

Technical Factsheet 62

The Audit of Occupational Pension Schemes

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INTRODUCTION

- 1 This factsheet is designed to provide guidance on the audit of occupational pension schemes, combining existing guidance with recent changes.
- 2 The Pensions Act 1995 created a statutory authority responsible for the regulation of occupational pension schemes. The Occupational Pensions Regulatory Authority (OPRA) took over responsibility for regulating occupational pensions on 6 April 1997 from the Occupational Pensions Board (now disbanded). OPRA has extensive powers and is not only able to impose civil penalties but also able to instigate criminal proceedings against individual trustees and corporate bodies. This is because failure to comply with the requirements of the Pensions Act 1995 constitutes a civil or criminal offence.

REGULATORY FRAMEWORK

- 3 The Pensions Act 1995 sets out the regulatory framework for occupational pension schemes. The main features include:
 - **PROFESSIONAL ADVISERS** - all professional advisors (such as auditors, actuaries, fund managers etc) should be appointed by the trustees.
 - **MEMBER NOMINATED TRUSTEES** - scheme members have the right to nominate at least one-third of the trustees, with a minimum of two member nominated trustees (one if the scheme has less than 100 members).
 - **MINIMUM FUNDING REQUIREMENT (MFR)** - the Act introduced a minimum funding requirement for defined benefit schemes. The MFR regulations require actuarial valuations to be carried out normally every three years. It allows for a schedule of contributions to be drawn up covering the next five years. The actuary

will review the schedule of contributions annually to ensure that the scheme meets the MFR.

- **INVESTMENT PRINCIPLES** - with effect from 6 April 1997, section 35 of the Pensions Act 1995 requires trustees to prepare a written statement of investment principles.
- **SELF-INVESTMENT** - investment in the sponsoring company or any connected company, is restricted to 5% of the scheme's assets. Under Occupational Pension Schemes (Investments) Regulations 1996 SI 1996 No. 3127 it is a criminal offence to knowingly make an investment in breach of 5% limit.
- **REPORTING TO OPRA** - Section 48 of the Pensions Act 1995 sets out scheme auditors' and actuaries' reporting requirements to OPRA. This is discussed in more detail within the "Reporting requirements to OPRA" section in this factsheet.

TYPES OF PENSION SCHEME

- 4 Types of pension scheme:

DEFINED BENEFIT SCHEME

These schemes are sometimes known as final salary schemes. The benefit under the scheme is calculated by reference to the member's pensionable earnings, usually for a period ending on or before the normal pension date.

Because of the complexities of determining future obligations and required levels of funding these schemes require actuarial assessments.

DEFINED CONTRIBUTION SCHEME

Under these schemes, the pension payable is determined by the extent to which funds are available when the individual pension commences.

HYBRID AND MIXED BENEFIT SCHEMES

Hybrid and mixed benefit schemes represent a combination of both types of benefits.

INSURED SCHEMES

These are schemes where the long-term investment is an insurance policy. The trustees enter into a contract with a life assurance company to secure pension benefits for the members. Such schemes are primarily used by small employers.

EARMARKED SCHEMES

These are money purchase schemes under which all the benefits are secured by one or more insurance policies or annuity contracts. Under such schemes the policies and contracts are specifically allocated to the provision of benefits for individual members or any other person(s) who have the right to benefit under the scheme.

RELEVANT EARMARKED SCHEMES

These are money purchase schemes where:

- all the members are trustees
- all the decisions made by the trustees are unanimous, or unanimous if any of the trustees who are not members are disregarded
- all of the benefits are secured by one or more contract of insurance or annuity contracts specifically allocated to the provision of benefits to or in respect of individual members.

MANAGED FUNDS

Some schemes use pooled funds for the purposes of their investment. The arrangement generally consists of an investment contract that offers participation in one of more pooled funds. Such schemes are not insured schemes.

SELF-ADMINISTERED SCHEMES

Under such schemes, the trustees are responsible for managing the investments. Subject to any conditions within the trust deed and legislation, the trustees are free to invest in any form of investment. Investment management is usually handled by a third party investment manager or custodian. Other functions, such as scheme administration, can be handled in-house or by a third party administrator.

