



Technical Release

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ACTUARIES' AND AUDITORS' INTER-PROFESSIONAL COMMUNICATION - PENSIONS AND OTHER POST RETIREMENT BENEFITS

Memorandum prepared by an Institute of Chartered Accountants in England and Wales (ICAEW) working party¹ containing guidance on inter-professional communication between the actuary and the auditor in the context of accounting requirements relating to retirement benefits in employer accounts and pension scheme financial statements.

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¹ The working party comprised representatives of the Faculty and Institute of Actuaries, and of the Pensions Committee of the ICAEW. The membership is listed in Appendix 2.

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PREFACE

1. The previous memorandum *Actuaries' and Auditors' Inter-professional Communication – Pensions* (TECH 45/03) was issued in 2003. It has been updated to reflect relevant provisions of the 2004 Pensions Act, changes to the requirements of Financial Reporting Standard 17 (FRS 17), *Accounting for Retirement Benefits*, IAS 19, *Employee Benefits*, IAS 26, *Accounting and Reporting by Retirement Benefit Plans*, Auditing Practices Board (APB) Practice Note (PN) 15: *The audit of occupational pension schemes in the United Kingdom (Revised)* and the implementation of International Standards on Auditing (ISAs) (UK and Ireland). The opportunity has also been taken to update the guidance in the light of professional experience in the intervening period. References to regulatory and other official material are current as at 31 December 2007.
2. **In accordance with applicable professional guidance, both actuaries and auditors should look to the management of the employer organisation or scheme trustees for information in the first instance. If, however, actuaries or auditors cannot obtain the information they need from the client without undue difficulty, they may be able to ask each other. This memorandum sets out the topics on which such communication might be useful, and explains the underlying considerations. It is important to bear in mind that the employer directors/scheme trustees are central to the communication process, both as the primary source of the information sought, and as the authority for direct communication between actuaries and auditors when either of the latter consider this to be necessary. All references in this memorandum to communications between actuaries and auditors are on the basis that they have been agreed in advance with the client and that supplementary communication between employer/scheme actuaries and auditors is appropriate only where the information sought by the communication cannot be obtained without undue difficulty from client staff or records.**
3. The accounting and disclosure requirements of IAS 19 and FRS 17 could have a material impact on the financial statements of the reporting entity so it is vital that the auditor is able to communicate freely with the actuary.
4. **The memorandum is not intended to be used as a checklist and it does not constitute an actuarial guidance note or an auditing standard. The material has been developed by a working party of representatives from the Faculty and Institute of Actuaries and the Institute of Chartered Accountants in England and Wales as an indication of what is reasonable for the members of one professional body to ask those of the other. It is designed as a practical tool for actuaries and auditors and, as such, it is not mandatory or intended as an indication of best practice. However, it does provide a mutually agreed starting point for communications between actuaries and auditors, which should benefit all parties, including clients. The main emphasis of this memorandum is on pensions, but the points noted will also be relevant in considering costs relating to other types of post retirement benefits such as healthcare.**

INTRODUCTION

5. Actuaries and auditors have key roles in relation to an employer's pension arrangements. The terms of their respective engagements, including arrangements for communications with the employer, the scheme trustees, and professional advisers to the employer and scheme trustees, will be set out in the actuary's and the auditor's terms of engagement. There are many areas where the work of one professional interacts with that of the other in relation to pension schemes themselves and the associated employer's pension costs and disclosures.
 6. The two main relationships between actuaries and auditors for the purposes of this memorandum are those between the employer actuary and the employer auditor and between the scheme actuary and the scheme auditor. The principles underlying communications between the professionals are generally the same, for example in both professional relationships the actuaries and auditors obtain permission from their mutual client before communicating directly with each other, and one element of the communication will concern the timetable for the work to be undertaken. Where different considerations arise from the different relationships, these are discussed in separate sections.
 7. The objective of this memorandum is to establish what is reasonable for members of one professional body to ask those of the other when performing engagements in accordance with applicable technical and ethical standards. In order to meet its key objective, the memorandum:
 - explains the respective roles and responsibilities of actuaries and auditors
 - identifies those areas where communication may be useful on matters relating to each professional's responsibilities
 - explains why inter-professional communication may be appropriate in certain circumstances
 - focuses on those matters that are most relevant to the application of professional standards in the context of the financial reporting of retirement benefits by employers or of pension schemes.
- The guidance is designed to focus communications between actuaries, auditors and the client in order to avoid superfluous or irrelevant information seeking that would lead to inefficiency and unnecessary costs. It is not necessary for actuaries and auditors to communicate with each other if the necessary information can be obtained from the employer or scheme trustees: the nature and extent of the communication should be tailored to the individual circumstances of each assignment.
8. It is not intended that there should be a routine exchange of written questions and answers. The information required may already be available in formal reports. Further information deemed relevant to each circumstance may well be exchanged orally, in meetings and informal discussions. As explained in the Preface, the starting point for relevant information should be the mutual client and it will normally be appropriate to keep the client informed of any communications between actuaries and auditors.
 9. References in this document to the client employing organisation are to the 'employer', unless the context requires specific reference to a type of entity, such as a company. References to 'directors' are to the persons charged with governance of the employer. References to 'scheme', in the context of employer financial reporting, are to any

retirement benefit arrangement required to be accounted for in accordance with International Accounting Standards, e.g. IAS 19 (or FRS 17 for entities preparing their financial statements under UK Financial Reporting Standards).

10. Where material relates to both employer and scheme, references are to ‘the client’.
11. A knowledge of the relevant legislative framework is assumed. The principal legislation and other material are listed in the bibliography in the Appendix. Section numbers relate to the Pensions Act 1995 unless otherwise stated. Statutory Instruments are referred to by year and number. The term “financial statements” is used to denote both pension scheme accounts and annual statutory accounts of the employer.

