Financial Reporting Council

November 2017

Feedback Statement and Impact Assessment

The Revision of Practice Note 15: The Audit of Occupational Pension Schemes in the United Kingdom

The Financial Reporting Council (FRC) is responsible for promoting transparency and integrity in business. The FRC sets the UK Corporate Governance and Stewardship Codes and UK standards for accounting and actuarial work; monitors and takes action to promote the quality of corporate reporting; and operates independent enforcement arrangements for accountants and actuaries. As the Competent Authority for audit in the UK the FRC sets auditing and ethical standards and monitors and enforces audit quality.

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FEEDBACK STATEMENT AND IMPACT ASSESSMENT

The revision of Practice Note 15: *The Audit of Occupational Pension Schemes in the United Kingdom*

Introduction

The FRC is committed to acting as a proportionate and principles-based regulator, and balances the need to minimise the impact of regulatory requirements on business, while working to support the delivery of high-quality audit and assurance work, to maintain investor and wider stakeholder confidence in audit.

In April 2017 we proposed the revision of Practice Note 15: *The Audit of Occupational Pension Schemes in the United Kingdom* (PN 15) to reflect:

- Revisions to UK auditing standards (ISAs (UK));
- Changes to UK accounting standards (FRS 102) and the revision of the pension SORP;
- Continuing developments in regulatory codes and guidance issued by The Pensions Regulator (TPR);
- Changes in relevant legislation; and
- The increase in master trusts in the pension sector.

The revised PN 15 was developed with the assistance of an expert working group, including representation from audit firms, the pensions industry, and the Pensions Regulator (TPR). Some members of the working group are members of the Pension Research Accountants Group (PRAG), an independent research and discussion group for the development and exchange of ideas in the pension field and which developed the pension SORP. The guiding principles followed in reviewing and updating the guidance included:

- Updating the guidance to address the drivers for revision identified above;
- Taking out material that is a repeat of what is in the relevant ISA (UK) itself;
- Taking out material that an auditor would be able to find elsewhere, including in Regulations, TPR Codes and accounting standards or the pension SORP (in most cases replacing with a cross reference).

The consultation period closed on 30 June 2017.

Responses to the Consultation

We received 13 responses - 10 from audit firms, two from professional bodies and one from PRAG. In line with the FRC's commitment to transparency, these responses are published on our website[1]. The FRC, with the assistance of the expert working group, has considered the responses and determined actions that should be taken in finalising the revision of PN 15.

[1] https://www.frc.org.uk/consultation-list/2017/consultation-and-impact-assessment-proposal-to-re

Summary of responses to the questions posed in the consultation

Q1 Overall do you agree with the proposed revisions to the Practice Note? If not please explain why.

Overall there was support for the FRC's objectives in revising the guidance. However, certain respondents identified some matters for which they would like guidance that has been deleted to be reinstated, and some other matters where more guidance would be helpful. These are covered in relation to questions 2 to 4 below.

Practice Notes are intended to assist auditors in applying the ISAs (UK) and should be read in conjunction with the ISAs (UK). They are not intended to be "how to" manuals for an audit. Some suggestions for more guidance related to matters that are outside the scope of PN 15 (e.g. because they are not considerations relating to the audit of a pension scheme's financial statements or the auditor's statement about contributions; or because they require interpretation and/or clarification of the responsibilities of trustees). While the FRC will not address these matters in the PN it will consider whether they should be drawn to the attention of other bodies who may respond to them.

Q2 Is the included guidance appropriate? If you believe it should be amended please explain why and how.

Three respondents (two firms and one professional body) stated that the guidance was appropriate. Three firms answered that the guidance was appropriate but identified some areas where they believed it could be further improved. Four respondents (three firms and one professional body) answered just by identifying areas where they believed the guidance could be improved. The remaining three respondents answered explicitly that they did not think the guidance was appropriate and indicted the areas where they believed it needed to be changed or added to.

Many of the respondents gave helpful editorial suggestions and identified points of detail specific to particular sections. Particular issues identified by respondents (but in no cases a majority) included:

- Reviewing the definitions of master trusts and earmarked schemes.
- More guidance in general for master trusts and earmarked schemes (including the impact of auto-enrolment and reporting on contributions in the auditor's statement about contributions).
- More specific guidance on materiality in relation to the auditor's statement about contributions.
- The updated guidance on ISA (UK) 570, which more strongly emphasises that the requirements do apply to pension schemes, including the need to consider the going concern status of the scheme.
- The responsibilities of auditors who are appointed voluntarily where the law does not require a statutory auditor.

FRC response

Editorial suggestions were welcomed, particularly those that aid clarity, and have been reflected where considered appropriate.

Master trusts

The Pensions Act 2017 (PA 2017) was issued in April 2017 and is focused on master trusts as defined in that Act. It provides for an authorisation and supervision regime for master trusts to be introduced, so that master trusts would have to demonstrate to TPR that they meet certain key criteria on establishment, and then continue to do so. The FRC will monitor the subsidiary regulations that will be made under PA 2017 and consider whether there are consequences for the audit of master trusts that should be addressed in FRC guidance. The definition of a master trust scheme has been included in PN 15 (paragraph 8).

