



**Proposal to revise Practice Note 15: The audit of occupational
pension schemes in the United Kingdom**

RESPONSE FROM ICAS TO
THE FINANCIAL REPORTING COUNCIL

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Background

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Almost two thirds of our working membership work in business; many leading some of the UK's and the world's great companies. The others work in accountancy practices ranging from the Big Four in the City to the small practitioner in rural areas of the country.

We currently have around 3,000 students striving to become the next generation of CAs under the tutelage of our expert staff and members. We regulate our members and their firms. We represent our members on a wide range of issues in accountancy, finance and business and seek to influence policy in the UK and globally, always acting in the public interest.

ICAS was created by Royal Charter in 1854.

General comments

The ICAS Pensions Panel welcomes the opportunity to respond to the FRC's proposal to revise Practice Note 15: The audit of pensions schemes in the United Kingdom.

We have reservations about the usefulness of the draft Practice Note to pension scheme auditors. It is not a one stop shop, and rightly so. However, we believe that the material in the Practice Note is not sufficient to support auditors with a small portfolio of pension scheme audits and it is also unlikely to enhance the audit work of firms with specialist teams of pension auditors.

Another key area of concern is the guidance for pension scheme auditors on the application of ISA (UK) 570 on going concern. Conceptually, the going concern assumption is a poor fit for pension scheme accounts which are stewardship accounts primarily intended to record and report on scheme investments, with the trustees having a fiduciary duty towards the beneficiaries of the scheme.

We are concerned that proposals in the Practice Note could lead to auditors issuing qualified "except for" audit opinions routinely to comply with paragraph 18-1 of ISA (UK) 570.

The Pensions SORP does not expect pension scheme accounts to include, in the accounting policies note, a statement that the accounts have been prepared on a going concern basis. Therefore, the Practice Note should, as a minimum, align with the recommendations of Pensions SORP which directs pension trustees to make statements of fact.

We understand it is not the intention of the FRC to issue guidance which could result in "except for" audit opinions being issued as a matter of routine and therefore we recommend that the material in the draft Practice Note on going concern is reconsidered to avoid any unintended consequences.

We have responded to each of the consultation questions and in our response to question 2, we provide detailed comments on aspects of the draft Practice Note.

Any enquiries should be addressed to Christine Scott, Head of Charities and Pensions, at cscott@icas.com

Comments on consultation questions

Question 1

Overall do you agree with the proposed revisions to the Practice Note? If not, please explain why?

Response

We understand the desire to reduce the length of the Practice Note and to include references to third party sources as this can avoid building in obsolescence. However, we are not convinced that the draft Practice Note will be of value to specialist pension scheme auditors and may not provide sufficient tailored guidance to firms with a small portfolio of audit clients.

The consultation paper states that:

“Auditors who do not consider and apply the guidance included in a relevant Practice Note should be prepared to explain how the engagement standards have been complied with.”

..... the expectation being that all pension scheme audits are conducted in accordance with the Practice Note. Therefore, it is self-evident that time and resources will be spent by pension scheme auditors to ensure that audit programmes are updated to reflect the guidance. This will be the case even if the firm, or an audit team within a firm, concludes that their existing audit programmes are sufficient to comply with the ISAs (UK). With this in mind we would urge the FRC to amend the content of the Practice Note to ensure that it adds value to the audit work undertaken on pension schemes.

Our detailed comments on individual sections of the draft Practice Note are set out in question 2 and are intended to enhance the value of the Practice Note.

Question 2

Is the included guidance appropriate? If you believe it should be amended please explain why and how.

Response

We have the following detailed comments on aspects of the Practice Note:

Occupational pension schemes - key characteristics

- Paragraph 44 on the annual report refers to the inclusion of a “trustees’ summary statement of contributions”. We are not aware of the preparation of a summary statement of contributions being a legal requirement and understand that its preparation may be being driven by guidance in the extant Practice Note 15. Therefore, we would welcome confirmation in the Practice Note as to the source of the requirement for a “trustees’ summary of contributions”.
- Paragraph 44 on the annual report. The bullet point on the auditor’s statement about contributions payable to the scheme should be revised to highlight that this requirement no longer applies to multi-employer schemes with at least 20 participating employers.
- Paragraph 55 on reporting on contributions. This paragraph refers to a statement being required “unless the scheme had more than 20 participating employers at the start of the scheme year.” However, the wording in the Audited Accounts Regulations refers to a scheme which has “at least 20 participating employers”. Therefore, we believe the Practice Note should be amended to refer to 20 or more participating employers.

