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By email to [AAT@frc.org.uk](mailto:AAT@frc.org.uk)

Dear Mr Billing

**Proposal to revise Practice Note 15: The Audit of Occupational Pension Schemes in the United Kingdom**

PricewaterhouseCoopers LLP acts as scheme auditors for approximately 700 occupational pension schemes in the United Kingdom, so we appreciate the opportunity to respond to the consultation and impact assessment named above.

**Question 1: Overall do you agree with the proposed revisions to the Practice Note?**

We agree with the proposal to update the Practice Note. Timely revision of Practice Note 15 (PN15) following the revisions to UK auditing standards is important in meeting PN15's objective in assisting auditors in applying the requirements of ISAs (UK).

We also fully support your guiding principles, namely to reduce repetition of ISA (UK) content and other standards and information, whilst updating for changes to UK accounting standards, regulatory codes of practice, legislation and other industry developments - as this results in a shorter and more focussed Practice Note.

**Questions 2 – 4:**

As a result of your detailed review and proposed revisions to the Practice Note, there have been a number of changes.

Our main observation is that, whilst the guidance on the Auditor's Statement about Contributions has been expanded and improved, it does not provide guidance on what should be included in the Auditor's Statement, only an illustrative example. We suggest that more detailed guidance is provided.

We have included our comments on the updated ISA (UK) guidance in Appendix A to this letter. Appendix B comments on other sections of the Practice Note.

Rather than taking these questions separately, we have set out all of our comments on the Practice Note exposure draft, in order, within the appendices, signposting by section or paragraph number for ease of reference. Our responses therefore cover appropriateness, deleted guidance and other matters for inclusion as requested by your three questions.

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**Contact for enquiries**

Please do not hesitate to contact Andy Lowe on 0207 213 5284 if you wish to discuss any aspects of our response.

Yours sincerely

*PricewaterhouseCoopers LLP*

PricewaterhouseCoopers LLP



## **Appendix A – Comments relating to ISA (UK) guidance:**

### **ISA (UK) 210: Agreeing the terms of Audit Engagement**

85: ISA (UK) 210.A20 recommends auditors consider reminding management that they remain responsible for the financial statements in the letter of engagement in cases where a third party prepares the financial statements. Paragraph 85 identifies third parties may hold the financial records in the context of auditor access, but not trustee responsibility when third parties prepare the financial statements. We suggest that it is expanded to highlight the ISA (UK) recommendation.

89: In our experience, it is rare to see a declaration of no circumstances from outgoing auditors in annual reports, so suggest 'is often' is replaced by 'may be'. To ensure that auditors are aware of potential breaches, add to the final sentence "and the scheme actuary within 14 days."

In line with earlier paragraphs regarding appointment, the section on resignation should confirm the deadline of 14 days in which the auditor is required to respond to a removal notice from the trustees with the statement of circumstances or no circumstances.

### **ISA (UK) 240: The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements**

98: Compared to the previous version of PN15, paragraph 93 no longer sets out types of fraud, so the last sentence of paragraph 98 should be updated.

99: The instruction to raise matters of 'pension scams' with the trustees could result in a 'tipping off' offence (as a result of actions then taken by the trustees) and oversight of other reporting obligations if the current guidance in this new paragraph is followed in isolation. If auditors become aware of possible scams, the guidance should identify the obligation to consider reporting to SOCA and the risk of tipping off, before considering reporting to TPR and finally the trustees, if appropriate. This could be achieved by cross reference to paragraph 109.

### **ISA (UK) 250: Section A – Consideration of Laws and Regulations in an Audit of Financial Statements**

105: As currently drafted, it could be interpreted that earmarked schemes would not benefit from the exemption identified in paragraph 104 and that only earmarked schemes, as the subject of paragraph 105, could have non-statutory requirements for audit within the trust deed and rules. Paragraphs 104 and 105 should be reworded to reflect the regulatory requirements more clearly.

### **ISA (UK) 250: Section B – The Auditor's Statutory Rights and Duty to Report to Regulators of Public Interest Entities and Regulators of Other Entities in the Financial Sector**

126: The nature of the breach is not relevant when considering if a duplicate report is necessary, so should be deleted from this paragraph. TPR Code of Practice 01 specifically states that a breach is not regarded as being of material significance once aware of that particular breach. The focus of paragraph 126 should be the completeness and accuracy of facts that have been reported to the regulator, when considering as auditors whether the report fully reflects their own concerns. Whilst this may require additional attention for a more serious breach, serious breaches may not require duplicate reporting and, conversely, breaches of a less serious nature may need reporting if the facts are incomplete in existing reports.