THE EMPLOYER FINANCIAL REPORTING FRAMEWORK

Pension aspects in relation to employer financial reporting

12. Employers that set up retirement benefit schemes, or that participate in an industry-wide multi-employer scheme, are required to account for pension scheme costs in their statutory financial statements. Although IAS 19 and FRS 17 deal with retirement benefits payable under both defined contribution schemes and defined benefit schemes, it is the requirements for valuation and disclosure arising from defined benefit schemes that normally give rise to the need for the involvement of an actuary in the process of preparing information for the employer’s financial statements. Accordingly, the material in this memorandum covering IAS 19/FRS 17 relates to defined benefit schemes.
13. Professional guidance has been issued by the Auditing Practices Board and Board for Actuarial Standards to auditors and actuaries respectively² on the practical implications of FRS 17 for the conduct of their work. The examples of points for consideration by employer actuaries and auditors in relation to their work on FRS 17 reporting requirements are based on the material in these two documents.
14. In summary, the requirements of FRS 17³ are for:
 - a. the scheme assets and liabilities to be measured using specified methods;
 - b. the surplus in a defined benefit scheme to be recognised as an asset by the employer to the extent that the employer can recover the surplus through reduced contributions and refunds. A deficit is recognised as a liability to the extent that the deficit reflects the employer’s legal or constructive obligation;
 - c. the change in the defined benefit asset or liability (other than that arising from contributions to the scheme) to be analysed into specified components and recognised in the profit and loss account or the statement of total recognised gains and losses (STRGL); and
 - d. certain additional disclosures to be made in the reporting entity’s financial

² APB PN 22: *The Auditors’ Consideration of FRS 17 ‘Retirement Benefits’ – Defined Benefit Schemes*. The Board for Actuarial Standards: Guidance Note 21, *Post-retirement medical plans* and Guidance Note 36, *Accounting for Retirement Benefits under Financial Reporting Standard 17*

³ FRS 17 was amended by the ASB in December 2006 to bring its measurement of quoted securities and its disclosure requirements into line with those of IAS 19. The changes are effective for accounting periods beginning on or after 6 April 2007, with early adoption encouraged.

statements.

15. Many employers are now accounting for retirement benefits in accordance with IAS 19 rather than or as well as FRS 17. The two standards are similar in many respects and the results can be the same. However, IAS 19 provides an option to defer the recognition of actuarial gains and losses (the so-called ‘corridor approach’) but this is not widely used in the UK.
16. IAS 19/FRS 17 requires the employer financial statements to include information about each significant scheme operated. If the employer has more than one scheme, disclosure may be given on a combined basis or in appropriate groupings of schemes.

Disclosures specific to companies: director and other key management pension arrangements

17. Details regarding employee pension costs and the provision of benefits to past directors, are required to be disclosed by companies legislation⁴. Certain pension funds are related parties of the reporting entity and so subject to the reporting requirements of IAS 24 (FRS 8), although FRS 8 grants an exemption from disclosure for emoluments in respect of services as an employee (which would include of directors’ pensions).
18. Companies legislation also requires detailed disclosures to be made by quoted companies in respect of directors’ pensions, including details of the increase during the year and the accumulated total amount in respect of the accrued benefit to which each director would be entitled, and the increase in the transfer value of the accrued benefit in the year.

Employer financial statements – the actuary’s role

19. The employer directors will usually appoint an actuary as part of the process to enable them to comply with IAS 19 /FRS 17. As explained in actuarial Guidance Notes 21 and 36⁵, the employer actuary will give advice on assumptions and assist the directors in their responsibility to prepare the accounting numbers and disclosures.
20. Other advice not covered by this protocol which may be requested includes, for example:
 - providing advice about any healthcare information
 - providing information required by companies legislation
 - furnishing other information required by UK, international and other accounting standards.
21. An employer actuary may provide the above advice to the employer in relation to a particular retirement benefit arrangement. Where the employer runs several retirement benefit arrangements, particularly if they operate in different jurisdictions, the actuary’s advice may be just a part of the entity’s total assessment of its retirement benefit commitments.

Employer financial statements – the auditor’s role

22. The employer’s auditor is required by law to express an opinion on the financial

⁴ Sections 411 and 412, Companies Act 2006

⁵ GN 36 refers only to FRS17.

statements as to whether they have been prepared in accordance with the relevant requirements. The auditor's role is therefore to obtain sufficient appropriate audit evidence on which to base the conclusion as to whether the information relating to retirement benefit arrangements in the financial statements is fairly stated. Central to forming the conclusion is the auditor's consideration of whether the assumptions underlying the actuarial valuation are appropriate and mutually compatible with future cash flows relating to the liabilities. As part of the evidence gathering process, the auditor may, therefore, wish to communicate with the employer's actuary. **Because of the confidentiality duty that both auditors and actuaries owe to their client, the client's permission is obtained before communicating with each other** (this may be provided for in the engagement terms agreed by actuaries and auditors with their client, rather than needing an ad hoc request in the course of the assignment).

23. The auditor reviews the figures, disclosures and other information within the financial statements as part of the process of forming an opinion on whether the information meets statutory and professional requirements and whether the financial statements, as a whole, give a true and fair view.
24. The true and fair view is itself underpinned by the concept of materiality. In accordance with ISA (UK and Ireland) 320, the auditor is required to consider materiality and its relationship with audit risk when conducting an audit. The ISA explains that "Information is material if its omission or misstatement could influence the economic decisions of users taken on the basis of the financial statements. Materiality depends on the size of the item or error judged in the particular circumstances of its omission or misstatement. Thus, materiality provides a threshold or cut-off point rather than being a primary qualitative characteristic which information must have if it is to be useful". The Public Sector Perspective paragraph at the end of ISA 320 is also useful: "In assessing materiality, the public sector auditor must, in addition to exercising professional judgment, consider any legislation or regulation which may impact that assessment. In the public sector, materiality is also based on the 'context and nature' of an item and includes, for example, sensitivity as well as value. Sensitivity covers a variety of matters such as compliance with authorities, legislative concern or public interest".

