements, the criteria may be International Financial Reporting Standards or International Public Sector Accounting Standards; when reporting on internal control, the criteria may be an established internal control framework or individual control objectives specifically designed for the engagement; and when reporting on compliance, the criteria may be the applicable law, regulation or contract. Examples of less formal criteria are an internally developed code of conduct or an agreed level of performance (such as the number of times a particular committee is expected to meet in a year).
35. Suitable criteria are required for reasonably consistent evaluation or measurement of a subject matter within the context of professional judgment. Without the frame of reference provided by suitable criteria, any conclusion is open to individual interpretation and misunderstanding. Suitable criteria are context-sensitive, that is, relevant to the engagement circumstances. Even for the same subject matter there can be different criteria. For example, one responsible party might select the number of customer complaints resolved to the acknowledged satisfaction of the customer for the subject matter of customer satisfaction; another responsible party might select the number of repeat purchases in the three months following the initial purchase.
36. Suitable criteria exhibit the following characteristics:
 - (a) **Relevance:** relevant criteria contribute to conclusions that assist decision-making by the intended users.
 - (b) **Completeness:** criteria are sufficiently complete when relevant factors that could affect the conclusions in the context of the engagement circumstances are not omitted. Complete criteria include, where relevant, benchmarks for presentation and disclosure.
 - (c) **Reliability:** reliable criteria allow reasonably consistent evaluation or measurement of the subject matter including, where relevant, presentation and disclosure, when used in similar circumstances by similarly qualified practitioners.
 - (d) **Neutrality:** neutral criteria contribute to conclusions that are free from bias.
 - (e) **Understandability:** understandable criteria contribute to conclusions that are clear, comprehensive, and not subject to significantly different interpretations.

The evaluation or measurement of a subject matter on the basis of the practitioner's own expectations, judgments and individual experience would not constitute suitable criteria.

37. The practitioner assesses the suitability of criteria for a particular engagement by considering whether they reflect the above characteristics. The relative importance of each characteristic to a particular engagement is a matter of judgment. Criteria can either be established or specifically developed. Established criteria are those embodied in laws or regulations, or issued by authorized or recognized bodies of experts that follow a transparent due process. Specifically developed criteria are those designed for the purpose of the engagement. Whether criteria are established or specifically developed affects the work that the practitioner carries out to assess their suitability for a particular engagement.
38. Criteria need to be available to the intended users to allow them to understand how the subject matter has been evaluated or measured. Criteria are made available to the intended users in one or more of the following ways:
 - (a) Publicly.
 - (b) Through inclusion in a clear manner in the presentation of the subject matter information.
 - (c) Through inclusion in a clear manner in the assurance report.
 - (d) By general understanding, for example the criterion for measuring time in hours and minutes.

Criteria may also be available only to specific intended users, for example the terms of a contract, or criteria issued by an industry association that are available only to those in the industry. When identified criteria are available only to specific intended users, or are relevant only to a specific purpose, use of the assurance report is restricted to those users or for that purpose.⁸

Evidence

39. The practitioner plans and performs an assurance engagement with an attitude of professional skepticism to obtain sufficient appropriate evidence about whether the subject matter information is free of material misstatement. The practitioner considers materiality, assurance engagement risk, and the quantity and quality of available evidence when planning and performing the

⁸ While an assurance report may be restricted whenever it is intended only for specified intended users or for a specific purpose, the absence of a restriction regarding a particular reader or purpose, does not itself indicate that a legal responsibility is owed by the practitioner in relation to that reader or for that purpose. Whether a legal responsibility is owed will depend on the circumstances of each case and the relevant jurisdiction.

engagement, in particular when determining the nature, timing and extent of evidence-gathering procedures.

Professional Skepticism

40. The practitioner plans and performs an assurance engagement with an attitude of professional skepticism recognizing that circumstances may exist that cause the subject matter information to be materially misstated. An attitude of professional skepticism means the practitioner makes a critical assessment, with a questioning mind, of the validity of evidence obtained and is alert to evidence that contradicts or brings into question the reliability of documents or representations by the responsible party. For example, an attitude of professional skepticism is necessary throughout the engagement process for the practitioner to reduce the risk of overlooking suspicious circumstances, of over generalizing when drawing conclusions from observations, and of using faulty assumptions in determining the nature, timing and extent of evidence gathering procedures and evaluating the results thereof.
41. An assurance engagement rarely involves the authentication of documentation, nor is the practitioner trained as or expected to be an expert in such authentication. However, the practitioner considers the reliability of the information to be used as evidence, for example photocopies, facsimiles, filmed, digitized or other electronic documents, including consideration of controls over their preparation and maintenance where relevant.

Sufficiency and Appropriateness of Evidence

42. Sufficiency is the measure of the quantity of evidence. Appropriateness is the measure of the quality of evidence; that is, its relevance and its reliability. The quantity of evidence needed is affected by the risk of the subject matter information being materially misstated (the greater the risk, the more evidence is likely to be required) and also by the quality of such evidence (the higher the quality, the less may be required). Accordingly, the sufficiency and appropriateness of evidence are interrelated. However, merely obtaining more evidence may not compensate for its poor quality.
43. The reliability of evidence is influenced by its source and by its nature, and is dependent on the individual circumstances under which it is obtained. Generalizations about the reliability of various kinds of evidence can be made; however, such generalizations are subject to important exceptions. Even when evidence is obtained from sources external to the entity, circumstances may exist that could affect the reliability of the information obtained. For example, evidence obtained from an independent external source may not be reliable if the source is not knowledgeable. While recognizing that exceptions may exist, the following generalizations about the reliability of evidence may be useful:
 - Evidence is more reliable when it is obtained from independent sources outside the entity.

- Evidence that is generated internally is more reliable when the related controls are effective.
 - Evidence obtained directly by the practitioner (for example, observation of the application of a control) is more reliable than evidence obtained indirectly or by inference (for example, inquiry about the application of a control).
 - Evidence is more reliable when it exists in documentary form, whether paper, electronic, or other media (for example, a contemporaneously written record of a meeting is more reliable than a subsequent oral representation of what was discussed).
 - Evidence provided by original documents is more reliable than evidence provided by photocopies or facsimiles.
44. The practitioner ordinarily obtains more assurance from consistent evidence obtained from different sources or of a different nature than from items of evidence considered individually. In addition, obtaining evidence from different sources or of a different nature may indicate that an individual item of evidence is not reliable. For example, corroborating information obtained from a source independent of the entity may increase the assurance the practitioner obtains from a representation from the responsible party. Conversely, when evidence obtained from one source is inconsistent with that obtained from another, the practitioner determines what additional evidence-gathering procedures are necessary to resolve the inconsistency.
45. In terms of obtaining sufficient appropriate evidence, it is generally more difficult to obtain assurance about subject matter information covering a period than about subject matter information at a point in time. In addition, conclusions provided on processes ordinarily are limited to the period covered by the engagement; the practitioner provides no conclusion about whether the process will continue to function in the specified manner in the future.
46. The practitioner considers the relationship between the cost of obtaining evidence and the usefulness of the information obtained. However, the matter of difficulty or expense involved is not in itself a valid basis for omitting an evidence-gathering procedure for which there is no alternative. The practitioner uses professional judgment and exercises professional skepticism in evaluating the quantity and quality of evidence, and thus its sufficiency and appropriateness, to support the assurance report.

Materiality

47. Materiality is relevant when the practitioner determines the nature, timing and extent of evidence-gathering procedures, and when assessing whether the subject matter information is free of misstatement. When considering materiality, the practitioner understands and assesses what factors might influence the decisions of

the intended users. For example, when the identified criteria allow for variations in the presentation of the subject matter information, the practitioner considers how the adopted presentation might influence the decisions of the intended users. Materiality is considered in the context of quantitative and qualitative factors, such as relative magnitude, the nature and extent of the effect of these factors on the evaluation or measurement of the subject matter, and the interests of the intended users. The assessment of materiality and the relative importance of quantitative and qualitative factors in a particular engagement are matters for the practitioner's judgment.

Assurance Engagement Risk

48. Assurance engagement risk is the risk that the practitioner expresses an inappropriate conclusion when the subject matter information is materially misstated.⁹ In a reasonable assurance engagement, the practitioner reduces assurance engagement risk to an acceptably low level in the circumstances of the engagement to obtain reasonable assurance as the basis for a positive form of expression of the practitioner's conclusion. The level of assurance engagement risk is higher in a limited assurance engagement than in a reasonable assurance engagement because of the different nature, timing or extent of evidence-gathering procedures. However in a limited assurance engagement, the combination of the nature, timing and extent of evidence-gathering procedures is at least sufficient for the practitioner to obtain a meaningful level of assurance as the basis for a negative form of expression. To be meaningful, the level of assurance obtained by the practitioner is likely to enhance the intended users' confidence about the subject matter information to a degree that is clearly more than inconsequential.
49. In general, assurance engagement risk can be represented by the following components, although not all of these components will necessarily be present or significant for all assurance engagements:
- (a) The risk that the subject matter information is materially misstated, which in turn consists of:
 - (i) Inherent risk: the susceptibility of the subject matter information to a material misstatement, assuming that there are no related controls; and

⁹ (a) This includes the risk, in those direct reporting engagements where the subject matter information is presented only in the practitioner's conclusion, that the practitioner inappropriately concludes that the subject matter does, in all material respects, conform with the criteria, for example: "In our opinion, internal control is effective, in all material respects, based on XYZ criteria."

(b) In addition to assurance engagement risk, the practitioner is exposed to the risk of expressing an inappropriate conclusion when the subject matter information is not materially misstated, and risks through loss from litigation, adverse publicity, or other events arising in connection with a subject matter reported on. These risks are not part of assurance engagement risk.

- (ii) Control risk: the risk that a material misstatement that could occur will not be prevented, or detected and corrected, on a timely basis by related internal controls. When control risk is relevant to the subject matter, some control risk will always exist because of the inherent limitations of the design and operation of internal control; and
- (b) Detection risk: the risk that the practitioner will not detect a material misstatement that exists.

The degree to which the practitioner considers each of these components is affected by the engagement circumstances, in particular by the nature of the subject matter and whether a reasonable assurance or a limited assurance engagement is being performed.

Nature, Timing and Extent of Evidence-gathering Procedures

- 50. The exact nature, timing and extent of evidence-gathering procedures will vary from one engagement to the next. In theory, infinite variations in evidence-gathering procedures are possible. In practice, however, these are difficult to communicate clearly and unambiguously. The practitioner attempts to communicate them clearly and unambiguously and uses the form appropriate to a reasonable assurance engagement or a limited assurance engagement.¹⁰
- 51. “Reasonable assurance” is a concept relating to accumulating evidence necessary for the practitioner to conclude in relation to the subject matter information taken as a whole. To be in a position to express a conclusion in the positive form required in a reasonable assurance engagement, it is necessary for the practitioner to obtain sufficient appropriate evidence as part of an iterative, systematic engagement process involving:
 - (a) Obtaining an understanding of the subject matter and other engagement circumstances which, depending on the subject matter, includes obtaining an understanding of internal control;
 - (b) Based on that understanding, assessing the risks that the subject matter information may be materially misstated;
 - (c) Responding to assessed risks, including developing overall responses, and determining the nature, timing and extent of further procedures;
 - (d) Performing further procedures clearly linked to the identified risks, using a combination of inspection, observation, confirmation, re-calculation, re-performance, analytical procedures and inquiry. Such

¹⁰ Where the subject matter information is made up of a number of aspects, separate conclusions may be provided on each aspect. While not all such conclusions need to relate to the same level of evidence-gathering procedures, each conclusion is expressed in the form that is appropriate to either a reasonable assurance or a limited assurance engagement.

further procedures involve substantive procedures including, where applicable, obtaining corroborating information from sources independent of the responsible party, and depending on the nature of the subject matter, tests of the operating effectiveness of controls; and

(e) Evaluating the sufficiency and appropriateness of evidence.

52. “Reasonable assurance” is less than absolute assurance. Reducing assurance engagement risk to zero is very rarely attainable or cost beneficial as a result of factors such as the following:

- The use of selective testing.
- The inherent limitations of internal control.
- The fact that much of the evidence available to the practitioner is persuasive rather than conclusive.
- The use of judgment in gathering and evaluating evidence and forming conclusions based on that evidence.
- In some cases, the characteristics of the subject matter when evaluated or measured against the identified criteria.

53. Both reasonable assurance and limited assurance engagements require the application of assurance skills and techniques and the gathering of sufficient appropriate evidence as part of an iterative, systematic engagement process that includes obtaining an understanding of the subject matter and other engagement circumstances. The nature, timing and extent of procedures for gathering sufficient appropriate evidence in a limited assurance engagement are, however, deliberately limited relative to a reasonable assurance engagement. For some subject matters, there may be specific pronouncements to provide guidance on procedures for gathering sufficient appropriate evidence for a limited assurance engagement. For example, ISRE 2400, “Engagements to Review Financial Statements” establishes that sufficient appropriate evidence for reviews of financial statements is obtained primarily through analytical procedures and inquiries. In the absence of a relevant pronouncement, the procedures for gathering sufficient appropriate evidence will vary with the circumstances of the engagement, in particular, the subject matter, and the needs of the intended users and the engaging party, including relevant time and cost constraints. For both reasonable assurance and limited assurance engagements, if the practitioner becomes aware of a matter that leads the practitioner to question whether a material modification should be made to the subject matter information, the practitioner pursues the matter by performing other procedures sufficient to enable the practitioner to report.

