TECHNICAL RELEASE

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AUDIT REPORTING ON FINANCIAL STATEMENTS OF PENSION SCHEMES PREPARED FOR SEGREGATION UNDER THE PENSION PROTECTION FUND MULTI – EMPLOYER REGULATIONS

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ICAEW is a professional membership organisation, supporting over 140,000 chartered accountants around the world. Through our technical knowledge, skills and expertise, we provide insight and leadership to the global accountancy and finance profession.

Our members provide financial knowledge and guidance based on the highest professional, technical and ethical standards. We develop and support individuals, organisations and communities to help them achieve long-term, sustainable economic value.

This guidance has been prepared by the Pensions Subcommittee of the ICAEW Business Law Committee, which includes representatives from public practice and the business community. The Committee is responsible for ICAEW policy on business law issues and related submissions to legislators, regulators and other external bodies. The guidance reflects consultation with the Audit and Assurance Faculty, which is responsible for technical audit and assurance submissions on behalf of ICAEW as a whole.

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FOREWORD

This guidance is issued by the Pensions Committee of the Institute of Chartered Accountants in England and Wales in October 2013, to give guidance to Institute members when issuing audit reports to Trustees on the segregation of pension schemes, under the Multi – Employer Regulations. This guidance has been produced after discussions with the Pension Protection Fund. This guidance does not constitute an auditing standard. Professional judgement should be used in its application.

INTRODUCTION

1. Where an insolvency event has occurred in one or more of the participating employers in a multi employer scheme and there is likely to be a funding deficit, The Pension Protection Fund (Multi-employer Schemes) Regulations, SI 2005 No 441, apply in determining the way in which eligibility for entry to the Pension Protection Fund is to be established in relation to the insolvent employer(s). The Pension Protection Fund (Valuation) Regulations, SI 2005 No 672, set out the rules for audited accounts which are required for the purpose of the actuarial valuation and for the sections affected.

2. An actuarial valuation is required at the date of the insolvency event to assess the scheme's ability to pay benefits at PPF compensation level. This valuation is known as a s143 valuation as the requirements commence at s143 of the Pensions Act 2004. Accounts for the entire scheme are required for the purpose of the valuation. The Actuary determines the split of liabilities for each section as represented by each participating employer. For schemes which do not maintain separate sections, (or where insolvencies occur within sections), this valuation will create these segregated sections. The assets of the scheme are then allocated to the section in proportion to the liabilities. The result is a statement of net assets at the relevant date (the date before the insolvency event) which shows the allocation of assets between the sections representing the solvent and insolvent employers. The PPF normally requires this statement to be audited.

3. Where participating employers become insolvent at different dates, audited accounts and s143 valuations may be required as at each relevant date.

4. It is recognised that there is a need to achieve consistency in the preparation of the accounts by Trustees for PPF purposes and also a consistency of audit reporting on these accounts.

5. The PPF has updated its guidance on the background to and accounting for these events in a document entitled 'Guidance on Accounting Issues - Sectionalised Schemes and Associated Accounting and Audit Issues', which is on its website www.pensionprotectionfund.org.uk.

6. This technical release, which has been produced in consultation with the PPF, is intended to give guidance to those involved with the audit of accounts prepared at the relevant date, accounts for segregation purposes and the segregated net assets statement. It also addresses some of the issues arising for accounts after the initial segregation.

Background

7. Many pension schemes in the UK are sponsored by more than one employer, typically by a number of related companies in a group, with the group holding company acting as Principal Employer.

8. When one or more employers participating in such a group scheme experiences an insolvency event, the Multi-Employer Regulations apply to govern the situation.

9. Depending on the scheme rules, these regulations take effect to create a separate section of the scheme for the insolvent employer into which the members associated with that employer are allocated. The liabilities for these members are valued and the corresponding proportion of the scheme's assets also allocated to that section, so that the funding level of that section can be assessed.

10. If that section has insufficient assets to pay benefits at least equal to PPF benefits, then that section and that section alone will transfer into the PPF. What happens to the rest of the scheme depends on the situation of the remaining employers; if they remain solvent, the rest of the scheme will continue outside of the PPF as a normal ongoing scheme. If any of the remaining employers go on to experience an insolvency event (whether at the same or a later

date), another section of the scheme will be created for members associated with that employer, whose funding level will be separately assessed, while the rest of the scheme continues as a normal ongoing scheme.