THE PENSION SCHEME FINANCIAL REPORTING FRAMEWORK

Roles of the actuary and the auditor

25. Legislation links the duties and responsibilities of the actuary and the auditor quite closely:
 - s47 requires the trustees of most occupational pension schemes to appoint an auditor (the scheme auditor) and, other than defined contribution schemes, to appoint an actuary (the scheme actuary)
 - the statutory roles of the scheme actuary and the scheme auditor are also set out in legislation. Statements from the scheme actuary and the scheme auditor are required to be included in the scheme's annual report although they have fundamentally different objectives.
 - it is the duty of trustees to disclose to the professional advisers such information and explanations as they may reasonably require which may include information from the employer and its auditor (SI 1996 No.1715)

- both the scheme actuary and the scheme auditor as well as others involved with the administration of occupational pension schemes have a duty to report breaches to the Pensions Regulator (the Regulator) in certain circumstances.
26. Under regulations and actuarial professional guidance, Guidance Note 9 the actuary will seek audited accounts for actuarial valuation purposes⁶: if the actuarial calculations are not based on audited accounts, GN9 requires the actuary to comment on this fact in the report.
27. The scheme actuary and the scheme auditor may both undertake work for the trustees other than their statutory duties either in connection with the scheme's annual report and financial statements or in connection with other aspects of the scheme.

Pension schemes – the scheme actuary's role

28. The scheme actuary's main responsibility is to provide forward-looking information about the liabilities and likely ability of the scheme to meet the benefit promises.
29. Under the Pensions Act 2004, the scheme actuary's duties in relation to scheme financial statements and certification include:
- preparing an actuarial valuation of assets and liabilities in accordance with s.224(2)(a) and the associated certificate in accordance with s.225;
 - preparing an actuarial report in accordance with s.224(2)(b);
 - preparing a valuation under s.224(1)(b) where the technical provisions basis has been set by the Pensions Regulator;
 - preparing the valuation to enable risk-based pension protection levies to be calculated in accordance with s.179;
 - certifying the schedule of contributions in accordance with s.227;
 - preparing the valuation of a closed scheme in accordance with s.156;
 - in accordance with s.230(1), advising the trustees or managers of a scheme before they:
 - make any decision as to the methods and assumptions to be used in calculating the scheme's technical provisions (s.222(4));
 - prepare or revise the statement of funding principles (s.223);
 - prepare or revise a recovery plan(s.226);
 - prepare or revise the schedule of contributions (s. 227)
 - modify the scheme as regards the future accrual of benefits under s.229(2).

The foregoing provisions of the Pensions Act 2004 came into force on 30 December 2005. The following italicised bullet points set out the duties of actuaries in relation to scheme financial statements and certification for schemes that continue to be subject to the regime of the Pensions Act 1995 until they have their first valuation under the scheme specific funding regime:

- *certifying the schedule of contributions for the MFR and periodically certifying the continued adequacy of rates (s.58)*
- *certifying proposed modifications to the scheme (s.67)*

⁶ GN9: [*Funding Defined Benefits - Presentation of Actuarial Advice*](#); GN 27: *Retirement Benefit Schemes - Minimum Funding Requirement*; Occupational Pension Schemes (Minimum Funding Requirement and Actuarial Valuations) Regulations 1996 (SI 1996/1536)

- *advising the trustees on discontinuance or winding-up (s.73 and s.75) and on GN19 certificates*
- *determining whether the benefits provided satisfy the statutory requirements for contracting-out (s.12B Pensions Scheme Act 1993 (PSA))*
- *certifying a basis for transfer values in and out (s.97 PSA) or divorce valuations.*

Pension schemes – the scheme auditor’s role

30. The objective of the financial statements generally is to provide information about the financial position, performance and financial adaptability of the reporting enterprise. In the context of pension scheme accounts they show the accountability of the trustees for the resources entrusted to them.
31. The Occupational Pension Schemes (Requirement to Obtain Audited Accounts and a Statement from the Auditor) Regulations 1996 SI 1975 (as amended by SI 2005/2426) require the trustees to obtain audited financial statements (subject to certain exemptions) and require the scheme auditor to:
- provide a report as to whether, in his opinion, the financial statements show a true and fair view of transactions, assets and liabilities (other than liabilities to pay pensions and benefits after the end of the scheme year) and contain the information required by the Regulations; and
 - provide a statement as to whether, in his opinion, contributions have, in all material respects, been paid at least in accordance with the schedule of contributions (for defined benefit schemes), or the payment schedule (for defined contributions schemes).
32. This statutory requirement covers the financial statements as a whole and so the scheme auditor considers the scheme actuary’s work relevant to the numbers or other information included in the financial statements or to the auditor’s statement about contributions. However, APB PN 15 (Revised) points out that “The nature of the scheme auditors’ statutory opinion excludes consideration of liability to pay pension and benefits after the end of the scheme year. As a result, scheme auditors do not ordinarily rely on the work of the scheme actuary to provide audit evidence to support their report on a scheme’s financial statements”⁷. Apart from the examples given in PN 15 (Revised), scheme auditors are unlikely to use the work of the scheme actuaries directly in accordance with ISA (UK and Ireland) 620, *Using the work of an expert*. Instead, the reasons for liaison between the trustees, the scheme actuary and the scheme auditor include enabling the planning of the timing of audit procedures in the context of the timetable for the production of the trustees’ annual report, checking that the correct, current schedule of contributions is being used by the scheme, and understanding the nature and extent of the actuary’s involvement in the determination of benefits payable by the scheme.
33. Another matter where liaison between the scheme auditor, the client and the scheme actuary is useful is any actuarial information, statement or certificate included with or within the trustees’ annual report. ISA (UK and Ireland) 720, *Other information in Documents containing Audited Financial Statements* requires the auditor to read the other information presented in conjunction with the financial statements. ISA 720 states that if, as a result of the auditor’s reading, the scheme auditor becomes aware of any apparent misstatements in the other information, or identifies any material inconsistencies with the