## **ISA (UK) 315: Identifying and Assessing the Risks of Material Misstatement Through Understanding the Entity and its Environment**

This section follows the structure of ISA (UK) 315, providing guidance on understanding the entity and its internal controls and using this understanding to assess risks, however the section on 'Schedules of contributions and payment schedules' does not appear to contribute to understanding or assessing likely risks.

- The relevant terminology (schedule of contribution vs payment schedule) has been covered in paragraph 55 already;
- The understanding of importance of contribution rates (and potentially multiple contribution rates relating to different accrual rates) should be clarified under 'Scheme nature' in paragraph 158(a) alongside definitions of pensionable earnings and types of benefits;
- The most likely risk of material misstatement at an assertion level would be due to a change in contribution rates, and should be covered in paragraph 165, as it would be changes in rates which would most likely lead to non-compliance with the relevant schedule; and
- There is no requirement for auditors separately to consider testing the adequacy of internal controls relating to contributions, so paragraph 164 is sufficient to highlight that the auditor should assess the adequacy of controls in addressing risks of material misstatement.

We therefore suggest that paragraph 162 is deleted, as all guidance is covered elsewhere.

## **ISA (UK) 320: Materiality in Planning and Performing an Audit**

In paragraph 170, a different level of materiality is likely to be appropriate. Having specified that the benchmark for materiality for the scheme auditor's statement about contributions should be normalised contributions required by the schedule, it is highly unlikely that materiality for the financial statement audit opinion will have been based on the same benchmark, given paragraph 167 suggests total contributions as one of a range of possible benchmarks.

The words 'receivable' and 'payable' should be deleted from paragraph 167 as terminology used by the SORP has been updated to reduce ambiguity in these account names, as they imply debtor and creditor balances. We assume that the practice note intends to refer to Fund Account income and expenditure and this should be clarified.

## **ISA (UK) 402: Audit Considerations Relating to an Entity Using a Service Organisation**

Paragraph 173 identifies that auditors should consider whether third parties are 'service organisations' as defined by ISA (UK) 402, but the term 'service provider' is then used in paragraphs 178 and 180. As 'service provider' is not defined, it is not clear if this is intended to refer to service organisations, third parties which are not service organisations, or all third parties. We recommend service organisations is used consistently, when appropriate, and 'service providers' only used if clearly defined as third parties other than service organisations.

It may also help to clarify that third parties may or may not provide services relevant to financial reporting and this should be considered on a case-by-case basis. A certain third party may have an internal controls report and often act as a service organisation, but provide a limited scope of services to certain schemes, meaning they are not part of the scheme's financial reporting.



185: Add '(where applicable)' as a statement may not be required.

### **ISA (UK) 520: Analytical Procedures**

191: Suggest 'However, disaggregation may be required when differing rates of contributions...' to assist auditors in understanding how the analytic may be applied effectively to meet the objective of the ISA (UK).

### **ISA (UK) 540: Auditing Accounting Estimates, Including Fair Value Accounting Estimates, and Related Disclosures**

196: It is not clear whether the final sentence is encouraging auditors to perform sensitivity analysis or reminding auditors that management may have performed sensitivity analysis over assumptions which need to be considered, and disclosed the assumptions as required by FRS102: 11.43. In our experience, we rarely see disclosures by schemes to demonstrate how estimation uncertainty may affect the fair value accounting estimate; and we believe this is consistent with SORP 3.13.5, as schemes typically do not hold material assets subject to high estimation uncertainty.

It should be clarified whether the Practice Note is recommending performing sensitivity analysis as part of a risk assessment to better understand the key assumptions impacting valuation and estimation uncertainty, or in the context of ISA (UK) 540.A92 – A95, to conclude on whether the estimate is materially misstated.

201 – 202: Practice Note 23 specifically states that insurance contracts are not in scope. Furthermore, of the investments noted in paragraph 195 of PN15, property is also not in scope for PN23 (as it is not a financial instrument).

The SORP aligns disclosure requirements for all investments (i.e. elevates the requirements for holdings such as property) to those required by financial instruments. Specific examples of guidance in PN23 impacting all investments, which may be overlooked if not dealing with pure financial instruments are:

- PN23 137-2 reminds teams to consider whether the overall counterparty risks have been considered
- PN23 138 onwards addresses presentation and disclosure risks

We suggest that a paragraph is added to remind auditors of these considerations, which can impact the valuation and disclosure of investments, including those investments which are not covered in PN23.

203 – 206: The balance of guidance provided in the Practice Note for PIVs, which are often relatively simple and specialist pension investments and other complex investments, is not consistent with the relative complexity of the asset types. We suggest paragraph 206 is expanded to remind auditors that PN23 (paragraphs 78 – 80) provides guidance on when to use work of experts in valuing financial instruments, the assessment of their competence and capabilities and the associated audit considerations when management use experts (paragraphs 133 – 135).

