



National Audit Office

SGN 05

Forming audit opinions – considerations for auditors of local authorities where there is limited or no assurance over the classification between usable and unusable reserves in local authority financial statements.

Issued on 15 December 2025

Supplementary Guidance Note (SGN) 05

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About Supplementary Guidance Notes

Supplementary Guidance Notes (SGNs) are prepared and published by the National Audit Office (NAO) on behalf of the Comptroller and Auditor General (C&AG) who has power to issue guidance to auditors under Schedule 6 paragraph 9 of the Local Audit and Accountability Act 2014 (the Act). SGNs are prepared and published when the C&AG wishes to address a particular issue. SGNs are part of the full suite of Auditor Guidance Notes (AGNs) which as such constitute guidance to which local auditors must have regard under Section 20(6) of the Act. The guidance in SGNs supports auditors in meeting their requirements under the Act and the [Code of Audit Practice](#) published by the NAO on behalf of the C&AG.

The NAO also issues Weekly Auditor Communications (WACs) to local auditors to bring to their attention relevant information to support them in carrying out audit work. The firms that are local auditors under the Act may use WACs to update their own internal communications and reference tools.

SGNs are numbered sequentially and published on the NAO's website. Any new or revised SGNs are brought to the attention of local auditors through the WACs.

The NAO prepares Supplementary Guidance Notes (SGNs) solely to provide guidance to local auditors in interpreting the Code of Audit Practice made under the Local Audit and Accountability Act 2014. The contents of SGNs cannot be reproduced, copied or re-published by parties other than local auditors without permission from the NAO.

The SGNs are designed to assist local auditors in forming their own understanding of the requirements of the Code. Auditors are required to have regard to SGNs, which means that they must take into account the guidance issued by the NAO, and, if they decide not to follow it, they must give clear (in the sense of objective, proper, and legitimate) reasons within audit documentation as to why they have not followed the guidance. SGNs are in no way intended as a substitute for the exercise of the independent professional skill and judgement of a local auditor in deciding how to apply the NAO's guidance or when providing explanations as to why guidance has not been followed.



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Local auditors should not assume that SGNs are comprehensive or that they will provide a definitive answer in every case.

This Supplementary Guidance Note is relevant to all local auditors of local authorities covered by the Local Audit and Accountability Act 2014 and the [Code of Audit Practice](#) (the Code). It is not relevant to auditors of NHS foundation trusts or auditors of smaller authorities. Guidance on auditors' considerations when exercising additional powers is published in AGN 04 and reporting is published in AGN 07.

Introduction and context

This SGN has been issued to provide additional guidance to support external auditors when considering the impact of limited or no assurance on the classification between usable and unusable reserves in local authority financial statements. The issue arises after the implementation by the government of the reset and recovery program for local authority financial reporting. This SGN is consistent with International Standards on Auditing (ISAs) and should be read alongside previous statutory guidance issued by the C&AG and the LARRIGs (particularly LARRIG 6 on risk assessment) issued in conjunction with the FRC.

The C&AG's intention in issuing this guidance is to set out his preferred approach to help inform the judgement of local auditors in addressing similar issues in different local authorities on a consistent basis.

The potential for further guidance has been kept under review by the C&AG, informed by the NAO's discussions with audit firms.

Auditors should note that throughout this SGN, references to 'authority' and 'body' should be read as referring to any relevant authority subject to the requirement to comply with statutory deadlines for the publication of audited financial statements ('backstop dates').



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Section 1: Considerations for auditors in forming audit opinions where there is little or no assurance over the classification between usable and unusable reserves in local authority financial statements

Status of guidance

1. This guidance is issued and published by the Comptroller and Auditor General (C&AG) using his powers under s19 and Schedule 6 paragraph 9 of the Local Audit and Accountability Act 2014 and in the view of the NAO is compliant with the ISAs.
2. During the reset and recovery period regulators (the FRC and ICAEW) have confirmed that routine inspections of local authority audits would cease subject to there being no public interest case to do so. The Government has been working on a new system of quality oversight specifically tailored to the circumstances created by the rebuilding of assurance after the implementation of the statutory deadlines for the publication of audited accounts (the reset). On 2nd December the [Government issued a Written Ministerial Statement](#) highlighting that *“it remains in the public interest that disclaimed opinions are cleared as quickly as possible. Effective local audit ensures transparency and accountability for public money spent on vital services. I am committed to working with all those in the system to do everything in our power to get back on track and ensure that assurance is rebuilt within the five-year period.”*
3. Since LARRIGs 01-05 were published, two backstop dates have passed: 13 December 2024 for all years up to 2022-23 and 28 February 2025 for 2023-24. PSAA Ltd.’s latest published monitoring data¹ shows that some 216 2023-24 audit opinions were disclaimed due to the backstop. This data also forecasts a similar number of backstop driven disclaimers for 2024-25.