⁷ Paragraph 286

audited financial statements, the auditor should seek to resolve them. The auditor will normally check with the actuary that it is the latest actuarial information and certificate which is included in the annual report

34. Paragraph 349 of PN 15 (Revised) makes it plain that the auditor has no responsibility for checking the basis of the actuarial statements included in the annual report. Any liaison concerning the statements will therefore be because the client has asked the auditor to carry out some specific procedures, rather than because the auditor has any duty to check the statements. However, the auditor does read the ‘surround’ information with the financial statements. The last section of the Practice Note covers communication between the pension scheme auditor and the scheme actuary in relation to the completion of the trustees’ annual report and explains the importance of close liaison and a good working relationship between the two to enable the trustees’ reporting timetable to be met.
35. Where the actuary seeks audited accounts information, the auditor will require a ‘true and fair’ opinion to be associated only with a full set of financial statements of the scheme or relevant section of the scheme i.e. net assets statement, fund account, accounting policies and notes to the accounts covering the period since the last scheme year end.

ISSUES RELATING TO BOTH EMPLOYER AND PENSION SCHEME REPORTING WHERE INTER-PROFESSIONAL COMMUNICATION MAY BE USEFUL

As explained in paragraph 2 of this memorandum, the primary source of information is the client. Supplementary communication between employer/scheme actuaries and auditors being appropriate only where information cannot be obtained without undue difficulty from client staff or records. The remainder of this guidance assumes that authorisation has been obtained by actuaries and auditors from their mutual client to obtain information from each other through direct communication.

	Possible issue	Action to address issues
36.	<p>Terms of engagement</p> <p>The auditor and the actuary need to be able to communicate fully to the advantage of their mutual client and to enable the auditor to understand the actuary’s brief.</p>	<p>The auditor looks at correspondence between the client and the actuary, including any engagement letters, to ascertain and understand the purpose and terms of the actuary’s engagement.</p>
37.	<p>The control environment</p> <p>The internal controls and information systems operated by the employer and pension scheme administrator will affect the availability and reliability of data used by actuaries and auditors. For example, system or staff changes may have resulted in a weakening of controls or other problems that could have a significant impact on the accuracy of data concerning</p>	<p>The auditor and the actuary will find it helpful to exchange information about anything that either has come across that suggests the control environment affecting pensions is weak, and whether any such matters have been drawn to the attention of the mutual client. If the management of the employer’s pension scheme is carried out by a service organisation, the auditor</p>

the pension scheme membership and obligations or associated company records. Existing controls may have become redundant over time, leading to the implementation of new controls. Changes in the control environment could necessitate additional work to establish the integrity of the data.

can obtain information about the internal controls from a report provided in accordance with US Statement on Auditing Standards (SAS) 70, *Service Organizations* or AAF 01/06, *Assurance reports on internal controls of service organisations made available to third parties*, where the service organisation has commissioned such a report.

38. Timetable

It is important that a workable timetable is agreed, ideally by discussions between the client, actuaries and auditors. There needs to be enough time for both actuaries and auditors to meet the reporting deadlines, having regard to the availability of appropriately qualified staff and resources and allowing for late problems that may arise.

The actuary and the auditor ascertain whether the trustees or other parties concerned in meeting deadlines for the work have agreed the timetable and indicated that they can meet it.

EMPLOYER FINANCIAL STATEMENTS

ISSUES OF CONCERN TO ACTUARIES

Possible issue

Action to address issues

39. Understanding the accounting policies relevant to the actuarial valuation

The actuary may wish to confirm or clarify certain points relating to the choice and application of accounting policies.

Examples of relevant accounting policies include:

- multi-employer schemes - whether the accounting within subsidiaries is based on defined benefit or defined contribution principles (see paragraph 54 below)
- recognition of surplus/deficit in the balance sheet - surpluses may only be recognised to the extent that they are recoverable by the employer (in the form of reduced contributions etc.) and deficits may only be recognised to the extent that they result in obligations on the employer
- business reorganisations or disposals - the pensions treatment of business reorganisations or disposals should be consistent with the treatment of the other financial effects of those transactions.

40. **Limitations of scope of audit or uncertainties possibly affecting the auditor's opinion**

Auditors may find the scope of their work limited, for example due to inadequate information about matters to be included in pensions disclosures in the employer financial statements, or in pension scheme accounts. Actuaries need to understand the consequences of any such limitations and the effect on their own work. Limitations on scope may occur at different stages through the audit assignment. This is a good example of where the client would need to be kept informed of what is being said by the actuaries and auditors.

Examples of how a material uncertainty could arise would be if the data provided by the employer to the actuary were estimated, unreliable or not sufficiently analysed such that the margin of variability in the resulting valuation (as compared with the possible result with more refined data) exceeded materiality, or if factual information on pension scheme assets and/or liabilities were not available at the accounting date.

The actuary asks if there have been any limitations on the scope of the auditor's work or uncertainties in respect of pensions to which the auditor intends to refer in the audit report. The actuary asks the auditor to explain the background.

41. **Significant events affecting actuarial valuation**

There may be significant events or circumstances since the approval of the previous financial statements that could have an effect on the actuary's work.