Quantity and Quality of Available Evidence

54. The quantity or quality of available evidence is affected by:
- (a) The characteristics of the subject matter and subject matter information. For example, less objective evidence might be expected when information about the subject matter is future oriented rather than historical (see paragraph 32); and
 - (b) Circumstances of the engagement other than the characteristics of the subject matter, when evidence that could reasonably be expected to exist is not available because of, for example, the timing of the practitioner's appointment, an entity's document retention policy, or a restriction imposed by the responsible party.

Ordinarily, available evidence will be persuasive rather than conclusive.

55. An unqualified conclusion is not appropriate for either type of assurance engagement in the case of a material limitation on the scope of the practitioner's work, that is, when:
- (a) Circumstances prevent the practitioner from obtaining evidence required to reduce assurance engagement risk to the appropriate level; or
 - (b) The responsible party or the engaging party imposes a restriction that prevents the practitioner from obtaining evidence required to reduce assurance engagement risk to the appropriate level.

Assurance Report

56. The practitioner provides a written report containing a conclusion that conveys the assurance obtained about the subject matter information. ISAs, ISREs and ISAEs establish basic elements for assurance reports. In addition, the practitioner considers other reporting responsibilities, including communicating with those charged with governance when it is appropriate to do so.
57. In an assertion-based engagement, the practitioner's conclusion can be worded either:
- (a) In terms of the responsible party's assertion (for example: "In our opinion *the responsible party's* assertion that internal control is effective, in all material respects, based on *XYZ criteria*, is fairly stated"); or
 - (b) Directly in terms of the subject matter and the criteria (for example: "In our opinion internal control is effective, in all material respects, based on *XYZ criteria*").

In a direct reporting engagement, the practitioner's conclusion is worded directly in terms of the subject matter and the criteria.



58. In a reasonable assurance engagement, the practitioner expresses the conclusion in the positive form, for example: “In our opinion internal control is effective, in all material respects, based on *XYZ criteria*.” This form of expression conveys “reasonable assurance.” Having performed evidence-gathering procedures of a nature, timing and extent that were reasonable given the characteristics of the subject matter and other relevant engagement circumstances described in the assurance report, the practitioner has obtained sufficient appropriate evidence to reduce assurance engagement risk to an acceptably low level.
59. In a limited assurance engagement, the practitioner expresses the conclusion in the negative form, for example, “Based on our work described in this report, nothing has come to our attention that causes us to believe that internal control is not effective, in all material respects, based on *XYZ criteria*.” This form of expression conveys a level of “limited assurance” that is proportional to the level of the practitioner’s evidence-gathering procedures given the characteristics of the subject matter and other engagement circumstances described in the assurance report.
60. A practitioner does not express an unqualified conclusion for either type of assurance engagement when the following circumstances exist and, in the practitioner’s judgment, the effect of the matter is or may be material:
- (a) There is a limitation on the scope of the practitioner’s work (see paragraph 55). The practitioner expresses a qualified conclusion or a disclaimer of conclusion depending on how material or pervasive the limitation is. In some cases the practitioner considers withdrawing from the engagement.
 - (b) In those cases where:
 - (i) The practitioner’s conclusion is worded in terms of the responsible party’s assertion, and that assertion is not fairly stated, in all material respects; or
 - (ii) The practitioner’s conclusion is worded directly in terms of the subject matter and the criteria, and the subject matter information is materially misstated,¹¹

the practitioner expresses a qualified or adverse conclusion depending on how material or pervasive the matter is.

¹¹ In those direct reporting engagements where the subject matter information is presented only in the practitioner’s conclusion, and the practitioner concludes that the subject matter does not, in all material respects, conform with the criteria, for example: “In our opinion, except for [...], internal control is effective, in all material respects, based on *XYZ criteria*,” such a conclusion would also be considered to be qualified (or adverse as appropriate).

- (c) When it is discovered after the engagement has been accepted, that the criteria are unsuitable or the subject matter is not appropriate for an assurance engagement. The practitioner expresses:
- (i) A qualified conclusion or adverse conclusion depending on how material or pervasive the matter is, when the unsuitable criteria or inappropriate subject matter is likely to mislead the intended users; or
 - (ii) A qualified conclusion or a disclaimer of conclusion depending on how material or pervasive the matter is, in other cases.

In some cases the practitioner considers withdrawing from the engagement.

Inappropriate Use of the Practitioner's Name

61. A practitioner is associated with a subject matter when the practitioner reports on information about that subject matter or consents to the use of the practitioner's name in a professional connection with that subject matter. If the practitioner is not associated in this manner, third parties can assume no responsibility of the practitioner. If the practitioner learns that a party is inappropriately using the practitioner's name in association with a subject matter, the practitioner requires the party to cease doing so. The practitioner also considers what other steps may be needed, such as informing any known third party users of the inappropriate use of the practitioner's name or seeking legal advice.

Public Sector Perspective

1. *This Framework is relevant to all professional accountants in the public sector who are independent of the entity for which they perform assurance engagements. Where professional accountants in the public sector are not independent of the entity for which they perform an assurance engagement, the guidance in footnote 1 should be adopted.*

Appendix

Differences Between Reasonable Assurance Engagements and Limited Assurance Engagements

This Appendix outlines the differences between a reasonable assurance engagement and a limited assurance engagement discussed in the Framework (see in particular the referenced paragraphs).

Type of engagement	Objective	Evidence-gathering procedures ¹²	The assurance report
Reasonable assurance engagement	A reduction in assurance engagement risk to an acceptably low level in the circumstances of the engagement, as the basis for a positive form of expression of the practitioner's conclusion (Paragraph 11)	Sufficient appropriate evidence is obtained as part of a systematic engagement process that includes: <ul style="list-style-type: none"> • Obtaining an understanding of the engagement circumstances; • Assessing risks; • Responding to assessed risks; • Performing further procedures using a combination of inspection, observation, confirmation, re-calculation, re-performance, analytical procedures and inquiry. Such further procedures involve substantive 	Description of the engagement circumstances, and a positive form of expression of the conclusion (Paragraph 58)

¹² A detailed discussion of evidence-gathering requirements is only possible within ISAEs for specific subject matters.

Type of engagement	Objective	Evidence-gathering procedures ¹²	The assurance report
		<p>procedures, including , where applicable, obtaining corroborating information, and depending on the nature of the subject matter, tests of the operating effectiveness of controls; and</p> <ul style="list-style-type: none"> • Evaluating the evidence obtained (Paragraphs 51 and 52) 	
Limited assurance engagement	A reduction in assurance engagement risk to a level that is acceptable in the circumstances of the engagement but where that risk is greater than for a reasonable assurance engagement, as the basis for a negative form of expression of the practitioner's conclusion (Paragraph 11)	Sufficient appropriate evidence is obtained as part of a systematic engagement process that includes obtaining an understanding of the subject matter and other engagement circumstances, but in which procedures are deliberately limited relative to a reasonable assurance engagement (Paragraph 53)	Description of the engagement circumstances, and a negative form of expression of the conclusion (Paragraph 59)

Reporting to Regulators of Regulated Entities

Audit 05/03

This guidance is issued by the Audit and Assurance Faculty of the Institute of Chartered Accountants in England & Wales in October 2003 to outline to Institute members new reporting arrangements being introduced after discussions with the Regulators and Regulated Entities. This guidance does not constitute an auditing standard. Professional judgement should be used in its application.

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Glossary of Terms

Terms

Meaning

Cross-Regulatory Group	An inter-regulatory Regulatory Accounts working group set up by the Regulators to consider the issues surrounding Regulatory Accounts.
Cross-Regulatory Paper	The paper 'The role of regulatory accounts in regulated industries – A final proposals paper' issued by the Cross-Regulatory Group in April 2001.
RAGs	Regulatory Accounting Guidelines issued by, or agreed with, the Regulators which specify how Regulatory Accounts are to be prepared by the Regulated Entities. In certain industries, RAGS may be supplemented by more detailed framework documentation which is not prepared by, nor agreed with, the Regulator.
Regulators/Regulating Bodies	Government appointed regulatory bodies that oversee the activities of Regulated Entities. For the purposes of this document, these are: <ul style="list-style-type: none">• Ofgem (The Office of Gas and Electricity Markets)• Ofwat (Office of Water Services)• Ofcom (Office of Telecommunications)• Postcomm (Postal Services Commission)• CAA (Civil Aviation Authority)• ORR (Office of the Rail Regulator)• Ofreg (Office for the Regulation of Electricity and Gas in Northern Ireland)• Ofcom (Office of Communications).
Regulatory Accounts	Accounts prepared under bases and principles and incorporating information specified by, or agreed with, the Regulators.
Regulated Activities	Those activities of the Regulated Entities covered by the powers of the Regulators, usually defined in the Regulated Entities' regulatory licence.
Regulated Entities	Those entities whose activities are covered by the powers of the Regulators (as defined above) and who are required to provide Regulatory Accounts and/or Regulatory Information that is required to be reported upon by Independent Accountants.
Regulatory Information	Information provided to the Regulators by the Regulated Entities in connection with their regulated operations.
Regulatory Licence	The instrument of appointment of the Regulated Entity.
Regulatory Reports/Reporting	Reports made by Regulated Entities and/or accountants to Regulators.
Regulatory Return	A return of Regulatory Information (which can include Regulatory Accounts) provided to the Regulator by the Regulated Entities. Certain items within the Return are required to be reported upon by Independent Accountants as part of their regulatory reporting.
The Working Group	The sub-group of the 'Reporting to Third Parties' group set up by the ICAEW to consider Regulatory Reporting to Regulators of Regulated Entities.
Third Party	Any party, other than the Regulator, who has access to Regulatory Accounts, Regulatory Returns or Regulatory Information.
UK GAAP	Generally Accepted Accounting Principles in the United Kingdom.

SECTION 1

INTRODUCTION

1. The Audit and Assurance Faculty of the ICAEW issued Technical Release Audit 1/01, "*Reporting to Third Parties*" in September 2001. A separate working group ("the Working Group") was set up to consider the issues relating to reporting to Regulators of Regulated Entities and the application of Audit 1/01 to this reporting. The Working Group's scope of work specifically excluded reporting to other regulatory bodies, for example the Financial Services Authority.
2. The Working Group comprised representatives from the accountancy profession and the ICAEW, and consulted with the Regulators. The Regulated Entities were included in the consultation process. The Working Group took advice from Leading Counsel in respect of the wording of the second paragraph of the example Independent Accountants' report in Appendix B.
3. It is recognised that there is a need to achieve consistency in the practices adopted in respect of Regulatory Reporting by Independent Accountants. There is a need for guidance in respect of Regulatory Reporting and a need also to take account of issues raised by the Regulators in such reporting. This guidance is intended to help those involved in Regulatory Reporting.

Background

4. Regulated Entities are required to submit a large volume of information to their Regulating Bodies/Regulators, much of which is financial in nature.
5. The exact reporting requirements can vary significantly between industries and are determined and set out in the holders' regulatory operating licences and in related guidance and instructions issued by the Regulators. In some cases, elements of this information are required to be reported upon by Independent Accountants, often being the Regulated Entities' statutory auditors. It is this form of reporting by Independent Accountants which is the subject of this guidance.
6. The information required by the Regulators has evolved and generally extended since the time of privatisation. At the outset, the financial information required by the Regulators was centred around 'Regulatory Accounts' (see Appendix A for an overview of what these contained), sometimes drawn up under Current Cost Accounting principles. Developments in the level of data required to be submitted and independently reported upon have changed as a result of:
 - changes in the boundaries of the Regulated Activities, with previously Regulated Activities dropping out of the regulatory environment as competition develops;
 - developments in the information requirements of Regulators as the relevant regulatory regime has developed;
 - the desire of the Regulators to establish greater consistency in the form of Regulatory Reporting by Regulated Entities and in the form of independent reporting by accountants and others on such information. In this context, an inter-regulatory Regulatory Accounts working group comprising representatives from Ofgem, Ofwat, Oftel, Postcomm, CAA and ORR ("the Cross-Regulatory Group") has been established.

This Group has issued a paper '*The role of regulatory accounts in regulated industries – A final proposals paper*' dated April 2001 ("the Cross-Regulatory Paper"). In this paper, the Regulators agreed to adopt a set of common regulatory accounting principles, including the use of Regulatory Accounting Guidelines (RAGs) to provide guidance and instruction on the preparation and content of Regulatory Accounts;

 - the Regulators' desire to find reliable bases of measuring output performance of the Regulated Entities against their regulatory contract and the use of the Regulatory Accounts to assist in measurement; and
 - the development of new Regulatory Information requirements designed to promote competition in certain markets.
7. In the light of these developments, this guidance is for the use of Independent Accountants to assist them where they are conducting work which involves reporting on Regulatory Information which is addressed to Regulators and is required to be produced by the Regulated Entity under its Licence or Instrument of Appointment or otherwise by the Regulator. However, this guidance should not be regarded as a substitute for the specific legal and professional advice which firms may need to take on particular matters or engagements.