We would welcome guidance for auditors on what happens when a scheme moves from having 20 or more participating employers to less than 20 participating employers and the requirement to produce a statement on contributions kicks in. The Practice Note should make it clear whose responsibility it is to ensure that a statement is made when it is legally required to be made. We assume that the onus is on the trustees in the first instance and the auditor needs guidance on how to plan for this eventuality.

- Paragraph 57 on earmarked schemes. There is confusion around the definition of an earmarked scheme which the Practice Note could help to clarify.

The following definition of an “earmarked scheme” is included in The Occupational Pension Schemes (Requirement to obtain Audited Accounts and a Statement from the Auditor) Regulations 1996:

“An occupational pension scheme under which all the benefits are money purchase benefits and all the benefits are secured by one or more policies of insurance or annuity contracts and such policies or contracts are specifically allocated to the provision of benefits for individual members or any other person who has a right to benefits under the scheme...”

This definition is not necessarily applied consistently and is often met by policies within an occupational pension trust entity rather than the policies themselves constituting the whole of the scheme.

We would welcome clarification in the Practice Note of how the definition of an “earmarked scheme” should be applied in practice. Alternatively, recognition of the uncertainty around the definition and the different practices and legal interpretations that exist would be helpful to pension scheme auditors.

- Paragraph 59 on audit exemptions. Clarification is required about the basis of an auditor’s appointment where no appointment is required under the Pensions Act 1995. Where an auditor is appointed to report on a scheme’s financial statements, other than by statute, it would be helpful if the Practice Note could set out more clearly any other duties the auditor may or may not have. The paragraph refers to a scheme in this position not having to prepare a payment schedule but no reference is made as to whether a scheme would also be exempt from preparing a statement of contributions and therefore there being no requirement of an auditor’s report on that statement.

ISA (UK) 210: Agreeing the terms of audit engagements

- Paragraph 72 and paragraph 81 on the appointment of the scheme auditor may be contradictory. It may be helpful to cover the statutory and non-statutory appointments in entirely separate paragraphs to provide clarity i.e. not to refer to non-statutory appointments in paragraph 72.
- Paragraph 89 on resignation or removal of the auditor. The paragraph states that the statement of no circumstances on resignation as auditor is often included in the annual report. The disclosure of material in the annual report about the resignation of advisers including auditors is set out in regulation.

In relation to disclosure within the annual report, the Occupational and Personal Pension Schemes (Disclosure of Information) Regulations 2013, Schedule 3, paragraph 31 states that the following should be included:

“A copy of any statement made on the resignation or removal of the auditor or actuary and made in accordance with regulations made under section 47(6) of the 1995 Act (professional advisors).”

Section 47(6) of the Pensions Act 1995 further refers to requirements being set out in regulation. The relevant regulations are the Occupational Pension Schemes (Scheme Administration) Regulations 1996.

Regulation 5(4) states that:

“The notice of resignation referred to in paragraph (3) shall, in the case of the auditor or actuary, contain either—

- (a) a statement by the auditor or actuary specifying any circumstances connected with the resignation which, in his opinion, significantly affect the interests of the members or prospective members of, or beneficiaries under, the scheme; or
- (b) a declaration by the auditor or actuary that he knows of no such circumstances as are referred to in sub-paragraph (a).”

The key phrase in the 2013 Regulations is ‘a copy of any statement made on the resignation or removal of an auditor or actuary’. The 1996 Regulations refer to ‘a statement ...specifying any circumstances’ and ‘a declaration of no circumstances’.

It therefore appears that the annual report should include a statement of circumstances with no requirement to include a declaration of no circumstances.

Therefore, for the purposes of the guidance in the Practice Note, we recommend that the FRC clarifies the legal requirements and updates paragraph 89 to refer to what and when the annual report must disclose information about the resignation of auditors (and actuaries).

- Page 17 on the resignation or removal of the auditor. The material on the resignation of the auditor does not provide any guidance on what an auditor should do if their appointment lapses, for example, if the scheme winds up or transfers to the PPF. It is important for an auditor to establish when their appointment ceases in the context of their statutory duty to report to The Pensions Regulator (TPR). We would welcome guidance in the Practice Note on this point.

ISA (UK) 240: The auditor’s responsibilities relating to fraud in an audit of financial statements

- Paragraph 99 on pension scams relating to DB to DC transfers. We would welcome the inclusion of material in this section of the Practice Note on the risk of fraud perpetrated by cyber criminals.