Accounting issues

11. The key issue for trustees is the interaction of the Multi-employer Regulations with the Pension Protection Fund (Valuation) Regulations 2005 and the requirement to produce an actuarial valuation at the relevant date (the day before the insolvency event). Like all valuations, this is supported by audited accounts, the requirements for the contents being set out in the Schedule to the Valuation Regulations.

12. The date of the accounts is fixed by the date of the insolvency of the employer, which may not coincide with the scheme's statutory accounting date. The Occupational Pension Schemes (Audited Accounts and a Statement from the Auditor) Regulations 1996, SI 1996 No 1975) do allow trustees to change their scheme's accounting date to periods between six and eighteen months, so changing the date means that these accounts may serve a dual purpose, meeting both the PPF requirements and those for the annual report.

13. However, the processes of allocating scheme liabilities and scheme assets over the sections created for solvent and insolvent employers can be difficult and time consuming for the trustees and present particular problems as discussed in the following paragraphs.

Allocation of scheme liabilities and scheme assets

14. It is the trustees of the scheme who are responsible for the allocation of scheme liabilities and scheme assets over the scheme parts created by the insolvency of one or more employers under the Multi-Employer Regulations[1]. They will have to take into account:

    - The requirements, if any, of their own trust deed and rules;
    - The requirements of the relevant PPF regulations;
    - The recommendations of the scheme actuary;
    - Any specific directions issued by the PPF.

    Trustees have the primary responsibility for correct data. The Pension Protection Fund guidance version H4 June 2010 section 6 requires trustees to:

    - Take appropriate action to identify all potential scheme beneficiaries;
    - Resolve any data uncertainties about the members.

    In addition, this process will involve the actuary in:

    - Agreeing with the trustees how to establish the employer (or the last group employer) who employed the member;
    - Agreeing with the trustees how to deal with "orphan" members whose only employment relationship was with employers who no longer participate in the scheme;
    - Valuing the liabilities of all members and allocating the total scheme liabilities into the sections created by the insolvency of one or more employers;
    - Recommending to the trustees the allocation of scheme net assets, usually in the same ratio as the allocation of scheme liabilities.

[1] The Pension Protection Fund (Multi-Employer Schemes) (Modification) Regulations 2005, SI 2005/441

Timing of the allocation process and accounts preparation

15. The work involved in allocating scheme liabilities across sections, and the subsequent allocation of scheme assets, may be significant and time-consuming for the Trustees. Where it is practical and efficient the preferred approach is for the Trustees to complete statutory accounts for the scheme as a single entity, at the relevant date. As noted above, as long as the period is between six and eighteen months long, these accounts can be used to meet both requirements of providing annual report and accounts under s41 of the Pension Act 1995 and of the Pension Protection Fund (Valuation) Regulations 2005 rules for valuation. The accounts need to be prepared and audited in accordance with the project plan for the PPF assessment period agreed between the trustees, all of their advisers and the PPF

16. These accounts are used by the actuary to base the allocation of net assets across the different employers for the purposes of s143 valuation. Once allocation information is available from the scheme actuary, trustees should then prepare a segregated net asset statement and relevant notes, allocating the scheme's net assets over the parts.

17. The auditor then issues a second statutory opinion (s143) on these accounts which now include the segregated net assets statement. Where this approach is adopted for preparing the s143 statements, the auditor needs to consider the effect if any, of post balance sheet events between the date of the audit opinion on the statutory accounts prepared for inclusion in the scheme's annual report and the date of the opinion on the segregated s143 accounts.

18. If it is not possible to change the scheme's statutory accounting period to coincide with the assessment event, the Trustees will have to draw up accounts as at the relevant date for the purposes of the s143 valuation. In these circumstances, the auditor completes the audit under the rules set out in the Valuation Regulations when the accounts are prepared but does not issue the audit report until the segregated net asset statement is prepared and audited. As discussed in paragraph 17 above, the auditor then issues a statutory report (s143) on these statements.

19. Where there are multiple insolvency events, separate accounts need to be prepared as at the date before the date of each insolvency event (see section 4 on the form of reporting to be considered).