SMALL SELF-ADMINISTERED SCHEMES (SSASs)

A SSAS is a scheme generally with less than 12 members. Most SSASs are money purchase schemes and are less regulated than other schemes, especially where all the members are trustees and decisions require unanimity. Where this is the case the SSAS is exempt from appointing scheme auditors.

REQUIREMENTS FOR AN AUDIT

- 5 Section 47 of the Pensions Act 1995 requires the trustees of every occupational pension scheme to appoint auditors unless the scheme is exempted from appointing auditors. The auditor is required to give an opinion as to whether the financial statements:
- contain the information specified in the Schedule to the Occupational Pension Schemes (Requirement to obtain Audited Accounts and a Statement from the Auditor) Regulations 1996 made under the Pensions Act 1995
 - show a true and fair view of the financial transactions of the scheme during the scheme year and of the amount and disposition, at the end of the scheme year, of the assets and liabilities of the scheme, other than liabilities to pay pensions and benefits after the end of the scheme year.

6 Auditors are also required to state whether or not in their opinion contributions have been paid in accordance with the schedule of contributions or payments schedule.

7 Pension schemes that are able to exempt themselves from appointing auditors under SI 1996/1715 include:

- schemes that are unapproved
- unfunded schemes
- money purchase SSAs where all the members are trustees and all decisions are by unanimous agreement
- schemes with less than two members
- schemes providing only death benefits and which provide no accrued rights
- relevant ear-marked schemes that are money purchase schemes where all the benefits are secured by insurance or annuity contracts and where the benefits are specifically allocated to individual members
- schemes guaranteed by the Crown
- superannuation funds (schemes under section 615(6) ICTA 1988).

8 Earmarked schemes that are not relevant schemes are not required to obtain audited accounts but they still need to appoint auditors. This is because the trustees are still required to obtain an auditor's statement on whether the contributions have been made in accordance with the schedule of contributions.

Schedule of Contributions

9 The trustees of defined benefit schemes, to which the minimum funding requirements (MFR) apply, are required to prepare a schedule of contributions showing:

- the rates of contributions payable to the pension scheme by or on behalf of the employer and active members of the scheme
- the dates on which such contributions are paid.

10 The actuary's role is to certify the schedule of contributions, stating whether in his/her opinion the contributions payable are adequate to meet the MFR requirement.

11 The following schemes are exempt from the requirement to prepare a schedule of contributions:

- unfunded public sector pension schemes
- schemes that are guaranteed by the Government
- schemes that are neither approved nor relevant statutory schemes
- schemes with only one member
- schemes which only provide death benefits
- certain schemes that only provide lump-sum retirement benefits.

Payments Schedule

12 For money purchase pension schemes, the trustees are responsible for preparing a payments schedule for each scheme year. The schedule should show the following:

- the rates of contributions payable to the scheme by or on behalf of the employer and active members
- such other amounts payable to the scheme as may be prescribed
- the dates on or before which payments are to be made.

13 A small number of schemes do not need a schedule. These include:

- schemes that are neither approved nor relevant statutory schemes
- schemes with only one member
- schemes that provide death benefits only
- SSAs where all members are trustees and where each decision is by unanimous agreement
- relevant ear-marked schemes.

AUDITOR APPOINTMENT AND RESIGNATION PROCESS

Appointment

- 14 For an appointment to be effective, trustees must provide the scheme auditor with a written Notice of Appointment specifying:
- the date the appointment is due to take effect
 - to whom the auditors are to report to
 - from whom the auditors will take instructions from.
- 15 It is also good practice to state the date of the scheme year end, to facilitate the timely reporting to OPRA of late scheme financial statements.
- 16 For the appointment to be effective, auditors must acknowledge receipt of the Notice of Appointment within one month of its date. The appointment will not be effective unless and until this acknowledgement is sent by the auditors within the one month period.
- 17 As part of their letter of acknowledgement, the auditors are also required to state that they will advise the trustees as soon as they become aware of any conflicts of interest to which they are subject to in relation to the pension scheme.
- 18 An example Notice of Appointment and acknowledgement letter is included in the Auditing Practices Board Bulletin 2000/2: Supplementary Guidance for Auditors of Occupational Pension Schemes in the United Kingdom.
- 19 Once the appointment is effective, the auditors should agree the terms of their engagement with the trustees. The engagement letter should detail the

respective responsibilities of the trustees and auditors and define the scope of the audit to be carried out. Appendix 5 of Practice Note 15, The Audit of Occupational Pension Schemes, provides more guidance on engagement letters.