Auto-enrolment has been in place since 2008 (prior to the previous revision of PN 15). The FRC believes that the guidance in PN 15 for the audit of financial statements and the auditor's statement about contributions is appropriate for master trusts and auto-enrolment. The responses did not identify specific significant new issues to be addressed. Issues, if any, which may arise for the audit of employers, for example with regard to auto-enrolment, are not within scope.

Earmarked schemes

The definition of an earmarked scheme (in paragraph 57 of the PN) reflects the definition in legislation and is consistent with the definition given by TPR. Some respondents believe the definition is poor and not always consistently applied. However, it is not within the remit of the FRC to amend the definition or to provide a legal interpretation. Responsibility for determining whether a scheme is an earmarked scheme and, for example, is therefore only required by law to appoint an auditor to report about contributions and not on the financial statements, rests with the trustees - we have amended the guidance in the PN to clarify this is a responsibility of the trustees. One respondent asked for clarity on what specific information TPR would want to know about earmarked schemes - we have made TPR aware of that.

Materiality - auditor's statement about contributions

Guidance on materiality in relation to the auditor's statement about contributions is given in paragraphs 273 - 278 of the PN. The FRC believes that guidance to be appropriate. It identifies that materiality, for example in relation to breaches of the schedule in relation to the timing and/or amount of contributions, is a professional judgment and identifies some matters that may be taken into account. It would not be appropriate to give more specific guidance that could be interpreted as establishing 'rules' and contrary to the exercise of professional judgment. The guidance has been amended to be clearer that a matter that may be judged to represent a material breach of the schedule of contributions or payment schedule, and thereby a qualified auditor's statement about contributions, will not necessarily be a "matter of material significance" for separate reporting to TPR (paragraph 278).

Going concern

There was general concern about the updated guidance on ISA (UK) 570, *Going Concern*, including that it reflects an approach that certain respondents considered may not be relevant for pension schemes. In part this is because the nature of many pension schemes, which exclude long-term obligations to meet pension commitments, is such that even if the going concern basis of accounting were not to be used there may not be any impact on the valuation of scheme investments. Some respondents are concerned by the requirements in ISAs (UK) 570 and 700 to include a specific section in the auditor's report setting out whether the auditor has anything to report in respect of the use of the going concern basis of accounting in the preparation of the financial statements, or 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. There was a suggestion that this may result in routine qualifications where trustees have not paid particular attention to assessing going concern for a period of at least one year from the date of approval of the financial statements.

In updating the guidance in this area for the exposure draft, the FRC was mindful of the new auditor reporting requirements and understood that some concern may arise from the clarification that they do apply to audits of pension schemes. However, the FRC does not believe that these are unduly onerous for pension schemes or that they should result in "routinely" qualified opinions. As noted in the PN (paragraph 216), the pension SORP identifies that FRS 102 requires:

- When preparing financial statements, the management of an entity using the FRS shall make an assessment of the entity's ability to continue as a going concern … <u>In assessing whether the going concern basis of accounting is appropriate, management takes into account all available information about the future, which is at least, but is not limited to, twelve months from the date when the financial statements are authorised for issue</u>; [underlined text now added in finalising the PN] and
- When management is aware, in making its assessment, of material uncertainties related to events or conditions that cast significant doubt upon the entity's ability to continue as a going concern, the entity shall disclose those uncertainties.

Having regard to the nature of pension schemes, the pension SORP states that 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. This has now been included in the PN (paragraph 215). However, the FRC does not believe that this should be taken to provide an exemption from the requirements of FRS 102 that are highlighted - in particular, trustees should still assess the going concern status of the scheme, taking in to account "all available information about the future, which is at least, but is not limited to, twelve months from the date when the financial statements are authorised for issue".

The FRC recognises that a proportionate approach should be taken to assessing going concern and the guidance in the PN, which is consistent with the extant guidance, specifically identifies that "In making their assessment of the scheme's ability to continue as a going concern, the trustees of a defined benefit scheme do not necessarily need to prepare and review forecast financial information in order to confirm that their scheme will be able to meet promised benefits in full as they fall due" (paragraph 218).

Voluntary audits

The exposure draft identified that, where there is no statutory requirement for a scheme auditor to be appointed, the trustees may nevertheless appoint an auditor, and that this appointment should follow the same process as when an auditor is required by law. Some respondents asked for clarification of this.

As noted in the extant PN 15, a non-statutory auditor falls within the definition of the term ‘‘professional adviser’’ used in the Occupational Pension Schemes (Scheme Administration) Regulations, so the provisions relating to the appointment and removal of the scheme auditor, which reflect those applicable to ‘professional advisers’, apply to the appointment of a non-statutory auditor. This has now been clarified in the revised PN (paragraph 81). It is also clarified that for a voluntary audit, the auditor will be a professional adviser rather than a statutory “scheme auditor”.

The duty to report matters of material significance to TPR applies to all ‘professional advisers’, which is clearly stated in the relevant section of the PN (paragraph 323).