SECTION 2

DUTY OF CARE AND ENGAGEMENT CONTRACTS

8. This section considers the issue of reliance by the Regulators on the work of Independent Accountants reporting on Regulatory Information and provides guidance on this matter. It also considers the question of the potential for reliance by others on Regulatory Reports, and the steps which may be taken to clarify the scope of the Independent Accountants' work and responsibility to such third parties.

Who might rely on the accountants' work

9. The ICAEW's Technical Release Audit 1/01, 'Reporting to Third Parties' provides the guidance laid out in the following box:

Extract from Technical Release Audit 1/01

- *When accountants know that their report has been requested by a third party and that the third party will rely on the report, there is a risk, in the absence of an effective disclaimer, that the accountants owe the third party a duty to take reasonable care in preparing and providing the report. If the accountants do owe the third party such a duty, they could be liable to that third party if they were negligent and the third party suffered loss in reliance on the report.*

Accountants consider the legal effectiveness of disclaiming liability and of the proposed disclaimer in the particular circumstances of their engagement.

- *It is vital, therefore, for accountants to understand who the third party is, why it requires the report and the extent of loss which the third party could suffer in reliance on the report. If, for example, the third party runs a scheme for compensating the client's customers in the event of the client's insolvency, the accountants' risk is much greater than if, for example, the third party's only role is to perform marketing for a particular service sector.*
- *The accountants' understanding of the risks involved in providing a report underpins the decisions they make about whether to accept the engagement and on what terms. Depending upon the circumstances accountants either:*
 - (a) accept that they owe a duty of care to the third party and enter into an engagement contract with the third party, including provisions limiting liability if appropriate; or*
 - (b) proceed with an engagement for their client but before allowing the third party access to their report, require the third party to acknowledge in writing that the accountants owe the third party no duty of care; or*
 - (c) proceed with an engagement for their client but disclaim or limit any liability or duty to the third party by notice in their report; or*
 - (d) do not accept the engagement.*
- *If accountants regard a report as high risk, they agree to provide the report only if the third party is a party to the engagement contract or the third party has acknowledged in writing that the accountants owe no duty of care to the third party. If accountants regard a report as low risk, typically because the third party could suffer little or no loss in reliance on the report, then they may decide to provide the report without contracting with the third party. In this case a notice can be included in the report disclaiming or limiting the accountants' liability to the third party. In addition to that notice, it may be appropriate for the accountants to write to the third party, in advance of the third party receiving the report, notifying the third party of the basis on which the report will be provided. Also, if a third party writes to the accountants in an attempt to indicate reliance on a report, the accountants consider whether it is reasonable to accept such reliance. Where it is not, a disclaimer is given in writing.*

Accountants are advised not to allow their reports to be provided to a third party unless the basis and extent of their liability to the third party is clear and agreed. Accountants refer to the guidance in Statement 1.311 of the Institute's Members' Handbook, "Managing the professional liability of accountants" and consider the consequences of The Contracts (Rights of Third Parties) Act 1999 – see the guidance in Audit 4/00.

10. There are a number of parties who might be interested in the contents of information published or otherwise supplied by Regulated Entities to their Regulatory Bodies. As well as the Regulatory Body itself, these might include others in the same industry, potential entrants to the market, academics, journalists, analysts, consumer bodies and consumers/members of the public at large. Independent Accountants do not accept that they owe a duty of care or have any other legal responsibility to any person in respect of their report on Regulatory Information except those who have engaged the Independent Accountants to perform services under a written engagement contract or with whom the Independent Accountants have otherwise agreed in writing to accept such a responsibility.
11. Regulatory Accounts and Regulatory Returns are required by an individual Regulator, who specifies or agrees what they should contain and who uses that information as part of its overall role in regulating the regulated business. In these circumstances, Independent Accountants only accept that they owe a responsibility/duty of care to the Regulated Entity and the Regulator if either:
- i) both the Regulated Entity and the Regulator are parties to the written engagement contract with the Independent Accountants (“a tri-partite engagement contract”). The tri-partite engagement contract contains appropriate terms clarifying and limiting the scope and extent of the Independent Accountants’ responsibilities and liability; or
 - ii) the Regulated Entity alone is a party to a written engagement contract with the Independent Accountants (“a bi-partite engagement contract”) which makes provision for the Independent Accountants to accept separately a responsibility also to the Regulator, provided that the Regulator and the Independent Accountants can agree in writing the basis of this responsibility (“written notice”) AND the Regulator and the Independent Accountants actually agree, in writing, the basis on which this responsibility/duty of care is extended to the Regulator.

The bi-partite engagement contract contains appropriate terms clarifying and limiting the scope and extent of the Independent Accountants’ responsibilities and liability, and includes a mechanism enabling Independent Accountants to extend their responsibilities to the Regulator through the written notice on the basis that the Independent Accountants’ liability is capped, in aggregate, at a level no greater than the amount which would have been payable by them to the Regulated Entity under the bi-partite engagement contract. It will be a matter for the Regulator and the Regulated Entity to agree how the aggregate liability will be shared and recorded in the bi-partite engagement contract and the written notice. Should such an agreement not be reached, the Independent Accountants will consider capping their liability in aggregate.

The written notice between the Independent Accountants and the Regulator will confirm that the Independent Accountants accept a responsibility to the Regulator for the Independent Accountants’ report (even though the Regulator is not an addressee of the bi-partite engagement contract) provided that the Regulator agrees, in writing, that this will be on the same terms as the bi-partite engagement contract, a copy of which will be attached to the written notice, as if the Regulator had been an original addressee of the bi-partite engagement contract. An example of a written notice between the Independent Accountants and the Regulator is set out as Appendix E.

12. If the Regulator will not agree the basis on which the Independent Accountants are willing to accept a duty of care to the Regulator, either through (a) a tri-partite engagement contract, or (b) a bi-partite engagement contract supplemented by the written notice, the Independent Accountants do not accept a duty of care to the Regulator and will make that clear in their report. In these circumstances the Independent Accountants disapply in their bi-partite engagement letter any rights that the Regulator might otherwise have acquired under the Contracts (Rights of Third Parties) Act 1999 and send a copy of the bi-partite engagement contract to the Regulator.
13. Independent Accountants do not accept a responsibility/duty of care to other parties who may have an interest in, or who may ultimately use, the Regulatory Accounts, Regulatory Returns or other Regulatory Information reported upon by the Independent Accountants unless the Independent Accountants have identified the other party and agreed with the other party, in writing, the basis on which they accept this duty of care. Where a report is made by Independent Accountants to a Regulated Entity and a Regulator under a tri-partite engagement contract, that report will include a specific disclaimer of any liability or duty to any Third Party. Where a report is made by the Independent Accountants to a Regulated Entity and/or a Regulator under a bi-partite engagement contract, whether or not supplemented by written notice, that report will include a specific disclaimer of any liability or duty to any other person other than those to whom the Independent Accountants have addressed their report. The report is addressed to the Regulator as well as to the Company without any disclaimer of responsibility to the Regulator only where the Regulator has signed a tri-partite engagement contract or there is a bi-partite engagement contract supplemented by written notice signed by the Regulator. In other cases the report may be addressed to the Company and the Regulator (to meet the requirements of the Regulatory Licence) but includes a disclaimer under which responsibility is accepted to the Company only and co-addressing to the Regulator is expressed to be only to meet the requirements of the Regulatory Licence.
14. Where the Regulator has indicated to the Independent Accountants that they would like a Third Party to be able to rely on the Independent Accountants’ report and the Independent Accountants are in agreement with this, the Independent Accountants include in their report a clear statement that the Third Party can only rely on the report after becoming a party to the engagement contract for that report or agree with the Third Party a written notice specifying the basis on which the Independent Accountants extend their duty of care to the Third Party.

15. It has not previously been common practice for Regulators to sign engagement contracts commissioning the Independent Accountants' reports. These contracts have tended to be bilateral between the Independent Accountants and the Regulated Entity or its parent company.
16. In the Cross-Regulatory Paper, the members of the Cross-Regulatory Group proposed that the Regulators would be a party to a tri-partite engagement contract with the Independent Accountants and the Regulated Entities. That proposal is recognised in this guidance.
17. Certain Regulators have subsequently expressed a preference not to enter into a tri-partite engagement contract for certain engagements but rather, in these cases, to agree engagement terms with the Independent Accountants through the written notice procedure supplementing a bi-partite engagement contract agreed by the Independent Accountants and the Regulated Entity. That preference is also recognised in this guidance.

Guidance on the content of engagement contracts

18. Technical Release Audit 1/01 includes the following guidance on engagement contracts:

Extract from Technical Release Audit 1/01

Engagement contracts include the following:

- *a clear unambiguous description of the scope of work to be performed and the form of report to be provided using defined terms where appropriate to avoid misunderstandings;*
- *a description of the client's obligations and the client's responsibility for the information on which the accountants report;*
- *clarification that the engagement is separate from the statutory audit and that the accountants have no duty of care to the third party in relation to the statutory audit;*
- *an appropriate liability cap⁴, agreed having regard to the nature of the work being performed, the level of fee charged and other relevant factors. Any limitation of liability must be negotiated and agreed with the client, and must be fair and reasonable in compliance with the Unfair Contract Terms Act 1977⁵*
- *details of the addressee for the report, limitations as to the purpose for which the report is prepared and restrictions on who is entitled to see and rely upon the report and on the distribution of it;*
- *a copy of the form of report to be provided.*

⁴ Accountants consider whether the liability cap is reasonable given the specific circumstances of the engagement.

⁵ See the guidance in Statement 1.311 of the Institute's Members' Handbook, "Managing the professional liability of accountants";

Tri-partite engagement contracts

19. The above guidance from Technical Release Audit 1/01 is incorporated into the tri-partite engagement contract, and is applied to both the Regulator and the Regulated Entity. In addition, in the circumstances covered by this guidance, engagement contracts signed by the Regulator, the Regulated Entity and the Independent Accountants include the following:
 - i) an acknowledgement of a duty of care by the Independent Accountants both to the Regulated Entity and to the Regulator;
 - ii) an explicit denial of liability by the Independent Accountants to any other party other than the Regulator and the Regulated Entity whose information is being reported on. This denial should also be incorporated into the Independent Accountants' report (see paragraph 30 v);
 - iii) an acknowledgement from the Regulator and the Regulated Entity that;
 - a) wherever the complete Regulatory Accounts or other Regulatory Information covered by the Independent Accountants' report is published or otherwise made available, the Independent Accountants' report will also be published or otherwise made available; and
 - b) wherever substantial extracts¹ from the Regulatory Accounts or other Regulatory Information covered by the Independent Accountants' report are published or otherwise made available, and reference is made to the fact that they are audited or otherwise examined by Independent Accountants, there will be explicit statements: a) that the information published is only an extract; and b) about the limitation of scope of the Independent Accountants' report and the duty of care owed by the Independent

¹ For example, reproduction of primary statements as a whole.

Accountants; and c) referring to where the full set of Regulatory Accounts or Regulatory Information can be found or otherwise obtained;

- c) wherever any other information is referenced from the Regulatory Accounts or other Regulatory Information covered by the Independent Accountants' report, there will be an explicit reference by the Regulator to the source of that information and the limitation of scope of the Independent Accountants' report and the duty of care owed by the Independent Accountants;
 - iv) clarification that the Independent Accountants' opinion on the Regulatory Accounts is separate from their opinion on the statutory accounts of the Company, which are prepared for a different purpose;
 - v) clarification, where relevant, that the Regulatory Accounts or other Regulatory Information is prepared by disaggregating balances recorded in the general ledgers and other accounting records of the Company maintained in accordance with the Companies Act 1985 and used, in accordance with that Act, for the preparation of the Company's statutory financial statements;
 - vi) a statement, where appropriate, that no additional tests will be performed of the transactions and balances which are recorded in the general ledgers of the Regulated Entity other than those carried out in performing the audit of the statutory financial statements that include the Regulated Entity;
 - vii) a statement, where appropriate, clarifying what work is done in respect of any other information accompanying the Regulatory Accounts or other Regulatory Information, and confirmation if no audit opinion is expressed on this;
 - viii) clarification about the obligations, if any, of the Independent Accountants to attend tri-partite meetings with the Regulator, including frequency and timing, subject matter, arrangements for minutes and if appropriate the form of hold harmless letters to precede such meetings;
 - ix) clarification of how any liability cap will be split between the Regulated Entity and the Regulator;
 - x) a statement that the nature and format of the Regulatory Accounts or other Regulatory Information, RAGs and Regulatory Returns are determined by the individual Regulators, and that it is not appropriate for the Independent Accountants to assess whether the information being reported upon is suitable or appropriate for the Regulator's purpose. Independent Accountants do not agree to provide any implicit or explicit affirmation that the information being reported upon is suitable for the Regulator's purpose;
 - xi) confirmation that there are differences between UK GAAP and the basis of any information supplied to the Regulators. The engagement contract and the Independent Accountants' report will include a statement that financial information other than that prepared on the basis of UK GAAP does not necessarily represent a true and fair view of the financial performance or financial position of a company as shown in financial statements prepared in accordance with the Companies Act 1985;
 - xii) an example of the type of audit report/opinion that the Independent Accountants would expect to provide if the results of the audit work are satisfactory. This will be based on the example report set out in Appendix B, amended as appropriate for the particular circumstances of the engagement; and
 - xiii) a statement that nothing in the tri-partite engagement contract is intended to, nor should it, affect or in any way alter the relationship or the rights and obligations between the Regulated Entity and the Regulator as set out in the Regulatory Licence.
20. An example of a tri-partite engagement contract is shown at Appendix C. This should be tailored as necessary for the circumstances of each particular engagement.