20. One of the challenges that is likely to be faced is obtaining appropriate valuation information for investments at the date before the date of the insolvency event as it may not coincide with a month or quarter end. It is therefore critical that Trustees make arrangements to obtain investment information including valuation at the relevant date as soon as possible after the event.

21. If it is not possible to obtain information at the relevant date, the accounting policies need to state how investments have been valued. The auditor will need to consider if this is an appropriate basis.

Accounts prepared subsequent to the insolvency event

22. The trustees remain responsible for preparing scheme accounts on an annual basis during the assessment period in order to comply with the Disclosure Regulations, which require an annual report that includes the audited accounts (See the Occupational Pension Schemes (Disclosure of Information Regulations 1996 SI No 1715). Where the segregated information needs to be maintained the trustees will need to address issues such as the allocation of income, including investment income and expenses to the sections of the scheme as these may not be easily attributed to separate sections. The trustees need to account for the transactions and allocate these to the different sections between the relevant date, when the sections were created, and the annual accounting date. Note that as a result of the complexity, many schemes will unitise the investments. Both the Fund Account and the Statement of Net Assets should be presented in a columnar form, showing transactions and balances for each section.

23. There is no statutory requirement to present the annual scheme accounts in segregated format. The statutory annual report and accounts can be prepared for the scheme as a whole.

24. Where the allocation is presented in the statutory accounts the accounting policy notes need to make appropriate disclosures about the methods of allocating transactions across the parts of the scheme.

25. Where the segregated information is presented in non-statutory accounts, in addition to appropriate accounting policy notes, the statement of trustee’s responsibilities needs to be appropriately worded to refer to the maintenance of the parts and the allocation of transactions across the different parts. The non-statutory accounts will normally only include a statement of trustees’ responsibilities and accounts. They do not normally include trustee or investment reports.

26. If the assessment period is prolonged, then the segregated accounts will have to become statutory accounts when a triennial valuation is required, since accounts prepared for the purpose of a s224 valuation are statutory. This raises a potential issue for multi-employer schemes, where the insolvent employer’s section of the net assets statement does not require a valuation but the solvent employers’ sections does. In these circumstances, the auditor discusses with the scheme trustees the approach to take.

ENGAGEMENT PROCEDURES

27. Set out below are some considerations that apply for the audit of segregated accounts for PPF purposes

Engagement letter

28. The engagement letter will need to be tailored to reflect the particular circumstances of the individual scheme, the nature and scope of the auditor's role and the form and content of the report and financial statements. If the accounts for assessment purposes serve also as the annual accounts of the scheme, a new engagement letter is not a requirement, but may be useful in clarifying the auditor's role. A new engagement letter will be required when the subsequent opinion is sought for s143 purposes.

29. The financial statements are required to show a true and fair view and fall within the scope of the Pensions SORP so they should be prepared so as to comply in all material respects with its recommendations.

30. The example letter for a statutory audit set out in Example 4 of Appendix 4 in PN15 as a starting point for the tailoring, with regard to the following:

    - Responsibilities of trustees and auditor –The wording needs to be tailored to meet the requirements of the engagement.
    - Scope of work – Where the auditor is required to express a ''true and fair'' audit opinion, the auditor's work will be governed by the requirements of ISAs (UK and Ireland). For special purpose reports, the scope needs to be clearly defined in the engagement letter.
    - Representations by trustees and third parties – Information and explanations from the scheme's personnel are likely to be an equally important part of the work for the s143 report, so the auditor is likely to obtain relevant written representations towards the end of the audit.
    - Reporting to those charged with governance – These paragraphs are likely to be equally relevant to the s143 audits.
    - Auditor's Statement about Contributions – This is not required for non-statutory or special purpose accounts.

Application of ISAs (UK and Ireland)

31. Registered auditors are required to comply with ISAs (UK and Ireland) when conducting audits, although the way in which they are applied needs to be adapted to suit the particular characteristics of the scheme being audited. Non-statutory auditors therefore have regard to the commentary on the application of ISAs (UK and Ireland) set out in PN15.

APPROACH TO AUDIT

32. For segregated scheme accounts, the results of the allocation process (in terms of the segregation of scheme assets), and therefore the allocation process itself, are within the scope of the audit.