Resignation and Removal of Auditors

- 20 On the resignation, removal or death of an auditor, the trustees are required to appoint new auditors within three months. OPRA has indicated that, where the trustees have failed to appoint new auditors within the time limit, or where there was no previous auditor appointed under the Pensions Act 1995 and the scheme is not a new one, it regards such matters as being of material significance to it. Hence, on acceptance of the appointment, the auditors are obliged to note the breach and report it to OPRA.
- 21 Scheme auditors are required to give a written notice of resignation containing either:
- a statement specifying any circumstances connected with their resignation which, in their opinion, significantly affect the interests of the members or prospective members of, or beneficiaries under, the scheme.
- 22 The annual report must also include a copy of any statement made on resignation or removal in accordance with section 47(6) of the Pensions Act 1995; or
- a declaration of no circumstances (if this is the case, a copy of the declaration need not be included in the annual report).

AUDITING STANDARDS

23 Auditors of pension schemes must apply statements of auditing standards (SASs) when carrying out a pension scheme audit.

24 Auditors should be aware of their responsibilities under whistleblowing, especially as failure to report can result in penalties, ranging from a fine to disqualification from acting as auditor to any pension scheme. The duty and right to report breaches to OPRA is discussed later on in the factsheet.

25 The remainder of this section outlines some of the key features of auditing standards as applicable to pension schemes.

SAS 110: Fraud and error

26 The responsibility for the prevention and detection of fraud and error rests with the trustees. Auditors should plan and perform their work so as to give a reasonable expectation of detecting misstatements arising from fraud and error which are material to the financial statements.

27 When assessing the risk of fraud and error, the following persons should be considered:

- trustees
- members
- delegated third parties such as investment manager and scheme administrator
- sponsoring employer
- professional advisers such as actuary, investment adviser or lawyer.

28 Examples of fraud within pension schemes include:

- misappropriation of assets
- non-payment of contributions by employer

- borrowing by employer - either directly or use of assets as collateral for borrowing
- buying or selling of assets by trustees without the required mandate or authority.

29 Where fraud or error is discovered, the auditors should report their findings to the appropriate level of management, usually the trustees. In some cases, the auditors may be required to report the matter directly to OPRA without delay or without informing the trustees in advance i.e. if it is a public interest issue.

SAS 120: Consideration of law and regulations

30 Auditors should perform specific procedures to ensure that the pension scheme is in compliance with the laws and regulations applicable to it. This will require the scheme auditor to have sufficient knowledge of the pension scheme trust deed and rules, the regulatory framework (Pension Scheme Act 1993, Pensions Act 1995 and related regulations) and the SORP. In addition, the auditor should consider other laws and regulations that are central to the pension scheme's ability to conduct business, e.g. Inland Revenue requirements, tax status and money laundering.

SAS 130: Going concern

31 The going concern concept does not play the same fundamental role in the accounts of pension schemes as other financial statements. This is because auditors are not required to report on the long-term liabilities of a pension scheme. However, auditors should take note of the requirements of SAS 160: Other information in documents containing

audited financial statements. This requires auditors to read the other information and if as a result they become aware of any apparent misstatements or material inconsistencies with the audited financial statements, they should seek to resolve them.

SAS 140: Engagement letters

- 32 SAS 140 requires the auditor to agree the terms of their engagement with the trustees of the scheme. The letter should also cover access to third parties to whom the trustees may have delegated particular functions and the statutory duty to report to OPRA.

SAS 160: Other information in documents containing audited financial statements

- 33 Auditors should review information contained in the other documents to ensure that there are no material inconsistencies. Such other information includes:

- trustees report
- actuarial statement and certificate
- investment report
- compliance statement.

SAS 200: Planning, controlling and recording

- 34 Auditors should identify the areas that are key to the operation of the pension scheme. The key areas are likely to include:

- contributions receivable
- investment income
- benefits payable
- investment assets.

- 35 The auditor will need to consider the information available and access to it, i.e. to information held by third parties such as administrators or investment managers.

SAS 210: Knowledge of the business

- 36 Auditors must have an adequate knowledge of the statutory and regulatory framework which govern pension schemes. This would include details of scheme rules and governance, sponsoring employer, scheme administration, investments and other advisers.