Bi-partite engagement contracts supplemented by a written notice

21. The guidance from Technical Release Audit 1/01 is also incorporated into bi-partite engagement contracts where the Regulator has agreed to sign a written notice, and is applied to both the Regulator and the Regulated Entity. In addition, in the circumstances covered by this guidance, bi-partite engagement contracts signed by the Regulated Entity and the Independent Accountants include the following:
- i) an acknowledgement of a duty of care by the Independent Accountants to the Regulated Entity and an agreement to extend the duty of care to the Regulator provided that it agrees appropriate terms with the Independent Accountants in the form of a written notice;
 - ii) an explicit denial of liability by the Independent Accountants to any persons to whom they have not agreed, in writing, to accept responsibility. This denial should also be incorporated into the Independent Accountants' report (see paragraph 30 v);

- iii) an acknowledgement from the Regulated Entity (and from the Regulator where the Regulator has agreed to sign a written notice²) that;
 - a) wherever the complete Regulatory Information covered by the Independent Accountants' report is published or otherwise made available, the Independent Accountant's report will also be published or otherwise made available; and
 - b) wherever substantial extracts³ from the Regulatory Accounts or other Regulatory Information covered by the Independent Accountants' report are published or otherwise made available, and reference is made to the fact that they are audited or otherwise examined by Independent Accountants, there will be explicit statements: a) that the information published is only an extract; and b) about the limitation of scope of the Independent Accountants' report and the duty of care owed by the Independent Accountants; and c) referring to where the full set of Regulatory Accounts or Regulatory Information can be found or otherwise obtained;
 - c) wherever any other information is referenced from the Regulatory Accounts or other Regulatory Information covered by the Independent Accountants' report, there will be an explicit reference by the Regulator to the source of that information and the limitation of scope of the Independent Accountants' report and the duty of care owed by the Independent Accountants';
 - iv) clarification that the Independent Accountants' opinion on the Regulatory Accounts is separate from their opinion on the statutory accounts of the Company, which are prepared for a different purpose;
 - v) clarification, where relevant, that the Regulatory Accounts or other Regulatory Information is prepared by disaggregating balances recorded in the general ledgers and other accounting records of the Company maintained in accordance with the Companies Act 1985 and used, in accordance with that Act, for the preparation of the Company's statutory financial statements;
 - vi) a statement, where appropriate, that no additional tests will be performed of the transactions and balances which are recorded in the general ledgers of the Regulated Entity other than those carried out in performing the audit of the statutory financial statements that include the Regulated Entity;
 - vii) a statement, where appropriate, clarifying what work is done in respect of any other information accompanying the Regulatory Accounts or other Regulatory Information, and confirmation if no audit opinion is expressed on this;
 - viii) clarification about the obligations, if any, of the Independent Accountants to attend tri-partite meetings with the Regulator, including frequency and timing, subject matter, arrangements for minutes and if appropriate the form of hold harmless letters to precede such meetings;
 - ix) clarification of how any liability cap will be split between the Regulated Entity and the Regulator;
 - x) a statement that the nature and format of the Regulatory Accounts or other Regulatory Information, RAGs and Regulatory Returns are determined by the individual Regulators, and that it is not appropriate for the Independent Accountants to assess whether the information being reported upon is suitable or appropriate for the Regulator's purpose. Independent Accountants do not agree to provide any implicit or explicit affirmation that the information being reported upon is suitable for the Regulator's purpose;
 - xi) confirmation that there are differences between UK GAAP and the basis of any information supplied to the Regulators. The engagement contract and the Independent Accountants' report will include a statement that financial information other than that prepared on the basis of UK GAAP does not necessarily represent a true and fair view of the financial performance or financial position of a company as shown in financial statements prepared in accordance with the Companies Act 1985;
 - xii) an example of the type of audit report/opinion that the Independent Accountants would expect to provide if the results of the audit work are satisfactory. This will be based on the example report set out in Appendix B, amended as appropriate for the particular circumstances of the engagement; and
 - xiii) a statement that nothing in the bi-partite engagement contract is intended to, nor should it, affect or in any way alter the relationship or the rights and obligations between the Regulated Entity and the Regulator as set out in the Regulatory Licence.
22. An example of a bi-partite engagement contract is shown at Appendix D. This should be tailored as necessary for the circumstances of each particular engagement.

Bi-partite engagement contracts not supplemented by a written notice

23. If the Regulator will not agree engagement terms, either on a tri-partite basis or on a bi-partite basis supplemented by written notice, the Independent Accountants will agree a bi-partite engagement contract with the Regulated Entity incorporating the relevant aspects of paragraph 21 (that is excluding irrelevant aspects, such as items (viii), (ix) and (x)), and will expressly deny any duty of care to the Regulator in the engagement contract and their report.

² See Appendix E, example of a written notice.

³ For example, reproduction of primary statements as a whole.

SECTION 3

FORM OF REPORT

24. This section provides guidance on the form of report that is issued by Independent Accountants reporting on Regulatory Accounts and other Regulatory Information.

The Regulatory Licence

25. As noted in Section 1 of this guidance, the Regulatory Licence prescribes the Regulatory Information that it requires the Regulated Entity to report to the Regulator.
26. The Regulated Entity is usually required, under the terms of its Regulatory Licence, to procure an Independent Accountants' report, addressed to the Regulated Entity and/or the Regulator, supporting certain of the Regulatory Information submitted by the Regulated Entity to the Regulator.
27. Where a report on Regulatory Information is to be addressed to the Regulator and a duty of care is acknowledged to the Regulator, Independent Accountants agree either a tri-partite engagement contract with the Regulator and the Regulated Entity or a bi-partite engagement contract with the Regulated Entity supplemented by written notice with the Regulator, in accordance with the guidance set out in Section 2 (Duty of care and engagement contracts) of this paper.

Regulatory Accounts

28. SAS 600 (Auditors Reports on Financial Statements) states that "much of the guidance provided can be adapted to auditors' reports on financial information other than financial statements" [SAS 600, paragraph 1]. Regulatory Accounts are not prepared in accordance with the Companies Act nor necessarily in accordance with UK GAAP. Nevertheless, the guidance contained in SAS 600 can be applied equally to opinions expressed by Independent Accountants on Regulatory Accounts.
29. Applying SAS 600 to reports issued by Independent Accountants:
- *Independent Accountants' reports on financial statements should include the following matters:*
 - (a) *a title identifying the person or persons to whom the report is addressed;*
 - (b) *an introductory paragraph identifying the financial statements audited;*
 - (c) *separate sections, appropriately headed, dealing with*
 - (i) *respective responsibilities of directors (or equivalent persons) and the Independent Accountants;*
 - (ii) *the basis of the Independent Accountants' opinion;*
 - (iii) *the Independent Accountants' opinion on the financial statements;*
 - (d) *the manuscript or printed signature of the Independent Accountants; and*
 - (e) *the date of the Independent Accountants' report. (SAS 600.2).*
 - *The use of a standard format for Independent Accountants' reports on financial statements assists the reader to follow the report's contents. The section headings indicate to the reader the nature of the matters contained in the section concerned: for example, where a qualified opinion is expressed, the heading 'Qualified opinion' may be used.*
 - *Independent Accountants draft each section of their report on financial statements to reflect the requirements which apply to the particular engagement. However, the use of common language in Independent Accountants' reports assists the reader's understanding.*
30. The above guidance drawn from SAS 600 is incorporated into the form of report issued by Independent Accountants. In addition, opinions expressed by Independent Accountants on Regulatory Accounts include the following:
- i) a paragraph setting out the basis of the preparation of the Regulatory Accounts, for example in accordance with the RAGs;
 - ii) a statement that the Regulatory Accounts are separate from the statutory financial statements of the Company and have not been prepared on the basis of UK GAAP, and that financial information other than that prepared

on the basis of UK GAAP does not necessarily represent a true and fair view of the financial position of a company;

- iii) a statement that the nature, form and content of Regulatory Accounts are determined by the Regulator, and that it is not appropriate for the auditors/ Independent Accountants or the directors to assess whether the nature of the information being reported upon is suitable or appropriate for the Regulator's purposes.
 - iv) a statement that the audit of the Regulatory Accounts has been conducted in accordance with Auditing Standards issued by the Auditing Practices Board except that, as the nature, form and content of Regulatory Accounts are determined by the Regulator, the Independent Accountants' did not evaluate the overall adequacy of the presentation of the information, which would have been required if they were to express an audit opinion under Auditing Standards.
 - v) a statement clarifying to whom the Independent Accountants accept a responsibility, and to whom they do not⁴; and
 - vi) a statement that the Independent Accountants' opinion on the Regulatory Accounts is separate from their opinion on the statutory accounts of the Company, which are prepared for a different purpose.
31. Independent Accountants make clear, in their report, the Regulatory Information on which they are providing assurance, and that on which they are not. Where the Regulatory Information is part of a wider report or Regulatory Return, those additional matters being considered in connection with the Independent Accountants' report are clearly identified.
32. The Independent Accountants' report on Regulatory Accounts will be based on the example unqualified report set out at Appendix B, modified as appropriate for the particular circumstances of the engagement. Where such modifications are made, Independent Accountants will use existing guidance (for example Technical Release Audit 1/01 and SAS 600) in making those modifications. Where such modifications result in a departure from auditing standards, this will be reflected in the Independent Accountants' Report on the Regulatory Accounts.
33. An example of such a departure would arise if the Regulatory Accounts are an integral part of a broader Regulatory Return. If the Independent Accountants did not read the other information contained in the Regulatory Return for apparent mis-statements therein, or any material inconsistency with the audited Regulatory Accounts (as required under SAS 160 (Other information in documents containing audited financial statements (Revised))), then non-compliance with SAS 160 will be referred to in the 'basis of audit opinion' and 'opinion' paragraphs of the report on the Regulatory Accounts.

Other Regulatory Information/Regulatory Returns

34. When reporting on other Regulatory Information, Independent Accountants follow the guidance set out in Technical Release Audit 1/01, SAS 600 and this paper.

⁴ The Working Group has taken the advice of Leading Counsel in respect of appropriate wording to do this. The suggested wording is that in the second paragraph of the example Independent Accountants' report in Appendix B.

SECTION 4

MATERIALITY

35. This section considers the assessment of materiality in respect of work performed, and reports issued, by Independent Accountants reporting on Regulatory Accounts and other Regulatory Information, and provides guidance on this matter.

General guidance

36. Materiality, as defined in SAS 220 (Materiality and the Audit) and the Glossary of Terms published alongside APB Auditing Standards, is

“An expression of the relative significance or importance of a particular matter in the context of financial statements as a whole. A matter is material if its omission or mis-statement would reasonably influence the decisions of an addressee of the auditors’ report. Materiality may also be considered in the context of any individual primary statement within the financial statements or of individual items included in them. Materiality is not capable of general mathematical definition as it has both qualitative and quantitative aspects.”

37. Materiality is a matter of professional judgement for the Independent Accountants/auditors, based on their understanding of the circumstances of the engagement and communications with the addressees of their report, and cannot be expressed purely as a numerical value. Accordingly, Independent Accountants do not quantify a level of materiality applied in their reports on Regulatory Information, nor do they express an opinion which is ‘certified’ to be within a numerical materiality value. This recognises that the concept of materiality is not capable of expression in such manner.