ISA (UK) 250: Section B – The auditor’s statutory right and duty to report to regulators of PIES and regulators of other entities in the financial sector

- This is an area auditors find challenging as The Pensions Regulator TPR has not provided any guidance on matters it considers to be of material significance. Code of Practice 01 is now ten years old and would benefit from revision in light of experience. We understand that the FRC can only work with the material TPR has published but this does limit the usefulness of this section of the Practice Note.

ISA (UK) 265: Communicating deficiencies in internal control to those charged with governance and management

- Paragraph 146 on considering the aggregate impact of control deficiencies. We found this paragraph to be confusing. The previous paragraph deals with the reporting of individual deficiencies with paragraph 146 dealing with the aggregate impact. However, it’s not clear whether “aggregate impact” is referring to the auditor reporting in aggregate on a combined assessment of individual internal control deficiencies or an assessment of the aggregate of individual control deficiencies, other than those reported individually.
- Paragraph 146 also refers to reporting to TPR and we are not sure why this is sitting alongside material on the aggregate impact of control deficiencies. It would make more sense to deal with any issues in respect of reporting to TPR within the section on ISA (UK) 250: Section B, which is currently silent on the topic of reporting concerns about internal control deficiencies to the regulator.

ISA (UK) 320: Materiality in planning and performing an audit

- Paragraph 170 on the auditor’s statement on contributions. In our experience, a different level of materiality for the purposes of the auditor’s statement on contributions is appropriate. Therefore, we recommend that the FRC considers creating a rebuttable presumption that materiality will be different to that of the scheme, unless there is justification for it being the same.

ISA (UK) 540: Auditing accounting estimates, including fair value accounting estimates and related disclosures

- Paragraph 196 on estimation uncertainty relating to fair value accounting. We are not convinced that this paragraph is sufficiently tailored to the audit of pension schemes to be of value to a pension scheme auditor. Also, we are not clear who it is being suggested may undertake the sensitivity analysis being referred to. Auditing of fair value estimates is covered extensively in ISA (UK) 540 and the application material (see below) refers to management rather than the auditor undertaking sensitivity analysis. Therefore, sensitivity analysis undertaken on behalf of the pension trustees would seem to form the basis of audit evidence rather than an analysis undertaken by the auditor.

The comments are made with reference to the following application material from ISA (UK) (540)

“Estimation Uncertainty (Ref: Para. 8(c)(vi))

A38. Matters that the auditor may consider in obtaining an understanding of whether and, if so, how management has assessed the effect of estimation uncertainty include, for example:

- Whether and, if so, how management has considered alternative assumptions or outcomes by, for example, performing a sensitivity analysis to determine the effect of changes in the assumptions on an accounting estimate.
- How management determines the accounting estimate when analysis indicates a number of outcome scenarios.
- Whether management monitors the outcome of accounting estimates made in the prior period, and whether management has appropriately responded to the outcome of that monitoring procedure.”
- Paragraphs 203 and 204 on pooled investment vehicles. The classification of pooled investment vehicles is an issue for pension schemes and the auditor should be checking if the classification of pooled investment vehicles is in accordance with the accounting framework. The draft Practice Note does not address this aspect of the audit of pooled investment vehicles.
- Paragraphs 205 and 206 on specialist pension investments. Following the implementation of FRS 102, the Pensions SORP now requires annuity policies to be recognised as scheme assets in the Statement of Net Assets. In our experience checking the completeness of annuity policies is a challenge for auditors. However, there is no guidance in the draft Practice Note on what auditors should do to test completeness: the draft is more focussed on assessing the work of an expert. Also, there will be situations where auditors will have to adopt alternative audit procedures to gain assurance on the rights and obligations of annuity policies where the original policy document cannot be located and in some cases, may never have been issued formally for very old policies.

The IAASB is consulting on proposed changes to ISA 540 and as no changes have been adopted, we have based our comments on extant ISA (UK) 540.

ISA (UK) 570: Going concern

Paragraph 217 states that ‘The going concern basis is used in the preparation of financial statements unless a decision has been made to wind up the scheme.....’

Conceptually, the going concern assumption is a poor fit for pension scheme accounts which are stewardship accounts primarily intended to record and report on scheme investments, with the trustees having a fiduciary duty towards the beneficiaries of the scheme. Pension scheme accounts do not record the liability to pay pensions or recognise a debtor to reflect an employer’s agreed deficit recovery plan liabilities.