SAS 220: Materiality and the audit

- 37 Materiality plays the same sort of role in pension scheme accounts as for other accounts but the focus is different. There are often two overall criteria used, one is asset based and the second is income based; to recognise that the assets are normally considerably larger than the income.

SAS 300: Accounting and internal control systems, and audit risk assessment

- 38 The auditor should obtain a sufficient understanding of the accounting and internal control systems to plan the audit.

INHERENT RISK

- 39 Factors that may increase such risk could include:
- governance arrangements such as complex structures or major changes in the operation of the scheme
 - membership profile e.g. difficulties in establishing existence
 - delegation by trustees
 - involvement of sponsoring employer, especially if sole trustee
 - investment arrangements such as employer-related investment.

INTERNAL CONTROL

- 40 Auditors are required to assess the adequacy of the internal controls and report any weaknesses to the trustees. Key controls should exist over the following areas:

- contributions receivable
- benefits payable
- protection of scheme assets
- monitoring of custody arrangements.

ACCOUNTING RECORDS

- 41 Section 49 of the Pensions Act 1995 requires the trustees to maintain proper books and records. The Scheme Administration Regulations set out the nature of the books and records to be maintained. Auditors are not required to report a breach of these requirements in the audit report but they have a statutory duty to report such breaches to OPRA.

SAS 400: Audit evidence

- 42 A key issue in pension scheme audits is access to audit evidence controlled by the sponsoring employer or other third parties dealing with delegated activities. In such situations auditors will need to ensure that they obtain sufficient appropriate audit evidence. If the evidence cannot be obtained, this may affect their audit opinion.

SAS 410: Analytical procedures

- 43 Due to the nature of pension schemes such procedures are a useful source of audit evidence. Procedures commonly used include:
- comparison of actual income and expenditure to prior year and trends
 - comparison of actual expenditure with the estimates of the scheme auditor
 - comparison of published information on investment returns.

SAS 440: Management representations

- 44 Auditors must obtain key representations on items such as completeness of information in respect of compliance with law and regulations and related party transactions.

SAS 460: Related parties

- 45 This can present particular problems to auditors and where the risk is deemed high, auditors may need to undertake extensive substantive procedures to identify items that may not be highlighted.

SAS 480: Service organisations

- 46 The SAS requires auditors to consider the arrangements put in place by trustees to monitor outsourced activities and it requires auditors to assess whether the evidence they need is available.

SAS 520: Using the work of an expert

- 47 Auditors will need to liaise with the scheme's actuary when considering various statements and reports made by them. Auditors may also need to use other experts to provide audit evidence on:
- valuation of investments e.g. unquoted shares, works of art etc
 - legal opinions re trust deeds and rules.

SAS 620: The auditors' right and duty to report to regulators

- 48 The SAS provides guidance on the circumstances in which auditors of pension schemes are required to report directly to OPRA. This is in regard to information that comes to their attention in the course of their audit which is relevant to OPRA's functions, and which the auditors consider may be of material significance to OPRA.
- 49 Further guidance on applying SASs may be found in Practice Note 15.

REPORTING REQUIREMENTS TO OPRA

Duty to Report

50 Section 48(1) of the Pensions Act 1995 provides that auditors must report to OPRA where they have a reasonable cause to believe that:

- “any duty to the administration of the scheme imposed by any enactment or rule of law on the trustees or managers, the employer, any professional adviser or any prescribed person acting in connection with the scheme has not been or is not being complied with; and
- the failure to comply is likely to be of material significance in the exercise by the Authority of any of its functions.”

Breaches of the Pension Schemes Act 1993 and the Pensions Act 1995 which may Attract Criminal Sanctions

51 Pension Schemes Act 1993

- The provision, knowingly or recklessly, of false or misleading information to the Registrar, on a material point, by any person (Section 168A).

52 Pensions Act 1995

- A trustee of a scheme or any person connected or in association with a trustee acts as an actuary or an auditor of the scheme whilst ineligible to do so (Section 28).
- Purporting to be a trustee while suspended, prohibited or disqualified (Sections 6 and 30).
- The receipt by trustees, with their knowledge, of a reimbursement from scheme assets for any fine imposed as a result of criminal proceedings or an OPRA penalty (Section 31).
- An agreement by any trustee or manager to make an investment in breach of the prescribed restrictions on employer-related investments (Section 40).