Regulatory Accounts

38. There is a growing trend, amongst Regulators, to draft licence conditions that require the Regulated Entity to include a number of different analyses of their business segments and/or operations within the Regulatory Accounts. In providing their report, Independent Accountants assess materiality in the context of the Regulatory Accounts as a whole, taking together the component analyses/disclosures in the Regulatory Accounts, rather than each component analysis/disclosure separately.
39. Where the Regulator is an addressee to the Independent Accountants’ report, the Regulator may specify, with supporting reasons, particular factors that it considers to be material in the context of the Regulatory Accounts and the Independent Accountants’ report. These factors are specified in the engagement contract, discussed in Section 2 of this guidance, and incorporated into the Independent Accountants’ assessment of materiality. Independent Accountants plan their work to gain reasonable assurance that the Regulatory Accounts are free from material error, whether caused by fraud or other mis-statement. Where, as a consequence of considering the Regulator’s specified matters/factors, the Independent Accountants are required to perform additional procedures to provide the level of assurance required, they assess and agree with the parties to the engagement contract the scope of their work and the likely impact on audit fees for performing this work.
40. Although Independent Accountants consider the individual factors that the Regulator has asked them to consider in assessing materiality for the Regulatory Accounts, they only express an opinion on the Regulatory Accounts as a whole, and not on those individual factors.
41. Where the Regulator requires specific factors to be reported upon by the Independent Accountants, the Independent Accountants agree a list of procedures (‘Agreed Upon Procedures’) that they will perform for the Regulator. These procedures are specified within the engagement contract with the Regulator. The Independent Accountants report the findings of the procedures separately from the Regulatory Accounts opinion, by way of a factual report to the Regulator. The Independent Accountants do not express an opinion on the results of the Agreed Upon Procedures, nor the appropriateness of these procedures for the purposes of the Regulator. The engagement contract and report for the ‘Agreed Upon Procedures’ include a statement that the Regulator needs to make its own assessment of the appropriateness of the Agreed Upon Procedures and the reported findings.
42. Where Agreed Upon Procedures are required in addition to an opinion on the Regulatory Accounts, Independent Accountants may choose not to complete their work nor express their opinion on the Regulatory Accounts until:
- i) the Agreed Upon Procedures that have been specified by the Regulator have been completed and reported upon; and
 - ii) the Regulator has provided assurance to the Independent Accountants that nothing has come to the attention of the Regulator from that report (or otherwise) that indicates that there are any matters that the Regulator believes the Independent Accountants should take into account in arriving at their opinion on the Regulatory Accounts. If such matters do exist, the Independent Accountants will consider, in arriving at their opinion on

the Regulatory Accounts, the matters noted by the Regulator and/or agree additional Agreed Upon Procedures with the Regulator.

Other Regulatory Information/Regulatory Returns

43. The principles of SAS 220 can be applied to any form of reporting which is performed in accordance with Generally Accepted Auditing Standards in the UK.
44. When reporting on other Regulatory Information, the Independent Accountants follow the principles set out in SAS 220, as appropriate.

SECTION 5

WORKING WITH INDEPENDENT EXPERTS

45. This section considers the use of other experts in respect of work performed, and reports issued, by Independent Accountants reporting on Regulatory Accounts and other Regulatory Information, and provides guidance on this matter.

Background

46. The provision of opinions on Regulatory Information may involve work with, or reliance upon, other independent experts, for example there may be reliance upon technical/engineering experts to determine whether the cost of projects should be capitalised or expensed. In addition, other independent experts may work with, or place reliance upon the Independent Accountants' work or report in discharging their own reporting responsibilities.

Independent Accountants rely on other independent experts

47. Guidance in respect of the use of experts is contained within SAS 520 (Using the work of an expert), which states that *'Auditors have sole responsibility for their opinion, but may use the work of an expert'* [para 1] and *'When using the work performed by an expert, the auditors should obtain sufficient appropriate audit evidence that such work is adequate for the purposes of the audit'* [para 2].
48. Where the Independent Accountants have performed audit procedures and expressed an audit opinion, it is not expected that the use and/or findings of the expert would be referred to in that report, unless such reference is required to explain the report given. For example, if a qualified/modified audit report is given it may refer to the expert if reference would facilitate an understanding of the reason for the modification/qualification.
49. Where the Independent Accountants have performed Agreed Upon Procedures and the report provided does not include an audit opinion, it is expected that the use and/or findings of the expert would be referred to in that report, unless such reference is clearly not required. Such Agreed Upon Procedures and report would include, for example, Agreed Upon Procedures that the Independent Accountants may agree with the Regulator in relation to the Regulated Entity's compliance with Regulatory Accounting Guidelines which may include steps such as obtaining the opinion of the Regulated Entity's appointed technical consultants (sometimes referred to as the reporter) for example, as to the appropriateness of capital expenditure outlay and tendering procedures.
50. The Independent Accountants would need the consent of the expert prior to making reference to, and/or including extracts from the expert's report in the Independent Accountants' report.

Independent experts rely on work performed by the Independent Accountants

51. The Independent Accountants may be requested by a Third Party to perform certain procedures in connection with that Third Party's own regulatory reporting. For example, the Third Party (who may itself be an independent expert) may ask the Independent Accountants to verify that certain financial information is correctly extracted from a company's accounting records when reporting on information to be included in Regulatory Returns.
52. In such circumstances, the Independent Accountants obtain permission from the Regulated Entity prior to agreeing to do the work, and agree a tri-partite engagement contract with the Regulated Entity and the independent expert in accordance with the guidance set out in Technical Release Audit 1/01 and Section 2 of this paper.
53. The form of report issued to the independent expert should be prepared in accordance with the guidance set out in SAS 600 and Section 3 of this guidance.

APPENDIX A

REGULATORY ACCOUNTS

There is no precise definition of Regulatory Accounts, either in law or in practice, although they are commonly referred to by Regulatory Bodies, Regulated Entities and accountants and within RAGs and the Regulated Entities' licence arrangements.

Regulatory Accounts are analogous to financial statements prepared under the Companies Act, but are usually prepared under some variation of, or other basis to, UK GAAP⁵ and therefore a 'fairly presents in accordance with' opinion is more appropriate in the circumstances of Regulatory Accounts. Financial information other than that prepared on the basis of UK GAAP does not necessarily represent a true and fair view of the financial performance or financial position of a company as shown in financial statements prepared in accordance with the Companies Act 1985.

Regulatory Accounts typically include:

- a profit and loss account;
- a balance sheet or statement of mean capital employed;
- detailed/segmental analyses of operations, costs and income, as defined in the Regulatory licence; and
- a reconciliation between the results and net assets reported within the Regulatory Accounts and those reported within the statutory financial statements prepared in accordance with the Companies Act 1985.

Regulatory Returns usually incorporate Regulatory Accounts but may also include other financial information required by the Regulator. Independent Accountants are usually expected to report upon certain identified elements of the additional information contained within the Regulatory Return only.

Regulatory Accounts do not include other items included within Regulatory Returns, such as:

- the reports of other experts;
- management commentary on the accounting information; or
- other types of Regulatory Information required to comply with the Regulatory Licence.

⁵ Except as specified in the RAGs.

APPENDIX B

EXAMPLE OF AN UNQUALIFIED AUDIT REPORT FOR REGULATORY ACCOUNTS

(to be tailored as appropriate for the particular circumstances of each engagement)

Independent Accountants' report to the Director General, [Regulator] ("the Regulator") and ABC Limited⁶

We have audited the Regulatory Accounts of ABC Limited ("the Company") on pages x to x which comprise the profit and loss account, the statement of total recognised gains and losses, the balance sheet, [the cashflow statement] and the related notes to the Regulatory Accounts.

This report is made, on terms that have been agreed⁷, solely to the Company and the Regulator in order to meet [the requirements of the Regulatory Licence⁸]. Our audit work has been undertaken so that we might state to the Company and the Regulator those matters that we have agreed to state to them in our report, in order (a) to assist the Company to [meet its obligation under the Regulatory Licence to procure such a report] and (b) to facilitate the carrying out by the Regulator of its regulatory functions, and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Company and the Regulator, for our audit work, for this report or for the opinions we have formed.

Basis of preparation

The Regulatory Accounts have been prepared under the historical cost convention (as modified by the revaluation of certain fixed assets) and in accordance with conditions [], [] and [] of the Company's Regulatory Licence, Regulatory Accounting Guidelines [], [] and [] ("the RAGs") issued by the Regulator and the accounting policies set out in the statement of accounting policies.

The Regulatory Accounts are separate from the statutory financial statements of the Company and have not been prepared under the basis of Generally Accepted Accounting Principles in the United Kingdom ("UK GAAP"). Financial information other than that prepared on the basis of UK GAAP does not necessarily represent a true and fair view of the financial performance or financial position of a company as shown in financial statements prepared in accordance with the Companies Act 1985.

Respective responsibilities of the Regulator, the Directors and Auditors

The nature, form and content of Regulatory Accounts are determined by the Regulator. It is not appropriate for us to assess whether the nature of the information being reported upon is suitable or appropriate for the Regulator's purposes. Accordingly we make no such assessment.

The directors' responsibilities for preparing the Regulatory Accounts in accordance with conditions [], [] and [] of the Regulatory Licence are set out in the statement of directors' responsibilities on page x.

Our responsibility is to audit the Regulatory Accounts in accordance with United Kingdom Auditing Standards issued by the Auditing Practices Board, except as stated in the 'Basis of audit opinion', below and having regard to the guidance contained in Audit 05/03 '*Reporting to Regulators of Regulated Entities*'.

We report our opinion as to whether the Regulatory Accounts present fairly, in accordance with conditions [], [] and [] of the Company's Regulatory Licence, the RAGs [], [] and [], and the accounting policies set out on page x, the results and financial position of the company. We also report to you if, in our opinion, the Company has not kept proper accounting records or if we have not received all the information and explanations we require for our audit.

[We read the other information contained within the Regulatory Accounts, including any supplementary schedules on which we do not express an audit opinion, and consider the implications for our report if we become aware of any apparent mis-statements or material inconsistencies with the Regulatory Accounts.]

⁶ Any modification to this form of report should be made in accordance with SAS 600 – see Section 3. The report is addressed to the Regulator as well as to the Company without any disclaimer of responsibility to the Regulator only where the Regulator has signed a tri-partite engagement contract or there is a bi-partite engagement contract supplemented by written notice signed by the Regulator. In other cases the report may be addressed to the Company and the Regulator (to meet the requirements of the Regulatory Licence) but includes a disclaimer under which responsibility is accepted to the Company only and co-addressing to the Regulator is expressed to be only to meet the requirements of the Regulatory Licence. Refer to paragraph 13 for further guidance.

⁷ This requires an engagement letter in a satisfactory form to be in place.

⁸ Or other reference. If the appropriate reference is to a Regulatory Licence that licence will require to be defined appropriately in the reference or in some other suitable place.

Basis of audit opinion

We conducted our audit in accordance with Statement of Auditing Standards issued by the Auditing Practices Board except as noted below. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the Regulatory Accounts. It also includes an assessment of the significant estimates and judgements made by the Directors in the preparation of the Regulatory Accounts, and of whether the accounting policies are consistently applied and adequately disclosed.

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the Regulatory Accounts are free from material mis-statement, whether caused by fraud or other irregularity or error. However, as the nature, form and content of Regulatory Accounts are determined by the Regulator, we did not evaluate the overall adequacy of the presentation of the information, which would have been required if we were to express an audit opinion under Auditing Standards.

Our opinion on the Regulatory Accounts is separate from our opinion on the statutory accounts of the Company on which we reported on [date], which are prepared for a different purpose. Our audit report in relation to the statutory accounts of the Company (our "Statutory" audit) was made solely to the Company's members, as a body, in accordance with section 235 of the Companies Act 1985. Our Statutory audit work was undertaken so that we might state to the Company's members those matters we are required to state to them in a Statutory auditor's report and for no other purpose. In these circumstances, to the fullest extent permitted by law, we do not accept or assume any responsibility to anyone other than the Company and the Company's members as a body, for our Statutory audit work, for our Statutory audit report, or for the opinions we have formed in respect of that Statutory audit.

Opinion

In our opinion the Regulatory Accounts fairly present in accordance with conditions [], [] and [] of the Company's Regulatory Licence, Regulatory Accounting Guidelines [], [] and [], and the accounting policies set out on page x, the state of the Company's affairs at [date] and of its profit (or loss) [and cashflow] for the year then ended, and have been properly prepared in accordance with those conditions, guidelines and accounting policies.

[Name of auditor]

[Chartered Accountants and Registered Auditors]

[Address]

[Date]

- 1. The maintenance and integrity of the [name of entity] web site is the responsibility of the Directors and the maintenance and integrity of the [name of Regulator] web site is the responsibility of the Regulator; the work carried out by the auditors does not involve consideration of these matters and, accordingly, the auditors accept no responsibility for any changes that may have occurred to the Regulatory Accounts since they were initially presented on the web sites.*
- 2. Legislation in the United Kingdom governing the preparation and dissemination of financial statements and Regulatory Accounts may differ from legislation in other jurisdictions.*

APPENDIX C

EXAMPLE TRI-PARTITE ENGAGEMENT CONTRACT

(to be tailored as appropriate for the particular circumstances of each engagement)

Private and Confidential

The Directors

[Name and address of Regulated Entity]

For the attention of []

The Director General

[Name and address of Regulator]

For the attention of []

[Date]

[Name of Regulated Entity] (“the Company”)

Audit of the regulatory financial statements for the year ended [DATE]

Dear Sirs,

Introduction

This letter (including the attached Appendices and the Terms and Conditions) sets out our understanding of the basis on which we act as auditors reporting on the regulatory financial statements (“the Regulatory Accounts”) as specified in [LICENCE CONDITION OR OTHER REFERENCE] of the Instrument of Appointment of the Company as a [TYPE OF BUSINESS] under the [APPLICABLE LEGISLATION] (“the Regulatory Licence”) and the Regulatory Accounting Guidelines (“RAGs”) [agreed with/] issued by the Director General of [IDENTITY OF REGULATOR], [NAME OF REGULATOR] (“the Regulator”). We also set out the respective areas of responsibility of the directors of the Company (“the Directors”), the Regulator and ourselves, in respect of the audit of the Regulatory Accounts (the “Services”). This letter (with all its attachments) applies only to the audit report on the Regulatory Accounts and the scope of our work will be limited accordingly. If any additional work or report is required, separate engagement terms and conditions will need to be agreed.