Q3 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.

Seven respondents (five firms, one professional body and PRAG) believe that PN 15 should give an example audit report.

Three respondents (two firms and one professional body) believe that a full example statement of trustees’ responsibilities should be given rather than just extracts.

Three respondents (two firms and PRAG) suggested that it would be helpful to include more examples of matters that might be covered by written representations from the trustees.

One respondent (professional body) suggested it would be helpful to include an appendix that listed key pieces of TPR guidance and pension law.

FRC Response

Example auditor’s report

The FRC does not believe it is necessary to provide example auditor’s reports for all types of audited entity, including pension schemes. The requirements for the content of the auditor’s report are clearly set out in ISA (UK) 700. Some illustrative auditor’s reports which show how that content can be presented are set out in the Bulletin: *Compendium of illustrative auditor’s reports on United Kingdom private sector financial statements for periods commencing on or after 17 June 2016,* which an auditor can refer to and adapt. This is a policy which is being applied in all revised PNs.

Statement of trustees’ responsibilities

The FRC has reinstated a full example of a trustees’ responsibility statement (Appendix 4).

Example representations

The examples in the extant PN 15 that have been excluded from the revised PN 15 are mostly not specific to pension schemes. There is also a risk that a detailed list may be seen incorrectly as comprehensive and used as a checklist. Accordingly, the FRC has not reinstated those examples. It has been made clear that the auditor may identify other issues for which they wish to obtain written representations from management.

Summary of TPR guidance and pension law

The FRC does not believe it is appropriate to include an appendix to provide a comprehensive list of TPR guidance and pension law, which may become outdated in a relatively short period of time. Particular TPR guidance and pension law are referred to within the PN where relevant.

Q4 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?

As noted above, some respondents (4 firms, one professional body and PRAG) - asked for more guidance in general for master trusts, including the impact of auto-enrolment and reporting on contributions in the auditor's statement about contributions.

Certain respondents, individually, asked for more guidance in particular areas, including:

- the timing of reports to TPR;
- risk assessment under the section on (ISA (UK) 300 (although acknowledging this matter is covered in the section on ISA (UK) 315);
- audit work on annuity policies;
- auditing various types of investment;
- audited financial statements that are obtained for purposes other than the annual report;
- the governance statement signed by the Chair for DC arrangements;
- data protection rules.

FRC Response

Master trusts

See above re: question 2.

Other areas of guidance

These suggestions did not represent general widely held concerns. Having considered them individually, the FRC does not believe that significant new guidance should be added in respect of them.

The Pensions Act 2004 requires written reports to TPR to be made "as soon as practicable" and this is noted in paragraph 297. Additional guidance has been added in paragraph 310 to explain that TPR Code of Practice 01 indicates that once TPR is aware of a particular breach, it does not regard that breach as being of material significance for the purpose of another reporter making further reports under the requirement to report breaches of the law. An exception is where another reporter has additional or different information about that breach or the circumstances relating to it.

The Chair's statement explaining how the scheme meets the governance requirements is a new development since PN 15 was last revised. The section on ISA (UK) 720 identifies that the statement is "other information" which may accompany the financial statements of a pension scheme and one of the considerations for the auditor is whether it is consistent with the auditor's knowledge of the scheme (paragraph 248).

Data protection legislation is a developing area. The guidance for ISA (UK) 250 Section A has been updated to include the penalty regime for breaches of data protection laws and regulations as one of the matters that may have a material effect on the financial statements (paragraph 106).

Other matters

Reporting to TPR

In the extant PN 15 and the exposure draft, guidance on the duty to report to TPR was included in a section on ISA (UK) 250 Section B. Strictly that ISA (UK) only applies to the duty to report to regulators of public interest entities (PIEs) and regulators of other entities in the financial sector. While pension schemes may be considered generally to be of public interest they are not PIEs as defined for the purpose of law and ISAs (UK). Accordingly, the guidance in this area has now been moved to a separate section in the PN under the heading 'Reporting Matters of Material Significance to The Pensions Regulator'.

Auditor's statement about contributions

As suggested by certain respondents, the structure of the illustrative auditor's statement about contributions has been amended to present the opinion first, consistent with the structure of the auditor's report on the financial statements.

Impact Assessment

A Practice Note provides guidance to support best practice. Although a Practice Note is not prescriptive, the FRC's Statement on the Scope and Authority of Audit and Assurance Pronouncements states that auditors should be aware of and consider Practice Notes applicable to the engagement. 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 FRC has completed an impact assessment for the revised PN 15 and has not identified any additional costs resulting from the revised guidance included.

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Respondents to the Consultation:

Crowe Clarke Whitehill LLP
Deloitte LLP
Ernst & Young LLP
Institute of Chartered Accountants in England and Wales (ICAEW)
Institute of Chartered Accountants of Scotland (ICAS)
KPMG LLP
Kreston Reeves LLP
Mazars LLP
Moore Stephens LLP
Nexia Smith & Williamson
Pensions Research Accountants Group (PRAG)
PwC LLP
RSM UK Audit LLP

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