The auditor confirms with the actuary that the latter has been informed by the directors about the occurrence of events since the last financial statements in order to ascertain either that they do not have a material impact on the actuarial position of the scheme or that the actuary has calculated and reported on the impact.

42. **Analysis of company financial information for actuarial purposes**

Actuaries can obtain information about the accounting charge for pensions included in the latest audited financial statements from the directors. However, an actuary may need more accounting information than is available from the audited financial statements, for example if the employer operates a number of different occupational schemes with different professional advisers. Although this should be held by

Examples of analyses that may be needed by actuaries, if they cannot be obtained from the employer, include the following:

- Costs attributable to different pensions arrangements established by the sponsoring employer;
- Separating out healthcare from pensions provision;
- Whether the figures are stated net of

the employer to support its own accounts, where it is not readily available the actuary may wish to establish whether it has been retained by the auditors in their files.

If the actuary has any reservations about the information obtained from the employer the actuary may also wish to ascertain that it is consistent with the auditor's own analyses. The actuary may wish to use these analyses in preparing the report on current year pension costs if the actuary has responsibility in the relevant areas. The information may be particularly relevant where the current actuary is different from the actuary who acted in respect of the previous financial statements.

deferred tax or gross and the degree of accuracy to which the figures have been prepared;

- Whether there are any adjustments arising from limitations on the assets (see for example FRS 17 paragraphs 41 and 67);
- The accounting treatment of any unpaid contributions.

ISSUES OF CONCERN TO AUDITORS

Possible issue

43. Actuaries' qualifications and objectivity

Where the actuary is a member of the Faculty or Institute of Actuaries, or Society of Actuaries in Ireland, the auditor can be satisfied as to the professional standards governing the actuary's objectivity, professional qualifications, experience and resources. Where, however, the actuary is a member of an overseas professional body, for example where the employer is reporting under International Financial Reporting Standards and the actuary is qualified and based in another country, the auditor may wish to ascertain the professional qualifications of the actuary and whether the actuary is connected in any way to the reporting entity.

Action to address issues

The auditor asks an actuary based and qualified outside the UK and Ireland to which professional body the actuary belongs and assesses the adequacy of the qualification as the basis for placing reliance on the actuary's work. The auditor also ascertains the actuary's relationship to the client organisation.

The Faculty and Institute of Actuaries, and Society of Actuaries in Ireland, have mutual recognition agreements with actuarial bodies in Australia, Canada, India, Japan and the US, as well as EC countries plus Switzerland under the Mutual Recognition Directive. More information about the agreements can be found on the Faculty/Institute website at: http://www.actuaries.org.uk/files/pdf/worldwide/mutual_recog.pdf.

44. **Actuaries' engagement terms**

There may be events or circumstances that should be taken into consideration in discussion by the auditor with the directors and the actuary as indicating that the latter might need to undertake additional work⁸

Where the actuary's calculations are being based on an update of the most recent valuation rather than a full valuation, the auditor finds out whether the actuary has been made aware of any significant changes which, for whatever reason, have not been allowed for in the calculations. The auditor also ascertains whether the actuary has any significant level of uncertainty relating to aspects of the valuation, that result in the actuary's not being confident that the resulting figures will fall within the accuracy bounds set by the entity.

45. **Envisaged reporting by actuaries**

The auditor needs to understand the actuary's reporting brief and to establish the likely extent to which the auditor will be able to rely on the work of the actuary. The reliance placed on the actuary's work will also depend on the provision of relevant information by the company on a timely basis to the reporting actuary⁹.

The auditor seeks confirmation from the client that the employer directors will be able to give the auditor copies of any draft or final reports the actuary may provide to the directors for the purposes of FRS 17/IAS 19.

46. **Actuarial assumptions and source data**

Sometimes the employer directors are not in a position to give enough information to enable the auditor to understand the assumptions used in the actuarial valuation or to review the process used to develop them¹⁰.

In this case the auditor asks the actuary to confirm the principal assumptions used in the valuation and the source of any assumptions not directly recommended by the actuary to the employer. The auditor also asks what procedures the actuary has undertaken to establish the sufficiency, relevance and reliability of the source data provided to the actuary for the purpose of the valuation.

47. **Range of possible values**

If the range of possible values of the numbers included in the financial statements is larger than audit materiality,

The auditor obtains copies of any reports that the actuary has made to the employer regarding variations in liability valuations

⁸ PN 22, paragraphs 49 and 50, considers when updated valuations might not provide a sufficient basis for the actuary's calculations

⁹ See ICAEW publication AUDIT 1/02 *Practical points for auditors in connection with the implementation of FRS 17 'Retirement Benefits' – defined benefit schemes.*

¹⁰ APB PN 22, paragraphs 54 to 56, describes auditors' procedures in relation to source data used by actuaries, and actuarial assumptions

the auditor needs to ascertain the reason. The auditor also needs to establish whether the range can be reduced to within the assessment of materiality (for example by the performance of a more in-depth exercise) and, if not, whether it is due to the inherent impact of flexing key assumptions or a lack of good process (and so represents a limitation on the scope of the auditor's work¹¹). The range of possible values and considerations of materiality will normally be matters for discussion with the employer, rather than directly between the actuary and the auditor.

GN 36 requires the actuary to seek an indication of the materiality levels from the company and, given those levels, to consult the employer on the steps needed to achieve the degree of accuracy required for the valuation within the reporting timescale. Given the data available, the actuary should make the employer aware of the possible variation in the liability values and costs which the actuary is estimating.