This letter and the attached terms and conditions together comprise the entire contract (“the Contract”) for the provision of the Services [to the exclusion of any other express or implied terms, whether expressed orally or in writing, including any conditions, warranties and representations unless made fraudulently] and shall supersede all previous contracts, letters of engagement, undertakings, agreements and correspondence regarding the Services.

Responsibilities of the Directors and the Auditors

The Directors are required to ensure that the Company complies with all of the terms of its Regulatory Licence [or other reference].

The Directors are required to prepare Regulatory Accounts in accordance with the Company’s Regulatory Licence [or other reference] and the RAGs [agreed with/] issued by the Regulator, a copy of which are attached as Appendix []. The Directors are also required to:

- [OTHER LICENCE CONDITIONS ON WHICH THE DIRECTORS ARE REQUIRED TO GIVE A FINANCE-BASED REPORT PER THE REGULATORY LICENCE, for example];
- [Confirm that, in their opinion, the Company has sufficient financial and management resources for the next twelve months];

- *[Confirm that, in their opinion, the Company has sufficient rights and assets which would enable a special administrator to manage the affairs, business and property of the Company];*
- *[Report to the Director General of [NAME OF REGULATOR] changes in the Company's activities which may be material in relation to the Company's ability to finance its regulated activities];*
- *[Undertake the transactions entered into by the business consisting of the carrying out of the regulated activity ("the appointed business"), with or for the benefit of any group companies or related companies ("associated companies") or activities of the appointed business, at arms length]; and*
- *[Keep proper accounting records which comply with [LICENCE CONDITION OR OTHER REFERENCE]].*

We refer to the above as "the Specific Obligations".

Other than reporting on whether or not proper accounting records have been kept by the Company as required by Condition [] of the Regulatory Licence [or other reference], it is not our responsibility in providing the Services to report on the Specific Obligations or on any other obligations of the Company or the Directors under the Regulatory Licence [or other reference].

The Directors are also responsible for ensuring that the Company maintains accounting records which disclose with reasonable accuracy, at any time, the financial position of the Company, and for preparing Regulatory Accounts which present the results of the Company fairly in accordance with the Regulatory Licence. They are also responsible for making available to us, as and when required, all of the Company's accounting records, all other relevant records, including minutes of all directors', management and shareholders' meetings, and such information and explanations which we consider necessary for the performance of our duties as auditors.

It is our responsibility to form an independent opinion, based on our audit, on the Regulatory Accounts and to report our opinion to the Company and the Regulator.

Our report will be addressed to the Company and the Regulator and will state whether, in our opinion, the Regulatory Accounts present fairly in accordance with conditions [], [] and [] of the Regulatory Licence [or other reference] the state of the Company's affairs at [DATE] and of its profit (or loss) for the year then ended, and have been properly prepared in accordance with conditions [], [] and [] of that Licence [or other reference].

Our report will be made in accordance with the Contract, solely to the Company and the Regulator in order to meet the requirements of the Regulatory Licence [or other reference]. Our audit work will be undertaken so that we might state to the Company and the Regulator those matters we have agreed in the Contract to state to them in our report in order to (a) assist the Company to [meet its obligations under the Regulatory Licence to procure such a report] and (b) to facilitate the carrying out by the Regulator of its regulatory functions, and for no other purpose. To the fullest extent permitted by law, we will not accept or assume responsibility to anyone other than the Company and the Regulator for our audit work, for our report, or for the opinions we will form. Our report will contain a disclaimer of liability to other parties to this effect.

The Contract does not confer benefits on any parties who are not parties to it and the application of the Contracts (Rights of Third Parties) Act 1999 is excluded.

In arriving at our opinion, and in accordance with the Regulatory Licence (condition [REFERENCE]) [or other reference], we will consider the following matters, and report on any in respect of which we are not satisfied:

- whether appropriate accounting records have been kept by the Company and proper returns adequate for our audit have been received from operating locations not visited by us;
- whether the Regulatory Accounts are in agreement with the accounting records and returns retained for the purpose of preparing the Regulatory Accounts; and
- whether we have obtained all the information and explanations which we consider necessary for the purposes of our audit.

Our responsibilities also include:

- Providing in our report a description of the Directors' responsibilities for the Regulatory Accounts where the Regulatory Accounts or accompanying information do not include such a description; and
- Considering whether other information in documents containing the Regulatory Accounts is consistent with those Regulatory Accounts.

The Regulator and the Company acknowledge and agree that:

- wherever the Regulatory Accounts or other Regulatory Information covered by the Independent Accountants' report are published or otherwise made available in full, our audit report will also be published or otherwise made available in full as part of that communication;
- wherever substantial extracts⁹ from the Regulatory Accounts or other Regulatory Information covered by the Independent Accountants' report are published or otherwise made available, and reference is made to the fact that they are audited or otherwise examined by an Independent Accountants, there will be explicit statements by the Regulator: a) that the information published is only an extract; and b) about the limitation of scope of the Independent Accountants' report and the duty of care owed by the Independent Accountants; and c) referring to where the full set of Regulatory Accounts can be found or otherwise obtained; and
- wherever any other information is referenced from the Regulatory Accounts or other Regulatory Information covered by the Independent Accountants' report, there will be an explicit reference by the Regulator to the source of that information and the limitation of scope of the Independent Accountants' report and the duty of care owed by the Independent Accountant

Relationship between the Regulator and the Company

For the avoidance of doubt, nothing in this Contract is intended to nor does it affect or in any way alter the relationship or the rights and obligations between the Company and the Regulator as set out in the Regulatory Licence [and all relevant legislation].

Scope of our audit

Our audit will be performed with regard to the guidance contained in '*Audit 05/03: Reporting to Regulators of Regulated Entities*' issued by the Institute of Chartered Accountants in England & Wales.

Our audit will be conducted in accordance with Statements of Auditing Standards issued by the Auditing Practices Board except that, as the nature, form and content of Regulatory Accounts are determined by the Regulator, we will not evaluate the overall adequacy of the presentation of the information, which would have been required if we were to express an audit opinion under Auditing Standards. Our audit will include such tests of transactions and of the existence, ownership and valuation of assets and liabilities as we consider necessary. We shall obtain an understanding of the accounting and internal financial control systems to the extent necessary in order to assess their adequacy as a basis for the preparation of the Regulatory Accounts and to establish whether appropriate accounting records have been maintained by the Company.

We shall expect to obtain such appropriate evidence as we consider sufficient to enable us to draw reasonable conclusions therefrom. The nature and extent of our procedures will vary according to our assessment of the Company's accounting system and, where we wish to place reliance on it, the internal financial control system and may cover any aspect of the business operations.

[The Regulatory Accounts are prepared by disaggregating balances recorded in the general ledgers and other accounting records of the [NAME OF STATUTORY ENTITY] maintained in accordance with the Companies Act 1985 and used, in accordance with that Act, for the preparation of [NAME OF STATUTORY ENTITY]'s statutory financial statements.]

[No additional tests will be performed of the transactions and balances which are recorded in the general ledgers of [NAME OF STATUTORY ENTITY] other than those carried out in performing the audit of the statutory financial statements that include the Company.]

Our audit includes assessing the significant estimates and judgements made by the Directors in the preparation of the Regulatory Accounts and whether the accounting policies are appropriate to the Company's circumstances, consistently applied and adequately disclosed.

[We will read the [SPECIFY INFORMATION] ("Other Information") contained within the Regulatory Accounts, including any supplementary schedules on which we do not express an audit opinion, and consider the implications for our report if we become aware of any apparent mis-statements or material inconsistencies with the Regulatory Accounts. We will not perform any audit procedures nor provide any other assurance on the Other Information.]

We will plan our work to gain reasonable assurance that the Regulatory Accounts are free from material error, whether caused by fraud or other mis-statement.

The concept of materiality affects our audit planning and our consideration of matters arising from our audit. We take into account both qualitative and quantitative factors when assessing materiality. We will only express an opinion on the Regulatory Accounts as a whole and not on individual factors/components within Regulatory Accounts.

Where the Regulator requires specific factors to be reported upon by us, this should be addressed through the powers vested in the Regulator through the Regulatory Licence [or other reference]. For such reporting, we will agree a list of procedures ('Agreed Upon Procedures') that we will perform for the Regulator. These procedures will be specified in a

⁹ For example, reproduction of primary statements as a whole.

separate engagement contract between us and the Regulator [and will be shown to the Company]. We will report the findings of the Agreed Upon Procedures separately from the Regulatory Accounts opinion, by way of a factual report to the Regulator, in which we will not express an opinion on the results of the Agreed Upon Procedures, nor the appropriateness of those procedures for the purposes of the Regulator. As with the form and content of Regulatory Accounts, the Regulator will need to make its own assessment of the appropriateness of the Agreed Upon Procedures and the reported findings.

Where Agreed Upon Procedures are required in addition to an opinion on the Regulatory Accounts, we may choose not to complete our work nor express an opinion on the Regulatory Accounts until:

- i) the Agreed Upon Procedures that have been specified by the Regulator have been completed and reported upon; and
- ii) the Regulator has provided a written notice to us confirming that nothing has come to the attention of the Regulator from that report (or otherwise) that indicates that there are any matters which the Regulator believes that we should take into account in arriving at our opinion on the Regulatory Accounts. If such matters do exist we will consider, in arriving at our opinion on the Regulatory Accounts, the matters noted by the Regulator and/or agree additional Agreed Upon Procedures with the Regulator.

The Services are separate from our audit work on the statutory financial statements of the Company which is carried out in accordance with our statutory obligations under the Companies Act 1985. Our audit report on those statutory financial statements is intended for the sole benefit of the Company's shareholders as a group, to whom it is addressed, and not for any other purpose. Our audit of the Company's statutory financial statements are not planned or conducted in contemplation of the requirements of anyone other than such shareholders and, consequently, our audit work is not intended to address or reflect matters in which anyone other than such shareholders may be interested.

We do not and will not, by virtue of this report or otherwise in connection with this engagement, assume any responsibility whether in contract, negligence or otherwise in relation to our audits of the Company's statutory financial statements required by the Companies Act 1985; we and our employees shall have no liability whether in contract, tort (including negligence) or otherwise to any parties other than the Company and its members in relation to our audit of the Company's statutory financial statements.

The nature and format of the Regulatory Accounts are determined by the requirements of the Regulator. It is not appropriate for us to assess, and accordingly we will not make any assessment on, whether the nature of the information being reported upon is suitable or appropriate for the Regulator's purpose. It is a matter for the Regulator to consider whether the information being reported upon is appropriate for its own purposes and we will not give any implicit or explicit affirmation that the information being reported upon is suitable for the Regulator's purpose.

The Regulator and the Company accept that there [may be/are] differences between United Kingdom Generally Accepted Accounting Principles ("UK GAAP") and the basis of information provided in the Regulatory Accounts. Financial information, other than that prepared on the basis of UK GAAP, does not necessarily represent a true and fair view of the financial performance or financial position of a Company.

Internal audit

In developing our audit plan, we will liaise with the Company's internal auditors to ensure that our work is properly co-ordinated with theirs. It is our policy to rely upon internal audit work whenever possible, whilst ensuring that adequate audit coverage is achieved of all significant areas.

Meetings with the Regulator

We are willing to attend meetings with the Regulator to discuss the Services, if requested to do so, provided that we can agree appropriate terms on which such meetings are held. For the avoidance of doubt appropriate terms will include meeting only on a tri-partite basis in the absence of specific consent of the Company allowing us to meet with the Regulator [and its advisors].

Management representations

The information used by the Directors in preparing the Regulatory Accounts will invariably include facts or judgements which are not themselves recorded in the accounting records. As part of our normal audit procedures, we shall request appropriate directors or senior officials/management of the Company to provide written confirmation each year of such facts or judgements and any other oral representations which we have received during the course of the audit on matters having a material effect on the Regulatory Accounts. We will also ask the Directors to confirm in that letter that all important and relevant information has been brought to our attention. In connection with representations and the supply of information to us generally, we draw your attention to section 389A of the Companies Act 1985 under which it is an offence for an officer of the company to mislead the auditors.