33. Set out below are some considerations for the auditors when planning and executing their work, with reference to the allocation process.

Audit of the allocation process and the resultant segregated statement of net assets

34. As set out in section 2, agreement of the engagement terms will require that the trustees and auditor are clear about the requirements for audited accounts of scheme sections and the implications when setting the scope and other terms of engagement for this assignment.

35. As with any assignment, under ISA 315, the auditor will carry out a risk assessment to establish areas of audit emphasis and to allocate audit resource.

36. Auditors also have regard to ISA500 “Audit Evidence”, in particular the requirements of paragraph 8 on the work of a management’s expert, in determining the approach to be taken when auditing segregated accounts. The segregated statement of net assets will disclose the assets and liabilities for each section of solvent and insolvent employers. The assets and liabilities will be split by the trustees based on the information provided by the actuary or as directed by the PPF.

37. As the auditor will use the split of member liabilities calculated by the actuary to determine if the assets and liabilities have been allocated properly between the sections of solvent and insolvent employers, the auditor needs, to the extent necessary, to:
    - evaluate the competence, capabilities and objectivity of the expert
    - obtain an understanding of the work of the expert
    - evaluate the appropriateness of the expert’s work as audit evidence
    - consider the member and other data used by the actuary in the allocation process

38. Auditors are not expected to replicate or carry out detailed checks on the actuarial calculations themselves; however procedures could include:
    - review of the valuation results in the light of knowledge of the scheme, its history and development, and the development of the group of employers participating in the scheme;
    - review of the reasonableness of any assumptions used by the actuary, particularly the justification for using different assumptions for different parts (for example, regional or industry-sector specific assumptions on longevity);
    - mechanical recalculation and reconciliation of the percentage split per the actuary and that presented in the draft segregated net asset statement for audit.

    It is also important to check that disclosure is appropriate and adequate to describe the situation, including the background, basis of preparation, accounting policies, and allocation of assets, liabilities and transactions, so these are clear to a reader of the accounts.

39. When auditing subsequent periods to the initial segregation, the auditor needs to design audit procedures to determine if the allocation of transactions has been properly recorded between the different sections of the scheme.

FORM OF REPORT

The Audit Report – First application of segregation

40. This technical release envisages two possible alternative audit reports for scheme accounts as at the relevant date: a statutory opinion if the accounting period can meet the statutory requirements or a s143 opinion if the period is less than six months or longer than 18 months. For the report on the segregated net assets there are also two alternatives: the segregated statement of net assets can be included as notes to statutory accounts with the provision of a s143 opinion or a separate statement of net assets is prepared showing the segregation with the auditor issuing a special purpose report on the allocation.

41. The Pension Protection Fund (Valuation) Regulations 2005 set out the requirements for audited financial statements of the scheme to be prepared at the 'relevant time', that is the date prior to the insolvency date of the employer as at which the valuation is being carried out. Appendix 1 includes an audit report for s143 purposes.

42. Special purpose reports retain the same structure as a standard audit report, as shown in the current APB Compendium Bulletin of Audit Reports. PN15 – appendix 9 – sets out a template for a non-statutory audit report.

Wording of the Statement of trustees' responsibilities for segregated accounts

43. The Statement of Trustees' Responsibilities will have to be expanded to recognise explicitly the additional responsibilities of the trustees for the creation of scheme parts and obtaining financial statements accounting for the segregation of the scheme. The template in Appendix 2 includes suggested wording of a Statement of trustees' responsibilities incorporating these matters.

APPENDIX 1

Example of an audit report for s143 purposes

Independent Auditor's Report to the [trustees]/ [trustee], of the XYZ Pension Scheme

We have audited the financial statements[1] of [name of scheme] for the period ended [date] set out on pages [ ] to [ ].. The financial reporting framework that has been applied in their preparation is applicable law and UK Accounting Standards (UK Generally Accepted Accounting Practice).

This report is made solely to the scheme [trustees, as a body,]/ [trustee] in accordance with the Pensions Act 2004 and Regulations made there under. Our audit work has been undertaken so that we might state to the scheme [trustees]/ [trustee] those matters we are required to state to [them]/ [it] in an auditors' report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the scheme [trustees, as a body]/ [trustee], for our audit work, for this report, or for the opinions we have formed.