Audit 1/02, Practical Points for Auditors in Connection with the Implementation of FRS 17 'Retirement Benefits' - Defined Benefit Schemes, explains the audit considerations relating to the 'best estimates' on which FRS 17 assumptions, calculations or figures concerning retirement benefits are based. In particular, the guidance points out that best estimates may lie within a range of possible values because of uncertainties arising from 'flexing' normal actuarial assumptions, from inadequacy in the employer's process for providing information to the actuaries, or from an unusual event. The auditor's response to such uncertainties depends on their source and materiality and is, therefore, likely to require close liaison between the auditor, the employer and the

and costs.

The auditor finds out the actuary's views on the degree of precision attaching to the valuation and factors giving rise to potential material misstatement.

The auditor asks the actuary what factor or factors have the greatest impact on the size of the range of values within which the actuary's best estimate of the scheme surplus or deficit lies, and whether the issues could be addressed within the employer's reporting timetable for the employer to provide data that is more up to date or more finely analysed.

If these steps are not appropriate, or not sufficient to reduce the range below the auditor's assessment of materiality, the auditor finds out whether the size of the range is due to constraints in relation to the quality of the information supplied to the actuary by the employer for the purposes of the updated valuation, or whether it is due to events or circumstances between the last full valuation and the balance sheet date which give rise to changes in scheme liabilities that cannot be calculated precisely because their effect on the scheme is inherently uncertain.

If the auditor considers that the employer directors have not established an appropriate process with the necessary resources to enable the employer to comply with FRS 17/IAS 19, the auditor asks the actuary what additional steps would need to be taken to develop a more precise valuation and how long would this take.

¹¹ APB PN 22, paragraphs 61 to 63, considers the possibility that the range of values within which the actuary has estimated the scheme surplus or deficit extends beyond audit materiality. Consideration of this point is expanded by Technical Release AUDIT 1/02

¹² The reason for including paragraphs 46 and 47 in this document is to provide cross references to relevant professional guidance on potentially complex issues.

actuary.¹²

48. Effects of legislative or benefit changes

Where there have been:

- (i) legislative changes or tax changes,
- (ii) rule changes or major events (in pension terms), including changes in pension increase policy, or
- (iii) past service benefit awards (including increases to pensions in payment and deferred pensions) for which no explicit allowance was made in the funding plan,

the auditor needs to be able to consider the impact of these on the amounts disclosed in the financial statements.

If these matters are not disclosed in the valuation report, the auditor asks the actuaries to confirm the extent to which the financial effects of legislative or benefit changes have been allowed for in the measurement and disclosure of pension costs.

49. Events subsequent to the employer's balance sheet date

The financial statements should take account of significant events subsequent to the employer's balance sheet date, either in the amounts recognised or by way of narrative disclosures, depending on the circumstances.

The auditor asks the actuary whether there are any matters regarding the actuarial review for pension cost purposes not included in the valuation report, which might be relevant to the audit, for example:

- any matters which have come to the actuary's attention as occurring in the period between the reporting entity's balance sheet date and the date on which the accounting information was provided to the mutual client, that could have a material effect on the valuation of the scheme's liabilities; or
- the impact of any significant events of which the actuary or the auditor are aware, such as plans for a major change in activities, e.g. business acquisition or disposal, closure of a section of the scheme or benefit improvements.

50. Reporting

Auditors needs to be able to assess the results of the actuaries' work to ensure that sufficient information is available to meet the disclosure requirements of FRS 17/ IAS 19, to understand the background to those disclosures and audit the

The auditor asks if the actuary has had to depart from applicable professional requirements or guidance in the course of the actuary's work.

The auditor ascertains whether the actuary

accounting¹³.

Ordinarily, most valuation considerations relating to disclosures in the financial statements of the employer will be clear to the auditor from a reading of the actuary's report, but the following are examples of areas that may require further clarification:

- the share of surplus or deficit that is to be allocated to members
- the measurement basis for death-in-service benefits and incapacity benefits
- the impact of capping on the amount of the surplus in the scheme that is recognised in the financial statements.

is satisfied that the amounts and disclosures included in the draft financial statements that relate to retirement benefit arrangements on which the actuary has advised are adequately reflect the results of the actuary's work.

OTHER ISSUES WHERE COMMUNICATION BETWEEN EMPLOYER ACTUARIES AND AUDITORS MAY BE USEFUL

There may be other situations where actuaries and auditors may need to consider appropriate communications. Examples of these situations include the following:

51. **Directors' and other pensions**

The auditor considers whether the pensions disclosures relating to directors' emoluments, which the directors propose to include in the financial statements, have been developed on an appropriate basis. To this end the auditor may decide to ask the actuary to confirm that the increase in the transfer values of the accrued benefits have been calculated in accordance with the provisions of Ss. 411 and 412, Companies Act 2006 and the guidance in GN11.

52. **Company reorganisations and takeovers**

These typically result in changes in ownership of individual businesses and the auditor of the acquiring company will need to be satisfied that fair values have been attributed to scheme surpluses or deficiencies and any unfunded pensions liabilities of the acquired business, in accordance with Financial Reporting Standard FRS 7, *Fair values in acquisition accounting*¹⁴ or IFRS 3, *Business Combinations*. If only part of a business is being acquired or sold, the auditor and actuary may need to discuss the transaction and may need to liaise in assisting the client with any clearance application to the Pensions Regulator. If there is a potential section 75 liability, consideration will also need to be given to whether and how it should be accounted for.

¹³ PN 22, paragraphs 57 to 60, covers the auditor's assessment of the results of the actuary's work

¹⁴ FRS 7 has been amended by FRS 25/IAS 39 with effect for accounting periods beginning on or after 1 January 2005.

53. **Refunds of surplus to the employer**

Excess assets on winding up of a tax approved scheme cannot be paid out before all the liabilities of the scheme have been satisfied. However, refunds of surplus may be made from ongoing schemes if their rules so permit, subject to procedural safeguards. The measurement of such a surplus (calculated as the excess over buyout valuation) will require an actuarial valuation.