Detection of fraud, error and non-compliance with laws and regulations

The responsibility for safeguarding the assets of the Company and for the prevention and detection of fraud, error and non-compliance with law or regulations rests with the Directors. However, we shall endeavour to plan our audit so that we have a reasonable expectation of detecting material mis-statements in the Regulatory Accounts or accounting

records (including any material mis-statements resulting from fraud, error or non-compliance with law or regulations), but our examination should not be relied upon to disclose all such material mis-statements or frauds, errors or instances of non-compliance as may exist.

Timetable

We expect to commence our work on [DATE] and would normally expect to issue our report by [DATE].

Completion of our work will depend upon receiving, without undue delay, full co-operation from all relevant officials of the Company and their disclosure to us of all the accounting records of the Company and all other records and related information (including certain representations) that we may need for the purpose of our work.

Other requirements

In order to assist us with the examination of the Regulatory Accounts, we shall request early sight of all documents or statements which are due to be issued with those Regulatory Accounts.

Once we have issued our report we have no further direct responsibility in relation to the Regulatory Accounts for that financial year.

Preparation of Regulatory Accounts

Assistance with the preparation of Regulatory Accounts does not form a part of the audit function, but we shall discuss the Company's accounting principles with the management and/or the Directors and we may propose adjusting entries for their consideration.

Other services

We shall not be treated as having notice, for the purposes of our regulatory audit responsibilities, of information provided to members of our firm other than those engaged on the audit (for example information provided in connection with accounting, taxation and other services).

Fiduciary responsibilities

Because our audit work under the terms of this engagement is directed at forming an opinion on the Company's Regulatory Accounts our audit procedures will not normally extend to assets or documents of title in respect of assets that are in the Company's possession but owned by others.

Terms and conditions

The attached Terms and Conditions set out the duties of all parties in respect of the Services. The Terms and Conditions amongst other things:

- i) limit our liability to a maximum aggregate amount of £[X]. This limitation shall be allocated between the Company and the Regulator. [It is agreed that such allocation will be entirely a matter for the addressees of this letter, who shall be under no obligation to inform [Name of Auditor] of it, provided always that if (for whatever reason) no such allocation is agreed, neither the Company nor the Regulator shall dispute the validity, enforceability or operation of the limit of liability on the grounds that no such allocation was agreed]¹⁰; and
- ii) limit the period within which a claim may be brought.

[NAME OF AUDITOR] alone will be responsible for the performance of the engagement contract formed by this letter. You therefore agree that you will not bring any claim in respect of or in connection with this engagement whether in contract, tort (including negligence), breach of statutory duty or otherwise against any partner or employee of [NAME OF AUDITOR]. The foregoing exclusion does not apply to any liability that cannot be excluded under the laws of England and Wales.

Fees

[Details]

The fee for the work covered by this engagement letter will be agreed with, and paid by, the Company.

Safeguarding service

It is our desire to provide you at all times with a high quality service to meet your needs. If at any time you would like to discuss with us how our service to you could be improved or if you are dissatisfied with any aspect of our services, please raise the matter immediately with the partner responsible for that aspect of our services to you. If, for any reason, you would prefer to discuss these matters with someone other than that partner, please contact [] at []. In this way we are able to ensure that your concerns are dealt with carefully and promptly. We undertake to look into any complaint carefully and promptly and to do all we can to explain the position to you. This will not affect your right to complain to the Institute of Chartered Accountants in England and Wales.

¹⁰ This paragraph may be replaced by a specific allocation of the aggregate liability between the Company and the Regulator where the Company and the Regulator have reached such agreement, independently of the Independent Accountants, and wish to incorporate this into the engagement contract.

Acknowledgement and acceptance

Please acknowledge your acceptance of the terms of our engagement under the Contract by signing the confirmation below and returning a copy of this letter and the attached Terms and Conditions to us at the above address, whereupon the Contract will take effect from the date of the commencement by us of the Services.

Once it has been agreed, this letter will remain effective, from one audit appointment to another, until it is replaced.

If you have any questions regarding this Contract, please do not hesitate to contact us.

Yours faithfully,

[Name of Auditor]

I have read the above letter and accept the terms and conditions set out therein.

Signed:

(Name and position)
for and on behalf of [Name of Company]

(Date)

(Name and position)
for and on behalf of [Name of Regulator]

(Date)

APPENDIX D

EXAMPLE BI-PARTITE ENGAGEMENT CONTRACT

(to be tailored for the particular circumstances of each engagement)

Private and Confidential

The Directors

[Name and address of Regulated Entity]

For the attention of []

[Date]

[Name of Regulated Entity] (“the Company”)

Audit of the regulatory financial statements for the year ended [DATE]

Dear Sirs,

Introduction

This letter (including the attached Appendices and the Terms and Conditions) sets out our understanding of the basis on which we act as auditors reporting on the regulatory financial statements (“the Regulatory Accounts”) as specified in [LICENCE CONDITION OR OTHER REFERENCE] of the Instrument of Appointment of the Company as a [TYPE OF BUSINESS] under the [APPLICABLE LEGISLATION] (“the Regulatory Licence”) and the Regulatory Accounting Guidelines (“RAGs”) [agreed with/] issued by the Director General of [IDENTITY OF REGULATOR], [NAME OF REGULATOR] (“the Regulator”). We also set out the respective areas of responsibility of the directors of the Company (“the Directors”) and ourselves, in respect of the audit of the Regulatory Accounts (the “Services”). This letter (with all its attachments) applies only to the audit report on the Regulatory Accounts and the scope of our work will be limited accordingly. If any additional work or report is required, separate engagement terms and conditions will need to be agreed.

This letter and the attached Terms and Conditions together comprise the entire contract (“the Contract”) for the provision of the Services [to the exclusion of any other express or implied terms, whether expressed orally or in writing, including any conditions, warranties and representations unless made fraudulently] and shall supersede all previous contracts, letters of engagement, undertakings, agreements and correspondence regarding the Services.

The Regulator is not a party to the Contract. On condition that the Regulator accepts in writing a notice in the form appended (“the Regulator’s Contract”), we will accept duties and responsibilities to the Regulator in respect of our audit work, our audit report and our audit opinion on the Regulatory Accounts. Any such agreement will be on the basis that, amongst other things, the Company and the Regulator agree that our aggregate liability to the Company and the Regulator is limited to the maximum amount which would have been payable to the Company alone in respect of any breach of our obligations to the Company. References to rights and obligations between the Regulator and the auditors in relation to the Services and the Agreed upon Procedures are included in the Contract for the purpose only of the Regulator’s Contract and are not intended to create rights or obligations between the Regulator and the Company.

Responsibilities of the Directors and the Auditors

The Directors are required to ensure that the Company complies with all of the terms of its Regulatory Licence [or other reference].

The Directors are required to prepare Regulatory Accounts in accordance with the Company’s Regulatory Licence [or other reference] and the RAGs [agreed with/] issued by the Regulator, a copy of which are attached as Appendix []. The Directors are also required to:

- [OTHER LICENCE CONDITIONS ON WHICH THE DIRECTORS ARE REQUIRED TO GIVE A FINANCE-BASED REPORT PER THE REGULATORY LICENCE, for example];
- [Confirm that, in their opinion, the Company has sufficient financial and management resources for the next twelve months];

- *[Confirm that, in their opinion, the Company has sufficient rights and assets which would enable a special administrator to manage the affairs, business and property of the Company];*
- *[Report to the Director General of [NAME OF REGULATOR] changes in the Company's activities which may be material in relation to the Company's ability to finance its regulated activities];*
- *[Undertake the transactions entered into by the business consisting of the carrying out of the regulated activity ("the appointed business"), with or for the benefit of any group companies or related companies ("associated companies") or activities of the appointed business, at arms length]; and*
- *[Keep proper accounting records which comply with [LICENCE CONDITION OR OTHER REFERENCE]].*

We refer to the above as "the Specific Obligations".

Other than reporting on whether or not proper accounting records have been kept by the Company as required by Condition [] of the Regulatory Licence [or other reference], it is not our responsibility in providing the Services to report on the Specific Obligations or on any other obligations of the Company or the Directors under the Regulatory Licence [or other reference].

The Directors are also responsible for ensuring that the Company maintains accounting records which disclose with reasonable accuracy, at any time, the financial position of the Company, and for preparing Regulatory Accounts which present the results of the Company fairly in accordance with the Regulatory Licence. They are also responsible for making available to us, as and when required, all of the Company's accounting records, all other relevant records, including minutes of all directors', management and shareholders' meetings, and such information and explanations which we consider necessary for the performance of our duties as auditors.

It is our responsibility to form an independent opinion, based on our audit, on the Regulatory Accounts and to report our opinion to the Company and (in order to meet the requirements of the Regulatory Licence) to the Regulator.

Our report will be made in accordance with the Contract, solely to the Company and the Regulator in accordance with the Regulatory Licence [or other reference]. Our audit work will be undertaken so that we might state to the Company and the Regulator those matters we have agreed in the Contract to state to them in our report in order to (a) assist the Company to [meet its obligations under the Regulatory Licence to procure such a report] and (b) to facilitate the carrying out by the Regulator of its regulatory functions, and for no other purpose. To the fullest extent permitted by law, we will not accept or assume responsibility to anyone other than the Company for our audit work, for our report, or for the opinions we will form. Our report will contain a disclaimer of liability to all other parties but we will confirm acceptance in our report of responsibility in respect of our audit work to the Regulator also if the Regulator has agreed to the Regulator's Contract by signing the written notice appended.

Our report will be addressed to the Company and the Regulator to meet the requirements of the Regulatory Licence and will state whether, in our opinion, the Regulatory Accounts present fairly in accordance with conditions [], [] and [] of the Company's Regulatory Licence [or other reference] the state of the Company's affairs at [DATE] and of its profit (or loss) for the year then ended, and have been properly prepared in accordance with conditions [], [] and [] of that licence [or other reference].

The Contract does not confer benefits on any parties who are not parties to it and the application of the Contracts (Rights of Third Parties) Act 1999 is excluded.

In arriving at our opinion, and in accordance with the Regulatory Licence (condition [REFERENCE]) [or other reference], we will consider the following matters, and report on any in respect of which we are not satisfied:

- whether appropriate accounting records have been kept by the Company and proper returns adequate for our audit have been received from operating locations not visited by us;
- whether the Regulatory Accounts are in agreement with the accounting records and returns retained for the purpose of preparing the Regulatory Accounts; and
- whether we have obtained all the information and explanations which we consider necessary for the purposes of our audit.

Our responsibilities also include:

- providing in our report a description of the Directors' responsibilities for the Regulatory Accounts where the Regulatory Accounts or accompanying information do not include such a description; and
- considering whether other information in documents containing the Regulatory Accounts is consistent with those Regulatory Accounts.

The Company and (where the Regulator signs the written notice appended) the Regulator acknowledge and agree that:

- wherever the Regulatory Accounts or other Regulatory Information covered by the Independent Accountants' report are published or otherwise made available in full, our audit report will also be published or otherwise made available in full as part of that communication;
- wherever substantial extracts¹¹ from the Regulatory Accounts or other Regulatory Information covered by the Independent Accountants' report are published or otherwise made available, and reference is made to the fact that they are audited or otherwise examined by an Independent Accountant, there will be explicit statements by the Regulator: a) that the information published is only an extract; and b) about the limitation of scope of the Independent Accountants' report and the duty of care owed by the Independent Accountants; and c) referring to where the full set of Regulatory Accounts can be found or otherwise obtained; and
- wherever any other information is referenced from the Regulatory Accounts or other Regulatory Information covered by the Independent Accountants' report, there will be an explicit reference by the Regulator to the source of that information and the limitation of scope of the Independent Accountants' report and the duty of care owed by the Independent Accountant.

Where the Regulator does not sign a written notice in the form appended, the Company will procure that these events take place in the circumstances identified.

Relationship between the Regulator and the Company

For the avoidance of doubt, nothing in this Contract is intended to nor does it affect or in any way alter the relationship or the rights and obligations between the Company and the Regulator as set out in the Regulatory Licence [and all relevant legislation].

Scope of our audit

Our audit will be performed with regard to the guidance contained in 'Audit 05/03: Reporting to Regulators of Regulated Entities' issued by the Institute of Chartered Accountants in England & Wales.

Our audit will be conducted in accordance with Statements of Auditing Standards issued by the Auditing Practices Board except that, as the nature, form and content of Regulatory Accounts are determined by the Regulator, we will not evaluate the overall adequacy of the presentation of the information, which would have been required if we were to express an audit opinion under Auditing Standards. Our audit will include such tests of transactions and of the existence, ownership and valuation of assets and liabilities as we consider necessary. We shall obtain an understanding of the accounting and internal financial control systems to the extent necessary in order to assess their adequacy as a basis for the preparation of the Regulatory Accounts and to establish whether appropriate accounting records have been maintained by the Company.

We shall expect to obtain such appropriate evidence as we consider sufficient to enable us to draw reasonable conclusions therefrom. The nature and extent of our procedures will vary according to our assessment of the Company's accounting system and, where we wish to place reliance on it, the internal financial control system and may cover any aspect of the business operations.