The Pensions SORP (section 3.29) states “...that the going concern concept does not play the same fundamental role in the measurement and classification of assets and liabilities in pension scheme financial statements as it does in the financial statements of commercial entities.” This sentence could easily be extended to refer to not-for-profit entities providing services to the public or to beneficiaries. In hindsight, the Pensions SORP should perhaps have been more explicit about how pension trustees should address the requirement of FRS 102 to “assess the entity’s ability to continue as a going concern.”

With this in mind, the guidance in the Practice Note should, as a minimum, align with the Pensions SORP as drafted and this could mean addressing elements of ISA (UK) 570 in a different way. In particular, the following material in the Pensions SORP should be considered:

- Pensions SORP, paragraph 3.29.5 which states “Accordingly, the basis of preparation of the financial statements does not need to refer to the going concern concept unless the trustees or employer have taken a formal decision to wind up the scheme or there has been a cessation event.”

The Pensions SORP is directing the trustees to make statements of fact only (and not statements of judgement), reflecting that trustees will not assess going concern in the manner described in FRS 102 and are also unlikely to identify and report on a material uncertainty in the manner envisaged in FRS 102 or ISA (UK) 570.

Applying ISA (UK) 570 in the manner described in the Practice Note, could lead pension scheme auditors to have to consider the financial viability of the sponsoring employer or for the trustees to do so. We believe neither of these options are appropriate and this could lead to auditors issuing qualified “except for” audit opinions routinely to comply with paragraph 18-1 of ISA (UK) 570:

“18-1. If the period to which those charged with governance have paid particular attention in assessing going concern is less than one year from the date of approval of the financial statements, and those charged with governance have not disclosed that fact, the auditor shall do so within the auditor’s report (4b).

4b. If the non-disclosure of the fact in the financial statements is a departure from the requirements of the applicable financial reporting framework, the auditor would give a qualified opinion (“except for”).”

We understand it is not the intention of the FRC to issue guidance which could result in “except for” audit opinions being issued as a matter of routine and therefore we recommend that the material in draft Practice Note on going concern is reconsidered to avoid any unintended consequences.

The FRC has not developed illustrative auditor’s reports for pension schemes. However, in view of the difficulties pension scheme auditors may experience in relation to going concern, we believe that the FRC has a responsibility to develop illustrative auditor’s report examples based on ISA (UK) 570 and the guidance in the Practice Note. In developing such examples, the FRC can determine whether the guidance in the Practice Note is fit for purpose.

ISA (UK) 720: The auditor’s responsibilities relating to other information

- Paragraph 249 on ‘other information’. We do not believe it is necessary to list the other information as the Pensions SORP (FRS 102) sets out the other information which accompanies the accounts.

The auditor’s statement about contributions

- Paragraph 259 on payment schedules. In the first sentence amend “secure” to “ensure”.
- Paragraph 275 on materiality. We do not agree that auditors should not consider qualitative factors when assessing whether to qualify a statement about contributions.

Question 3

Has any extant guidance been deleted that you believe should be retained? If yes, please explain why it should be retained and whether, and if so how, it should be updated.

Response

We agree in principle that the Practice Note should cover those ISAs where there are pension scheme specific matters for the auditor to consider. Also, we are aware that there has been a change in approach and that cross-references to guidance and to aspects of the law are included throughout the Practice Note. However, an appendix or appendices listing key pieces of TPR guidance and pensions law and regulation would be a useful reference even if less detail is provided than in the extant Practice Note.

Question 4

Are there any other matters in relation to the audit of occupational pension schemes that you believe should be covered in the Practice Note and, if so, what do you believe the guidance should address?

Response

There are several issues which we do not believe are adequately covered some of which would be of value to audit firms with smaller portfolios of pension scheme clients. We mention some areas where we believe additional guidance is required in our response to question 2. In addition:

- Non-compliance with data protection rules is a potential risk to pension schemes and trustees do need to plan to ensure that their scheme will be compliant with the EU’s General Data Protection Regulation (GDPR) when it comes into force in May 2018. Member data may be held and processed by third parties and, along with increased fines for data breaches, we believe it is worth referring to the GDPR in paragraph 107, in relation to ISA (UK) 250: Section A, as an example of a regulation where instances of non-compliance may have a material impact on scheme financial statements.

Master trusts are an important part of the pension provision landscape now that many employers are using these to meet their auto-enrolment duties. The Practice Note has very little to say about master trusts: it would be helpful if the sections on individual ISAs highlighted any considerations for auditors in relation to the audit of mastertrusts.