### **ISA (UK) 570: Going Concern**

216: In penultimate line "...not ~~to be~~ required to be audited..."

217: In light of the prescriptive guidance on the basis of preparation and the implication that the 12 month assessment required by the ISA (UK) may be more informal, it would be helpful to explicitly

clarify whether the requirement to include a section in the audit opinion titled Material Uncertainty Related to Going Concern, when the scheme is in a PPF assessment period of uncertain outcome still applies.

Auditors should also be reminded that an emphasis of matter should be considered in accordance with ISA (UK) 570.A27, so the helpful observation that there may be no significant impact on the financial statements, even if prepared on a basis other than going concern in the final sentence, is not misinterpreted to remove the consideration of whether to include an emphasis of matter.

220: The reference to 'the near future' should be clarified, as should the guidance on the implications of a shortfall. ISA (UK) 570.13 requires an assessment of 12 months, however a lack of liquid assets may only result in delays in benefit payments or less liquid assets being sold below fair value, but is unlikely to threaten going concern of a well-funded scheme or a scheme with a strong employer covenant.

### **ISA (UK) 620: Using the Work of an Auditor's Expert**

233: The reference to 'contribution schedule' appears erroneous and we believe should be corrected to 'Summary of Contributions' as there is no requirement for the payment schedule or schedule of contributions to accompany the audited financial statements as part of the trustees' annual report.

If the intention is to ensure that auditors check consistency of any Schedule (and certificate) that has been included, this should be added to examples in paragraph 249 as it fits exactly under the requirements of ISA (UK) 720.

To reduce duplication of ISA (UK) 720 requirements, this paragraph should be updated to focus only on considering contacting the scheme actuary if the auditor identifies an issue with consistency of other information (such as the report on actuarial liabilities, the actuary's certificate or the Schedule) where there may be merit in liaising with the scheme actuary.

### **The Auditor's Statement about Contributions (the Statement):**

274: ISA (UK) 320 guidance has identified that materiality should be considered by reference to normalised contributions, and not all contributions, giving clear guidance on the quantitative aspects of materiality in terms of amounts, but late payments (or underpayments that are corrected) require more complex consideration, taking into account the number of days as well as the amount to assess the overall effect of late payments on the scheme; we recognise that this requires professional judgement. However, guidance on what factors auditors should consider would help avoid differing interpretations of similar situations between practitioners. For example:

- Should the effect of late payments on the overall contributions required by the schedule take into account the benefits of early payments to the scheme, where they have occurred?
- Can deficit funding, potentially recognised early in prior periods and, therefore, not reflected in the summary of contributions mitigate late payment of other types of contributions such as normal contributions and do early payments have a 'shelf life' until a new recovery plan is agreed?
- Can contributions that are not required by the Schedule, undesignated surpluses and contribution buffers, be taken in lieu of payment until correction is made for an underpayment or late payment?

275: Auditors are instructed to take account of the facts and effects of an exception, but not the underlying reasons for the exception. Further guidance on how to quantify and treat the 'effects' would also be beneficial to avoid differing interpretations. Sometimes, circumstances or actions taken to remedy late payments or correct underpayments can result in no impact or an improved situation for the scheme. For example:

- a late contribution payment may be corrected with interest or compensation for market movements (particularly in the case of a DC scheme, where investment purchases can be calculated based on the unit prices the members should have transacted)
- DC investment purchases may not actually be delayed, as administrators may be able to invest funds in line with a standard monthly timetable, if they typically take some time between receipt of contributions and purchase of funds
- investment assets may decline in value or schemes may be compensated by the employer with a correction for inflation, assumed asset returns or actual asset returns.

If trustees take swift and/or thorough action to mitigate the effect on members or scheme funding, does this allow the auditor to conclude differently on identical facts? Should the auditor allow factors outside the trustees' control, such as market movements which reduce the effects, to be a factor in determining an opinion on a summary of contributions collected? We note reasons and surrounding circumstances can be considered when deciding whether to report to TPR, raising similar questions about whether certain surrounding circumstances outside the trustees' control should actually be a factor in deciding whether a breach is reportable.

Appendix 3 provides an illustrative example of an unmodified Auditor's Statement about Contributions and extracts to illustrate changes required when qualifying the Statement, together with basic instructions for adverse Statements. However, these are illustrative examples only, and the section titled 'The Auditor's Statement about Contributions (the Statement)' does not set out what the Statement should include, so it is not clear what the fundamental requirements are. This contrasts with ISA (UK) 700, which clearly sets out the requirements of all opinions, supplemented by the FRC's Compendium of Illustrative Auditor's Reports. Much has been done to expand, clarify and update the guidance in this section, which is welcomed. However, paragraph 254 makes it clear that 'the Statement' is not an audit opinion, but is intended to convey reasonable assurance. In this context PN15 is the only source of guidance to practitioners; so in the absence of an alternative opinion framework, needs to clearly convey what must be included in the Statement, as well as the existing guidance on what auditors need to do. We believe that this is a key area for consideration.