¹ [Presentation](#)



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4. This SGN is intended to contribute towards the main objective set out in the LARRIGs, which is supporting auditors to deliver as much assurance as possible as quickly as practicable. Given the position of the FRC there will not be any further LARRIGs nor will they be opining on this issue in terms of Firms' compliance with the ISAs in respect of this guidance.

Guidance development and scope

5. Auditors are continuing to work through the consequences of the absence of assurance caused by prior year disclaimers. Among the issues discussed in the NAO's Local Government Technical Network has been the impact upon audit opinions where there is no or little assurance over the classification of reserves between usable and unusable. These reserves are shown on the face of the balance sheet and supported by individual notes to the accounts.
6. Local authority reserves are divided into usable and unusable categories, reflecting their intended purpose and restrictions. Usable reserves consist of funds that authorities can deploy to support service delivery, manage financial risks, or finance future expenditure, such as the general fund, earmarked reserves, dedicated schools grant, and capital receipts. In contrast, unusable reserves arise from accounting adjustments and cannot be spent; these include revaluation reserves and pension reserves, which capture unrealized gains or losses and other movements required for financial reporting. Only usable reserves are available to support a local authority's operational and strategic objectives.
7. This SGN provides guidance to auditors on considerations that they should have regard to when considering this issue and forming their audit opinions. While it applies with immediate effect from its issue date, firms will be at different stages depending on the nature of their own approaches and their portfolios therefore firms are only expected to consider this guidance where assurance has been obtained over the top half of the balance sheet.



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Matters for auditors to consider

8. The Code of Audit Practice requires auditors to comply with International Standards on Auditing (UK) (ISAs (UK)). ISA 700 deals with forming an audit opinion and reporting on financial statements. ISA 705 deals with modifications to the opinion in the independent auditor's report. This standard sets out two scenarios for disclaimed opinions. These are:
 - The auditor shall disclaim an opinion when the auditor is unable to obtain sufficient appropriate audit evidence on which to base the opinion, and the auditor concludes that the possible effects on the financial statements of undetected misstatements, if any, could be both material and pervasive. (ISA 705 Para 9).
 - The auditor shall disclaim an opinion when, in extremely rare circumstances involving multiple uncertainties, the auditor concludes that, notwithstanding having obtained sufficient appropriate audit evidence regarding each of the individual uncertainties, it is not possible to form an opinion on the financial statements due to the potential interaction of the uncertainties and their possible cumulative effect on the financial statements. (ISA 705 Para 10).
9. The circumstances considered in this SGN relate to the first scenario. In particular, how auditors might go about considering whether the absence of assurance over the classification between and within usable and unusable reserves in and of itself is pervasive. This is clearly a matter for auditor judgement. Auditors could consider several factors in reaching this judgement and these are set out in more detail below.

Assessment of pervasiveness in the context of usable and unusable reserves

10. ISA 705 (para 5) sets out the definition of pervasiveness for the purposes of the standard. This is repeated below for completeness:

- Pervasive effects on the financial statements are those that, in the auditor's judgment:
 - Are not confined to specific elements, accounts or items of the financial statements;
 - If so confined, represent or could represent a substantial proportion of the financial statements; and/or
 - in relation to disclosures, are fundamental to users' understanding of the financial statements.

11. Auditors must apply their own judgement to determine what they consider is fundamental. In our view, this is something that the auditor considers is so fundamental for users that its omission would not achieve the purposes of the financial statements if it was not taken account of.

12. The absence of assurance for auditors over the classification may be driven by several factors including what balances and transactions the auditor has been able to obtain sufficient appropriate audit evidence over as part of the current year audit. The nature of the issues in any individual engagement will help the auditor in considering whether the effects are pervasive, particularly as these may have been identified and considered already in the auditor's risk assessment. If, for example, there are other significant areas in addition to the reserve classification where assurance has not been obtained, auditors would be more likely to conclude that a disclaimer would be appropriate as the lack of assurance may be more likely to be pervasive.

13. Auditors should consider whether an absence of assurance over the classification between usable and unusable reserves on the face of the balance sheet affects



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more than the balance sheet or affects a substantial proportion of the financial statements. For example:

- How many years' opinions have been disclaimed and/or how many of those years' assurance has been rebuilt over reserves and the nature of the movements recorded in the financial statements in the disclaimed years. This also informs the risk assessment by reducing the risk of material misstatement in the rebuilding assurance process. If, for example, 2022/23 was disclaimed solely due to the backstop, and since then the auditor has been rebuilding assurance over the 'top half' of the balance sheet this is less likely to represent a substantial proportion of the financial statements. It follows, therefore, that the extent to which the lack of assurance might be considered to represent a substantial proportion of the financial statements will likely increase for audits where there are more years of disclaimers and less rebuilding work over reserves has taken place.
- Having sufficient assurance over the classification of transactions between and within the General Fund and the Dedicated Schools Grant and Housing Revenue Account where relevant and over capital expenditure, which could affect both usable and unusable reserves. Where this assurance has been obtained, this is less likely to represent a substantial proportion of the financial statements and vice versa.
- In terms of other disclosure notes on the reserves which form part of the wider financial statements, any incorrect information in relation to these disclosures is unlikely to be fundamental to the users of the accounts as characterised in paragraph 15 of this SGN.