[The Regulatory Accounts are prepared by disaggregating balances recorded in the general ledgers and other accounting records of the [NAME OF STATUTORY ENTITY] maintained in accordance with the Companies Act 1985 and used, in accordance with that Act, for the preparation of [NAME OF STATUTORY ENTITY]'s statutory financial statements.]

[No additional tests will be performed of the transactions and balances which are recorded in the general ledgers of [NAME OF STATUTORY ENTITY] other than those carried out in performing the audit of the statutory financial statements that include the Company.]

Our audit includes assessing the significant estimates and judgements made by the Directors in the preparation of the Regulatory Accounts and whether the accounting policies are appropriate to the Company's circumstances, consistently applied and adequately disclosed.

[We will read the [SPECIFY INFORMATION] ("Other Information") contained within the Regulatory Accounts, including any supplementary schedules on which we do not express an audit opinion, and consider the implications for our report if we become aware of any apparent mis-statements or material inconsistencies with the Regulatory Accounts. We will not perform any audit procedures nor provide any other assurance on the Other Information.]

We will plan our work to gain reasonable assurance that the Regulatory Accounts are free from material error, whether caused by fraud or other mis-statement.

The concept of materiality affects our audit planning and our consideration of matters arising from our audit. We take into account both qualitative and quantitative factors when assessing materiality. We will only express an opinion on the Regulatory Accounts as a whole and not on individual factors within Regulatory Accounts.

¹¹ For example, reproduction of primary statements as a whole.

Where the Regulator requires specific factors to be reported upon by us, this should be addressed through the powers vested in the Regulator through the Regulatory Licence [or other reference]. For such reporting, we will agree a list of procedures ('Agreed Upon Procedures') that we will perform for the Regulator. These procedures will be specified in a separate engagement contract between us [and] the Regulator and [will be shown to] the Company. We will report the findings of the Agreed Upon Procedures separately from the Regulatory Accounts opinion, by way of a factual report to the Regulator, in which we will not express an opinion on the results of the Agreed Upon Procedures, nor the appropriateness of those procedures for the purposes of the Regulator. As with the form and content of Regulatory Accounts, the Regulator will need to make its own assessment of the appropriateness of the Agreed Upon Procedures and the reported findings.

Where Agreed Upon Procedures are required in addition to an opinion on the Regulatory Accounts, we may choose not to complete our work nor express an opinion on the Regulatory Accounts until:

- i) the Agreed Upon Procedures that have been specified by the Regulator have been completed and reported upon; and
- ii) the Regulator has provided a written notice to us confirming that nothing has come to the attention of the Regulator from that report (or otherwise) that indicates that there are any matters which the Regulator believes that we should take into account in arriving at our opinion on the Regulatory Accounts. If such matters do exist we will consider, in arriving at our opinion on the Regulatory Accounts, the matters noted by the Regulator and/or agree additional Agreed Upon Procedures with the Regulator.]

The Services are separate from our audit work on the statutory financial statements of the Company which is carried out in accordance with our statutory obligations under the Companies Act 1985. Our audit report on those statutory financial statements is intended for the sole benefit of the Company's shareholders as a group, to whom it is addressed, and not for any other purpose. Our audits of the Company's statutory financial statements are not planned or conducted in contemplation of the requirements of anyone other than such shareholders and, consequently, our audit work is not intended to address or reflect matters in which anyone other than such shareholders may be interested.

We do not and will not, by virtue of this report or otherwise in connection with this engagement, assume any responsibility whether in contract, tort (including negligence) or otherwise in relation to our audits of the Company's statutory financial statements required by the Companies Act 1985; we and our employees shall have no liability whether in contract, tort (including negligence) or otherwise to any parties other than the Company and its members in relation to our audits of the Company's statutory financial statements.

The nature and format of the Regulatory Accounts are determined by the requirements of the Regulator. It is not appropriate for us to assess, and accordingly we will not make any assessment on, whether the nature of the information being reported upon is suitable or appropriate for the Regulator's purpose, whether or not the Regulator signs the written notice in the form appended. It is a matter for the Regulator to consider whether the information being reported upon is appropriate for its own purposes and we will not give any implicit or explicit affirmation that the information being reported upon is suitable for the Regulator's purpose.

There [may be/are] differences between United Kingdom Generally Accepted Accounting Principles ("UK GAAP") and the basis of information provided in the Regulatory Accounts. Financial information, other than that prepared on the basis of UK GAAP, does not necessarily represent a true and fair view of the financial performance or financial position of a Company.

Internal audit

In developing our audit plan, we will liaise with the Company's internal auditors to ensure that our work is properly co-ordinated with theirs. It is our policy to rely upon internal audit work whenever possible, whilst ensuring that adequate audit coverage is achieved of all significant areas.

Meetings with the Regulator

We are willing to attend meetings with the Regulator to discuss the Services, if requested to do so, provided that we can agree appropriate terms on which such meetings are held. For the avoidance of doubt appropriate terms will include meeting only on a tri-partite basis in the absence of specific consent of the Company allowing us to meet with the Regulator [and its advisors].

Management representations

The information used by the Directors in preparing the Regulatory Accounts will invariably include facts or judgements which are not themselves recorded in the accounting records. As part of our normal audit procedures, we shall request appropriate directors or senior officials/management of the Company to provide written confirmation each year of such facts or judgements and any other oral representations which we have received during the course of the audit on matters having a material effect on the Regulatory Accounts. We will also ask the Directors to confirm in that letter that all important and relevant information has been brought to our attention. In connection with representations and the supply of information to us generally, we draw your attention to section 389A of the Companies Act 1985 under which it is an offence for an officer of the Company to mislead the auditors.

Detection of fraud, error and non-compliance with laws and regulations

The responsibility for safeguarding the assets of the Company and for the prevention and detection of fraud, error and non-compliance with law or regulations rests with the Directors. However, we shall endeavour to plan our audit so that we have a reasonable expectation of detecting material mis-statements in the Regulatory Accounts or accounting records (including any material mis-statements resulting from fraud, error or non-compliance with law or regulations), but our examination should not be relied upon to disclose all such material mis-statements or frauds, errors or instances of non-compliance as may exist.

Timetable

We expect to commence our work on [DATE] and would normally expect to issue our report by [DATE].

Completion of our work will depend upon receiving, without undue delay, full co-operation from all relevant officials of the Company and their disclosure to us of all the accounting records of the Company and all other records and related information (including certain representations) that we may need for the purpose of our work.

Other requirements

In order to assist us with the examination of the Regulatory Accounts, we shall request early sight of all documents or statements which are due to be issued with those Regulatory Accounts.

Once we have issued our report we have no further direct responsibility in relation to the Regulatory Accounts for that financial year.

Preparation of Regulatory Accounts

Assistance with the preparation of Regulatory Accounts does not form a part of the audit function, but we shall discuss the Company's accounting principles with the management and/or the Directors and we may propose adjusting entries for their consideration.

Other services

We shall not be treated as having notice, for the purposes of our regulatory audit responsibilities, of information provided to members of our firm other than those engaged on the audit (for example information provided in connection with accounting, taxation and other services).

Fiduciary responsibilities

Because our audit work under the terms of this engagement is directed at forming an opinion on the Company's Regulatory Accounts our audit procedures will not normally extend to assets or documents of title in respect of assets that are in the Company's possession but owned by others.

Terms and conditions

The attached Terms and Conditions set out the duties of all parties in respect of the Services. The Terms and Conditions amongst other things:

- i) limit our liability to a maximum aggregate amount of £[X]. Where the Regulator accepts in writing a notice in the form appended (and on that basis we accept duties and responsibilities to the Regulator), this limitation shall be allocated between the Company and the Regulator. [In such circumstances such allocation will be entirely a matter for the Company and the Regulator, who shall be under no obligation to inform [Name of Auditor] of it, provided always that if (for whatever reason) no such allocation is agreed, neither the Company nor the Regulator shall dispute the validity, enforceability or operation of the limit of liability on the grounds that no such allocation was agreed]¹²; and
- ii) limit the period within which a claim may be brought.

[NAME OF AUDITOR] alone will be responsible for the performance of the engagement contract formed by this letter. You therefore agree that you will not bring any claim in respect of or in connection with this engagement whether in contract, tort (including negligence), breach of statutory duty or otherwise against any partner or employee of [NAME OF AUDITOR]. The foregoing exclusion does not apply to any liability that cannot be excluded under the laws of England and Wales.

Fees

[Details]

The fee for the work covered by this engagement letter will be agreed with, and paid by, the Company.

¹² This paragraph may be replaced by a specific allocation of the aggregate liability between the Company and the Regulator where the Company and the Regulator have reached such agreement, independently of the Independent Accountants, and wish to incorporate this into the engagement contract.

Safeguarding service

It is our desire to provide you at all times with a high quality service to meet your needs. If at any time you would like to discuss with us how our service to you could be improved or if you are dissatisfied with any aspect of our services, please raise the matter immediately with the partner responsible for that aspect of our services to you. If, for any reason, you would prefer to discuss these matters with someone other than that partner, please contact [] at []. In this way we are able to ensure that your concerns are dealt with carefully and promptly. We undertake to look into any complaint carefully and promptly and to do all we can to explain the position to you. This will not affect your right to complain to the Institute of Chartered Accountants in England and Wales.

Acknowledgement and acceptance

Please acknowledge your acceptance of the terms of our engagement under the Contract by signing the confirmation below and returning a copy of this letter and the attached Terms and Conditions to us at the above address, whereupon the Contract will take effect from the date of the commencement by us of the Services.

Once it has been agreed, this letter will remain effective, from one audit appointment to another, until it is replaced.

If you have any questions regarding this Contract, please do not hesitate to contact us.

Yours faithfully,

[Name of Auditor]

I have read the above letter and accept the terms and conditions set out therein.

(Name and position)
for and on behalf of [Name of Company]

(Date)

APPENDIX E

EXAMPLE WRITTEN NOTICE FROM THE INDEPENDENT ACCOUNTANTS TO THE REGULATOR FOR BI-PARTITE ENGAGEMENT ARRANGEMENTS (to be tailored for the particular circumstances of each engagement)

Private and Confidential

The Director General

[Name and address of Regulator]

For the attention of []

[Date]

[Name of Regulated Entity] (“the Company”)

Audit of the regulatory financial statements for the year ended [DATE]

Dear Sirs,

We refer to our engagement letter with the Company dated [DATE] (“the Contract”) relating to our audit of the Company’s regulatory financial statements for the year ended [DATE] (“the Regulatory Accounts”). A copy of the Contract is attached as Appendix 1 to this letter.

In the Contract we set out the basis on which we will act as auditors reporting on the Regulatory Accounts of the Company, together with the respective areas of responsibility of the directors of the Company and ourselves in respect of that audit and the scope of our audit. We also set out in the Contract the agreed extent of our liability to the Company in respect of our work. We confirm in the Contract that we will address our report on the Regulatory Accounts to the Company and, in order to meet the requirements of the Regulatory Licence, to you as well but we clarify that in our report we will deny liability in respect of our audit work and our report to any party other than the Company.

You have confirmed your interest in our audit of the Regulatory Accounts in your capacity as the Company’s Regulator and your interest in the scope of our engagement agreed with the Company. You have asked us to accept responsibility for our audit work and our report to you as well as to the Company so that there is no denial of responsibility to you in our report. This letter (“the Regulator’s Contract”) sets out the basis on which we are willing to accept such a responsibility, in return for your agreement to the terms of this letter including the following:

1. Our duties and responsibilities to you and your obligations to us will be those set out in the Contract as if incorporated into this letter. This sets out, amongst other things, terms relating to the disclosure of the Regulatory Accounts and other Regulatory Information covered by the Independent Accountants’ Report.
2. Our aggregate liability to you will be strictly limited to £[]¹³ in the event of any breach of our obligations to you under the Regulator’s Contract.
3. You do not wish to acquire rights against us in respect of use of the audit report for any purposes other than as the Company’s Regulator and accept the disclaimer of liability to any Third Party (being a person other than the Company or the Regulator) as set out in the Contract.
4. You accept that the nature and format of the Regulatory Accounts are determined by your requirements and that it will be for you to consider whether the information on which we report as auditors is suitable or appropriate for your needs and purposes.
5. You will not be bound by any amendment to the Contract, whether written, oral or arising from the Contract, which is not formally accepted by you in writing.

¹³ Independent Accountants will agree a figure by which their maximum aggregate liability to the Company and the Regulator is no greater than the amount which would have been payable by them to the Company under the Contract. For further guidance, see paragraph 11(ii).

Please acknowledge your acceptance of the terms and conditions of this letter by signing the confirmation below and returning a copy of it and the Contract to us at the above address.

Yours faithfully,

[Independent Accountants]

I have read the above letter and confirm acceptance of its terms and conditions on behalf of [NAME OF REGULATOR]

Signed _____

Name and position _____

[Cc: The Directors, [Name of Company]]

Enclosure: Copy of the Contract.