## Appendix B – Comments to enhance guidance sections:

### Introduction

4: Audits of occupational pension schemes may only be carried out by an auditor eligible for appointment as a statutory auditor under Part 42 of the Companies Act 2006 or other person approved by the Secretary of State for Work and Pensions

### Key characteristics

10: It would be helpful to expand the final sentence to explain that professional advisers follow a regulated appointment and resignation process and have statutory whistleblowing responsibilities.

13: In our experience Trustees of pension schemes often (rather than 'may') delegate aspects of administration.

Given the importance of the financial statements to Auditors, this paragraph (or section) should also clarify that the financial statements are generally prepared by the administrator (be that a third party or the employees of the sponsoring employer) but some schemes will rely on a Trustee with the appropriate knowledge to draft the financial statements. Alternatively, this could be clarified under ISA (UK) 210 in relation to the recommendations of ISA (UK) 210.A20.

15: Only considering User controls (as defined in ISA (UK) 402) is unlikely to fully address the requirements of the ISA, as in most cases the accounting records are maintained by a third party (including the employer) and the services and controls over them will form part of the Trustees' information systems as explained in ISA (UK) 402.3. Trustee controls over the service provider are therefore unlikely to fully address the requirements of ISA (UK) 315. To address this, we recommend adding "and relevant controls at the service organisation, if applicable" prior to "(refer to ISA (UK) 402....."

18: "Some but not all defined contribution schemes buy annuities from third parties in the name of members (rather than the Trustees) to avoid the need to value annuity policies held by the Trustee and uncertainty and the ongoing obligation to pay pension." This section appears to focus on the need for actuarial advice, but FRS102 and the SORP require annuity policies to be valued if held in the name of the Trustees, so would be unlikely to mitigate effectively this need for DC schemes.

22: In this paragraph, and a number of paragraphs throughout the whole document, 'accounts' has not been updated to 'financial statements' resulting in inconsistency. We recognise that certain references in legislation refer to accounts, which should remain.

28: Add "including the expected frequency for re-running a nomination process to fill vacancies." The current paragraph implies it is acceptable to continue with less than one third member nominated as long as they have gone through the process once.

32: Suggest "of material significance" to reduce the risk that this is misunderstood to be materiality. Alternatively, we suggest including a cross reference to paragraph 171 or expansion to clarify the further guidance in Code of Practice 01 which expands on what is of material significance.

44: The list of items generally included in an annual report specifies that the last two items are only relevant for DB schemes. Following this approach of stating when there are clear criteria for certain



items, the second bullet should be “For schemes with defined contribution arrangements, a statutory Chair’s governance statement in respect of those arrangements” and the fifth and sixth points combined (as they should only occur together) when there are fewer than 20 employers at the beginning of the period.

A key difference with most other entities is the lack of filing requirements for statutory financial statements (and annual reports) of pension schemes, however the Trustees may receive a request to submit a copy to HMRC. ‘Users’ of the accounts are, therefore, generally limited to the following: Trustees, professional advisers (particularly the Actuary when they require ‘relevant accounts’ for a valuation), HMRC, sponsoring employers and interested members.

55: Suggest **paid at least in accordance** and **paid in accordance** are emboldened to make this distinction more prominent, given the lengthening of the paragraph meaning it is now less clear.

57: Following the recent changes to the Audited Accounts Regulations, earmarked schemes that are exempt from having to obtain audited accounts may also find themselves exempt from having to prepare a summary of contributions and obtain an independent auditor’s statement about contributions payable to the scheme. The regulatory reporting responsibilities effectively fall away, as without a requirement to perform any testing, the auditor will not identify anything of material significance to report through work performed.

Explicit guidance on the role of scheme auditors in such scenarios is required, as it appears they would just be engaged to hold a role required by regulation and identify if the number of employers drops below 20.

58: The third bullet point should be deleted (and ‘either’ appended to the end of the second bullet point) as the sub bullet-points relate to schemes with fewer than 12 members, where all members are trustees of the scheme.

### **Liaison with the Scheme Actuary**

293(d): As noted under ISA (UK) 250: Section B, the assessment of whether a breach is of material significance to TPR also needs to take into account whether any report, already issued by the scheme actuary, addresses fully the auditor’s concerns. We recommend appending, “including understanding the content of any report to TPR already submitted by the scheme actuary.”