14. While it remains a matter for auditor judgement, in cases where all or most of the above considerations are met (where the auditor has sufficient assurance on the top half of the balance sheet and the classification of reserves is the only issue), it is open to the auditor to consider whether a modified opinion under ISA 705 (para 5) which drew attention to the specific areas where assurance was absent would be more appropriate.

15. Auditors should also consider whether a user's understanding of the financial position of a given local authority is materially impacted by the absence of assurance over the classification between usable and unusable reserves. ISA (UK) 320 requires that materiality is determined based upon what users are most



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likely to be interested in, and in local authority audits materiality is commonly set on expenditure and not the level of reserves.

16. Furthermore, guidance over rebuilding assurance set out in LARRIG 05 and 06, while highlighting the potential impact of a material misstatement of reserves does not specifically prescribe that auditors must include a significant risk of material mis-statement on reserves when considering build-back procedures – ultimately build back procedures are based on the auditor’s judgement driven by their risk assessment.
17. For the purposes of this consideration auditors should use councillors and local residents as the primary users of the local authority’s accounts. This approach has been determined as being appropriate by the CIPFA Better Reporting Group². Factors for auditors to consider in relation to each group are set out below.
18. Local councillors understanding of their local authority’s financial positions is not solely informed by the audited financial statements. Councillors have multiple sources of information and assurance. The quality of a local authority’s arrangements over financial sustainability, governance and approach to improving economy, efficiency and effectiveness are explicitly reported on by the local auditor under the Code of Audit Practice. Many local authorities produce monthly management accounts that provide the primary route for councillors to understand the financial performance of the local authority. The annual budget setting process – which necessarily takes place well ahead of the conclusion of the audit – includes processes that provide assurance to councillors including the report of the section 151 officer made under section 25 of the Local Government Act 2003. This report must address the adequacy of the calculations to support the budget setting process alongside assurance on the consequent level of financial reserves. The potential impact of the number of unaudited years and the complexity of the accounts will be significant factors in the auditor’s risk assessment especially where the body places reliance on audited figures to inform its budget setting process. In addition, section 151 officers have responsibilities under section 114 of the Local Government Finance Act 1988 to report to councillors where a council is unable to maintain a balanced budget.
19. Local residents similarly have access to the work of the local auditor when they use their public reporting powers to draw attention to significant weaknesses in arrangements to secure value for money or on other matters relating to the

² [Better Reporting Group](#)



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governance of a local authority. The issuing of section 114 notices is reported widely in local authority areas affected by them. Proceedings of local authorities are also now widely available via the internet so that any interested person could also see the reports to councillors described above.

20. This is consistent with LARRIG 05, which notes in paragraph 17: *“In particular, users of audited local authority financial statements have a strong interest in the general fund reserve balance, given its significance for setting council tax.”*

Auditors may therefore wish to consider whether a limitation of scope modification (qualified except for) which drew attention to the specific reserves where such assurance was absent would be more informative for councillors and local residents and therefore more appropriate given the scope and purposes of public audit.

Summary and conclusion

21. Each local authority audit is different, and this will be reflected both in auditors’ risk assessments and in the factors that auditors will consider relevant to forming their opinion on the financial statements. This is obviously also the case for auditors’ evaluation of the impact of any absence of assurance over the classification between usable and unusable reserves.
22. In determining the appropriate audit opinion in these particular circumstances (whilst not forgetting that there will be wider considerations regarding assurance when considering the opinion) auditors will need to evaluate carefully whether a complete or partial absence of assurance in relation to this classification meets the definition of being both material and pervasive, including whether any wider disclosures lacking assurance are fundamental to users’ understanding of the financial statements. From a public policy perspective, there may be a strong case for auditors in the public sector using a modified opinion (“qualified except for”) (ISA 705 (para 5)) in these circumstances even if this is subject to a longer list of ‘except for’ items than might be appropriate in a different setting.

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Section 2: Other support and raising technical issues or queries on this SGN

23. Auditors in firms should raise queries within the firm, in the first instance, so that the relevant technical support service can consider whether to refer queries to the NAO's Local Audit Code and Guidance (LACG) team by e-mailing LACG.queries@nao.org.uk.
24. Information supporting auditors is available on the LACG extranet. This includes details of third-party reports and information. Copies of referenced third party information and service auditor reports will also be available on the LACG extranet following issue. Updates will be communicated through the Weekly Auditor Communication (WAC). If there is a need for further statutory guidance during the year, the NAO may issue an addendum to this SGN.
25. The NAO also engages with the firms through its Local Auditors' Advisory Group (LAAG) and supporting technical networks to consider any emerging regime-wide technical issues on a timely basis. Auditors should follow their in-house arrangements for bringing significant emerging issues to the attention of their supplier's representative on LAAG or the relevant technical network.