54. **Multi employer schemes**

As part of their work, auditors consider whether the accounting policies adopted by an employer are appropriate to the entity's circumstances, consistently applied and comply with applicable regulations. For example, auditors may consider it appropriate for defined contribution reporting policies for multi employer schemes to be adopted by the directors when assets and liabilities of individual employees can be readily identifiable and the actuary has certified relevant individual Schedules of Contributions. In this situation auditors need to consider whether the exemption to applying defined benefit reporting policies has been properly utilised.

The considerations are different for scheme actuaries, whose main concern over inappropriate application of multi-employer scheme reporting exemptions result from a misunderstanding of the rules.

PENSION SCHEMES

ISSUES WHERE COMMUNICATION BETWEEN SCHEME ACTUARIES AND SCHEME AUDITORS MAY BE USEFUL

Possible issue

Action to address issues

55. **Regulatory matters**

The 2004 Pensions Act has left the whistleblowing role of both actuaries and auditors essentially unchanged. However, the Code of Practice 01 on reporting breaches of the law (CP01) issued by the Pensions Regulator makes the trustees the focal point for 'whistleblowing'. CP01 recognises that duplicate reporting (by actuaries and/or auditors) may occur in certain circumstances but indicates in paragraph 58 that it does not expect duplicate reporting to be routine.

Scheme actuaries and auditors are not required to actively seek information about reportable matters in the course of professional work. However, as indicated in paragraph 53 of CP01, all reporters are expected to have procedures such as a

The actuary and the auditor each ascertain whether the other has reported any matters to The Pensions Regulator in respect of the scheme. Both would ordinarily copy the report to the scheme trustees. As explained in paragraph 59 of CP01, the Pensions Regulator will ordinarily send an acknowledgement to the person reporting a breach and that this should be sent by the reporter with a copy of the original report to the trustees or manager. This in turn enables the trustees or manager to copy the documents to those other reporters who they consider may also be likely to come across the breach.

The auditor in particular may find an informal discussion with the actuary useful in identifying issues that could have an

system for recording breaches even if they are not reported. Communication between actuaries and auditors can therefore be very useful, for example in identifying matters that, while not of material significance to the Pensions Regulator, could be part of a more general failure.

Paragraphs 24 to 27 and 34 of the introduction to PN 15 (Revised) consider the statutory duty on scheme auditors and scheme actuaries to report matters of material significance to The Pensions Regulator. If either becomes aware of a matter which may be reportable they may find it useful to discuss this with the other professional. Paragraph 35 states that, “to facilitate effective liaison, scheme auditors and actuaries seek agreement from the trustees of a scheme to communication between them as part of their terms of engagement when accepting appointment”. The Practice Note also contains updated material on regulatory issues and reporting to the Pensions Regulator.

impact on contributions to the scheme on which the auditor is reporting, and possibly on the actuarial valuation.

ISSUES WHICH THE SCHEME ACTUARY MAY WISH TO DISCUSS WITH THE SCHEME AUDITOR

Possible issue	Action to address issues
<p>56. The financial statements of the scheme</p> <p>The actuary may wish to check, for the purposes of the actuarial valuation, that all assets belonging to the scheme have been taken into account.</p>	<p>The actuary asks the auditor whether debtors include all amounts receivable, such as contracting-out rebates due to the scheme from HMRC or DWP.</p>
<p>57. The trustees’ and other scheme reports</p> <p>The actuary needs to be aware of relevant information which could have an impact on his work, for example if membership numbers are inconsistent between the trustees’ report and the disclosures of transactions in the financial statements.</p>	<p>The actuary ascertains whether the auditor has identified any inconsistencies arising from the auditor’s reading of the trustees’ draft annual report for the period that might indicate errors in the data used by the actuary, benefit calculation errors, or investment valuation issues.</p>
<p>57. Assets designated to individual members including Additional Voluntary Contributions</p> <p>The actuary may wish to determine</p>	<p>The actuary asks the auditor for any</p>

whether there are assets included in the financial statements that are designated to meet the benefit interests of individual members (for example arising from AVCs) which are co-mingled with other scheme investments.

information the auditor may have of assets that are designated to individual members. Such assets are not available to meet the benefit entitlements of other members of the scheme and therefore do not form part of the pool of assets that are to be compared with the valuation of the scheme's benefit obligations.

59. Subsequent events

The auditor may be aware of events since the date of the Scheme net asset statement but before the signing of the accounts that might significantly affect the value to the scheme of assets that do not have a readily ascertainable market value, such as property or unlisted shares.

Discussing post balance sheet events with the auditor may enable the actuary to consider the relevance of such events to the valuation of scheme assets for which there is not a ready market.

ISSUES WHICH THE SCHEME AUDITORS MAY WISH TO DISCUSS WITH THE SCHEME ACTUARIES

Possible issue

Action to address issues

60. Schedule of contributions

The auditor is required to report whether in the auditor's opinion the contributions payable to the scheme during the year have in all material respects been paid at least in accordance with the schedule of contributions. Normally the scheme trustees / administrator should provide details of the schedules in place during a financial year, but the auditor may need clarification or supplementary information, for example where the auditor knows or finds out that there have been changes to contribution rates during the year. In any case the auditor will need to see the actuary's certification of all schedules in force during the year.

The auditor can ask the actuary to identify the schedule or schedules of contributions in force during the period under review and agree the schedule(s) to the actuarial certificate of adequacy.

The involvement of the scheme actuary in certifying schedules of contributions also makes the actuary well placed to assist in the resolution of any issues concerning interpretation or implementation.

The Pensions Regulator has published an example of a schedule of contributions.

Should the auditor have concerns about the wording of a schedule of contributions, for example in relation to the definitions of key terms such as "pensionable pay" or the effective date of a new schedule, he may wish to consult with the scheme actuary, who certified the schedule.