Respective responsibilities of [trustees]/[trustee] and auditor

As explained more fully in the Statement of [Trustees']/ [Trustee's] Responsibilities set out on page [number], the trustee[s] [have]/[has] determined that audited financial statements should be prepared for the purposes of a valuation under the Pension Protection Fund (Valuation) Regulations 2005 and [they]/ [it] [have]/ [has] accepted responsibility for preparing such financial statements, which are intended by [them]/[it] to show a true and fair view.

Our responsibility is to audit, and express an opinion on, the financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland). Those standards require us to comply with the Auditing Practices Board's (APB's) Ethical Standards for Auditors.

Scope of the audit of the financial statements[2]

A description of the scope of an audit of financial statements is provided on the APB's website at www.frc.org.uk/apb/scope/private.cfm.

Opinion on financial statements

In our opinion the financial statements:

- show a true and fair view of the financial transactions of the scheme during the period from [date 1] to [date 2] and of the amount and disposition at [date 2] of its assets and liabilities, other than liabilities to pay pensions and benefits after the end of the period;
- have been properly prepared in accordance with UK Generally Accepted Accounting Practice[3]; and
- contain the information specified in the Schedule to the Pension Protection Fund (Valuation) Regulations 2005 made under the Pensions Act 2004.

Audit firm signature
Statutory Auditor
Place and Date of signature

[2] The wording of the scope section of the audit report is a matter for the firm's policy. An alternative to cross-referral to the APB website is to provide a paragraph summary, the wording for which is normally based on the overview paragraph on the APB website.

[3] If appropriate/relevant, the auditor may want to add additional bullet points as to exactly what the net asset statement has been prepared in accordance with, for example its consistency with the actuarial calculation, or performance in accordance with any directions issued by the PPF.

APPENDIX 2

Suggested wording of the Statement of trustees' responsibilities for segregated financial statements

Statement of Trustees' Responsibilities[4]

Following the appointment of administrators to a participating employer of the Scheme on xxxxxx, the Trustees are responsible for obtaining audited accounts for the purposes of valuations required by section 143 of the Pensions Act 2004.

These audited financial statements, which are the responsibility of the Trustees, have been prepared as at xxxxxx under the Trust deed and the Pension Protection Fund (Valuation) Regulations 2005 so as to;

- show a true and fair view of the financial transactions of the scheme during the period and of the amount and disposition at the end of the scheme period of its assets and liabilities, other than liabilities to pay pensions and benefits after the end of the period; and
- contain the information specified in the Schedule to the Pension Protection Fund (Valuation) Regulations 2005, ('the Valuation Regulations') including a statement whether the financial statements have been prepared in accordance with the Statement of Recommended Practice 'Financial Reports of Pension Schemes'.

The Trustees have supervised the preparation of the financial statements and have agreed suitable accounting policies, to be applied consistently, making any estimates and judgments on a prudent and reasonable basis.

The Trustees also have a general responsibility for ensuring that adequate accounting records are kept and for taking such steps as are reasonably open to them to safeguard the assets of the scheme and to prevent and detect fraud and other irregularities, including maintenance of an appropriate system of internal control.

The Trustees are also responsible under regulations issued under the Pensions Act 2004 for the creation of new scheme parts to value the liabilities of those employers that have entered insolvency and those that have not, as at the date of the financial statements, and for obtaining a statement of the allocation of the scheme's net assets to those parts. In determining this allocation, the Trustee is responsible for consulting the Scheme Actuary and for acting in accordance with the Scheme Rules and with any directions from the Pension Protection Fund.

[4] The Pension Protection Fund website contains guidance on the trustees' statement of responsibilities.

APPENDIX 3

Suggested additional wording to be included in the statement of trustees' responsibilities for the normal annual report and accounts statutory financial statements containing segregated sections

Following the appointment of administrators to a participating employer of the Scheme on xxxxxx, the Trustees are responsible under regulations issued under the Pensions Act 2004 for the creation of new scheme parts to value the liabilities of those employers that have entered insolvency and those that have not, as at the date of the financial statements, and for obtaining a statement of the allocation of the scheme's net assets to those parts. In determining this allocation, the Trustee is responsible for consulting the Scheme Actuary and for acting in accordance with the Scheme Rules and with any directions from the Pension Protection Fund.