- A failure by an employer to pay over amounts deducted in respect of employees' contributions to the scheme within the prescribed time limits where any such person is knowingly concerned in the fraudulent evasion of his obligations (Section 49.11).
- The neglect or refusal without reasonable excuse by trustees, managers, professional advisers, employers or any other person holding information of interest to OPRA to produce relevant documents when asked to do so by OPRA (Section 101(1)).
- The intentional delay or obstruction without reasonable excuse by any person of an OPRA inspector investigating whether statutory requirements have been complied with (Section 101(2)).
- The provision to OPRA of information, which is false or misleading on a material point, by a person knowingly or recklessly (Section 101(5)).
- The alteration, suppression, concealing or destruction of any document required by OPRA for an investigation, by a person intentionally and without reasonable excuse (Section 101(6)).
- The disclosure of restricted information without the consent by any person (Section 104).

53 Breaches which Became Civil rather than Criminal Offences as at 3 April 2000

- A failure by trustees, managers or administrators without reasonable excuse to provide prescribed information to the Registrar (Regulation 7 of the Register of Occupational and Personal Pension Schemes Regulations 1997, SI 1997/371).

- A failure by trustees or managers without reasonable excuse to obtain audited financial statements within seven months of the end of the scheme year (Regulation 2 of the Occupational Pension Schemes [Requirement to obtain Audited Accounts and a Statement from the Auditor] Regulations 1996, SI 1996/1975)(as amended).
- A failure by the employer, without reasonable excuse, to pay employees' contributions to the scheme within the prescribed time limits except in cases where there is fraudulent evasion (Section 49).

Reporting of Late Scheme Financial Statements

- 54 Although the failure by trustees to obtain audited financial statements within seven months of the end of the scheme year is now a civil rather than criminal offence, auditors should continue to report such breaches to OPRA.
- 55 Auditors will therefore need to put in place procedures to establish whether trustees have obtained audited financial statements within the seven month period and as soon as they become aware of any failure to do so they are required to report the matter to OPRA. Where the auditors are newly appointed, they must establish the year end date as part of their acceptance procedures. If they become aware of any late financial statements they should report the breach to OPRA as soon as the appointment is effective.

OPRA Note 6 – Right to Report

- 56 OPRA issued Note 6 (ON 6) entitled "Pensions Act 1995, The Right to Report Problems to OPRA" in February 2000. The

guidance has been issued for the use of pension scheme trustees, their professional advisers and others involved in the running of a pension scheme who may wish to exercise their right to report problems to OPRA under Section 48(4) of the Pensions Act.

- 57 The guidance is also applicable where a person is appointed as a "non-statutory" auditor. In such cases the auditor would normally be treated as a professional adviser under the Pensions Act 1995 and would have a right (but not a duty) to report. An example could be where the trust deed and scheme rules require audited financial statements but there is no requirement under law for the financial statements to be audited.
- 58 ON 6 states that reporting to OPRA on a voluntary basis does not breach normal duties of confidentiality, so long as the person has been properly appointed by the trustees and that there is reasonable cause to believe that a breach of the regulations has occurred which is likely to be of material significance.

CONCLUSION

- 59 The audit of pension schemes is a complex area. Members undertaking such assignments should ensure that they are fully aware of their obligations as auditors of such schemes.
- 60 They should also keep fully up to date with any future changes in this area, for example, there could be potential changes as a result of Paul Myners' report on the pension industry. One of the recommendations made is that the minimum funding requirement for pension

funds should be abolished, in favour of full disclosure of their solvency. The Chancellor of the Exchequer has said in his Budget Statement on 7 March 2001 that the Government was proposing to implement all of the recommendations of the Myners' report.

SOURCE MATERIAL

61 Sources of further information are detailed below.

OPRA website: www.opra.gov.uk

APB Bulletin 2000/2

The Auditing Practices Board Bulletin 2000/2: Supplementary Guidance for Auditors of Occupational Pension Schemes in the United Kingdom

Practice Note 15

The Audit of Occupational Pension Schemes in the United Kingdom

Pensions SORP

The Financial Statements of Pension Schemes (available from ABG Professional Information)

OPRA Note 1

Pensions Act 1995, Section 48: Reporting to Opra

OPRA Note 6

The Right to Report Problems to Opra