61. **Actuarial valuation of the scheme**

The actuarial valuation of the scheme may show a significant surplus or deficit of funds in the scheme. Schedules must be reviewed and if necessary revised following each valuation. The auditor may want to know whether any planned benefit changes have been reflected in the valuation and the status of the process for the determination of future contribution rates if this information cannot be ascertained from the formal written reports and statements. Whilst these points do not affect the financial statements for the year being audited, they should be included in the trustees' report that the auditor reads in relation to the financial statements, as information about future periods.

The auditor checks whether any benefits changes or contribution rates which have been agreed by the trustees and employer in relation to future periods are in line with recommendations made by the actuary.

62. **Interim valuations and updates**

A full actuarial valuation will generally be undertaken every three years. There may or may not be interim valuations in the intervening years. The updates may result in a change in contribution rates and auditors will want to see whether changes in contribution rates that they have noted have been triggered by an annual review.

In a year falling between full actuarial valuations the auditor checks changes to contribution rates with the actuary if the updated schedules have not been provided by the trustees/administrator.

OTHER SITUATIONS OF INTER-PROFESSIONAL COMMUNICATION

There will be other situations where actuaries and auditors may need to consider appropriate communications. Examples of these situations include the following:

63. **Winding up**

Where a defined benefit scheme is being wound up, actuarial calculations may be needed to allocate assets to each class of liability. Any deficiency that falls on the employer(s) will also fall to be certified. In order to give such calculations, the actuary will normally require audited scheme financial statements, often made up to a date which will not coincide with the normal scheme year end.

64. **Non annual financial statements**

The need for inter-professional communication will also arise in connection with claims for statutory compensation for a loss suffered through fraud or other prescribed offences. The claim must be supported by an audited statement of assets and must be made within 12 months of the later of the employer's insolvency and the date when the scheme auditor or actuary ought reasonably to have known that the reduction in value of assets had occurred.

OTHER ASPECTS

Communication where the same firm fulfils more than one function

65. Instances may arise where an appointment is held for statutory or non-statutory work for a company or pension scheme where the firm also has another appointment or provides administrative services. There is thus the potential for a conflict of interest, or of a loss of independence. In such cases auditors and actuaries refer to the relevant authoritative guidance when determining whether they can accept (or retain) all of the current and/or potential professional appointments. Actuaries and auditors therefore refer to the guidance issued by their respective professional bodies and by the APB (Ethical Standards).

Professional advice

66. If either the actuary or the auditor has cause to believe that the other professional may have difficulty in providing appropriate professional advice without a fuller understanding of the context in which that advice is being sought, he should discuss the position with the client. In the absence of a satisfactory resolution, the scheme actuary or scheme auditor may deem it necessary to obtain written representations at an appropriate level from within the client's organisation and consider whether his own professional position has been impaired.

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APPENDIX 1: Bibliography

Guidance Notes issued by the Faculty and Institute of Actuaries or the Board for Actuarial Standards¹⁵

- GN 9 Funding Defined Benefits - Presentation of Actuarial Advice
- GN 11 Retirement benefit schemes - transfer values
- GN 19 Retirement benefit schemes - winding-up and scheme asset deficiency
- GN 21 Post-retirement medical plans
- GN 27 Retirement benefit schemes - minimum funding requirement
- GN 28 Retirement benefit schemes - adequacy of benefits for contracting-out
- GN 29 Occupational pension schemes- advisers to the trustees
- GN 49 :Occupational pension schemes - scheme funding matters on which advice of actuary must be obtained
- GN51 Retirement Benefit Schemes - Modification of Subsisting Rights Without Consent

Guidance issued by the Auditing Practices Board¹⁶

- Practice Note 15 (Revised): *The Audit of Occupational Pension Schemes in the United Kingdom*
- Practice Note 22: *The auditors' consideration of FRS 17 'Retirement Benefits – Defined Benefit Schemes'*
- International Standard on Auditing (UK and Ireland) 720 - *Other information in documents containing audited financial statements*
- International Standard on Auditing (UK and Ireland) 620 - *Using the work of an expert*

Other relevant reference material

International Accounting Standards Committee

- IAS 19, *Employee Benefits*
- IAS 24, *Related Party Disclosures*
- IAS 26, *Accounting and Reporting by Retirement Benefit Plans*

Accounting Standards Board

- FRS 17, *Retirement benefits*
- Amendments to FRS 17 'Retirement Benefits' and Financial Reporting Standard for Smaller Entities (FRSSE)
- UITF Abstract 35, *Death-in-service and incapacity benefits*

Pensions Acts 1995 and 2004 and associated statutory instruments

The Pensions Regulator: Codes of Practice and other guidance

Pensions Research Accountants Group

- Statement of Recommended Practice - *Financial reports of pension schemes*

Institute of Chartered Accountants in England and Wales Audit and Assurance Faculty

Practical Points for Auditors in Connection with the Implementation of FRS 17 'Retirement Benefits' – Defined Benefit Schemes (AUDIT 1/02)

- Assurance reports on internal controls of service organisations made available to third parties (AAF 01/06)

¹⁵ A full list of publications, as well as a link to material issued by the Board for Actuarial Standards, may be found at http://www.actuaries.org.uk/Display_Page.cgi?url=/maintained/about_the_profession/frc/gn_status.html

¹⁶ A full list of publications may be found on the APB website at <http://www.apb.org.uk/apb>

APPENDIX 2

Membership of Working Party

Members of the working party are:

Robert Hymas, ICAEW
Bryan Radford, I and F of Actuaries
Peter Rowley, ICAEW
David Slade (Chairman), ICAEW
Philip Turner, I and F of Actuaries
Alex Waite, I and F of Actuaries