

Pension Trustees

Evaluating your Scheme Auditor

THE
INSTITUTE OF
CHARTERED
ACCOUNTANTS
OF SCOTLAND



Guidance on assessing the pension scheme's auditor and the selection and appointment of a new auditor.



A Practical Guide from The Institute of Chartered Accountants of Scotland.

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Introduction

This guide is designed to assist pension trustees in managing and reviewing the service provided by the scheme auditor (the auditor) and to maximise the benefits from the statutory audit process. The guide consists of two checklists, each with a series of questions which should be considered:

- in an assessment of the auditor; and
- during an audit tender process.

The questions, whilst not exhaustive, are designed to highlight the relevant issues in order to help pension trustees evaluate the auditor of their pension scheme.

The scope of an audit is defined in accordance with auditing standards. In order to fulfil this statutory requirement, the auditor needs to undertake appropriate work which will be based, in part, on the auditor's assessment of the accounting and scheme risks. Prior to the audit commencing, the trustees could expect to be informed about the expected timetable and the proposed strategy.

An important element of the audit relationship is the quality of the service, which in a specialised field such as pensions will depend on technical knowledge and experience, and also the quality of the audit staff. Quality is affected too, by the working relationship between the auditor and the parties involved in the audit, and the standards of service are influenced by matters such as the auditor's ability to meet timetables and to provide constructive feedback. For their part, those working on behalf of the pension scheme should be prepared to engage and openly discuss issues with the auditor and should seek to work with the audit firm in a professional manner.

There are a number of important relationships in a pension scheme audit engagement which need to be managed effectively, including those between the trustees as a governing body, those preparing the accounts, the pension actuary and administrators, other professional advisers, and the employer. It is vital that these relationships allow for open and honest communications between all parties, and trustees should also encourage a positive working relationship with the auditor.

Some pension scheme trustees rely on their administrators and the auditor to manage the audit process, with the trustees only becoming actively involved if a major issue arises. However, trustees remain responsible for evaluating the service and without close involvement it may be difficult for them to assess their auditor, and there may be a temptation to rely on feedback and comments from the pension administrators. Trustees should consider whether there is a need to be more actively involved in the audit process, to ensure that both the pension administrators and the auditor have an effective and efficient approach to the audit. Trustees may wish to consider setting up an audit committee to do so.

This document is not intended to be prescriptive but simply to share good practice. It is relevant to any pension scheme but is particularly appropriate for smaller schemes. When using it, trustees should document a summary of their review and any subsequent conclusions.

Checklist 1: Assessment of the Auditor

Perceptions of audit service are influenced by matters such as the auditor's ability to meet timetables, provide pro-active support, and to give constructive feedback. Also important, in a specialised and regulated field such as pensions, is the auditor's knowledge and experience in this area, and the quality of the audit staff.

Those working on behalf of the pension scheme should be prepared to engage and openly discuss issues with the auditor and work with the audit team in a professional manner. There should be a sound working relationship, although it remains important that the audit firm has processes and procedures in place to ensure that it provides a professional, objective and independent service. For both the auditor and the pension trustees this is an important area of reputational risk management, and neither party can afford to allow their independence to be compromised.

Responsibility for auditing the accounts is distinct from the trustees' duty to prepare those accounts. The trustees are also responsible for preparing their report. The auditor will read the trustees' report and all other information in the annual report for any inconsistencies with the accounts. As part of this process the trustees may wish to consider the following questions:

- 1. Are the trustees satisfied that they understand their responsibility for producing accounts and ensuring the appropriateness of the accounting policies applied? Are the trustees aware of the timescales for approving and signing the accounts and ensuring they have the appropriate technical knowledge and understanding of the accounts to be able to discharge their responsibilities?*
- 2. Has a meeting been scheduled at which the trustees will approve the accounts and do the trustees ensure that they provide input into the accounts on a timely basis? Was the meeting on schedule and effective? If not, why not?*

An essential part of the trustees' risk management process is to assess formally the audit service each year. In doing so, the following questions should be considered:

Independence and Objectivity

- 1. Are the trustees satisfied that the audit partner and staff have the appropriate level of seniority, and relevant pension experience and expertise? In particular, this may need consideration when there is audit partner rotation or frequent staff changes.*
- 2. Does the auditor also undertake any work for the sponsoring employer or associated companies and, if so, could this give rise to conflicts of interest?*
- 3. Is the relationship between the auditor and those running the pension scheme such that the auditor retains his objectivity and is demonstrably independent? For example, might the relationship be compromised due to over-familiarity, or excessive awards of non-audit work?*

Audit Strategy

- 1. Did the auditor communicate the audit strategy, which included identifying the work to be undertaken, a timetable, identifying the personnel involved, and the audit fee? Has the auditor worked within this plan or agreed any changes in advance?*
- 2. Did the auditor discuss with the trustees the audit approach and scope of work to be carried out and do the trustees consider that these are appropriate?*
- 3. Has the auditor made suitable arrangements in relation to service organisations supplying outsourced functions to the pension scheme, for example, administrators, investment managers?*
- 4. Has the auditor made an assessment of the pension scheme's risks, both qualitative and quantitative, its accounting issues, and how they will be addressed as part of the audit approach, including use of experts in specialist or complex areas?*
- 5. Has the auditor discussed with the trustees whether there are any recent changes in the scheme that may lead to specific changes of focus in the audit, e.g. on investment transitions, transfers of administrator functions?*
- 6. Was the timing of the auditor's procedures and communication with the pension trustees tailored to the annual reporting cycle? Did the auditor explain what information would be communicated to the pension trustees and when, e.g. the audit strategy, any interim reports, adverse and unexpected findings, and the final report to the pension trustees?*

Conduct of the Audit

1. Did the auditor put in place procedures to report matters back to the trustees on a timely basis? Were issues, including adverse or unexpected findings, communicated on a timely basis?
2. Was the actual or potential resolution of significant audit and accounting issues discussed and agreed with administrators and the accounts preparation team? Were they documented for the pension trustees consideration and, if necessary, what follow up procedures have there been?
3. Did the auditor provide the pension trustees with a final report on the full year audit in advance of the trustee meeting to approve the annual accounts. This should include an overview of results, any significant audit and accounting issues, and any instances of material fraud or errors?
4. Did the auditor identify any areas for improvement in the audit approach and discuss these with the pension trustees?
5. Did the auditor make constructive recommendations on improving the scheme's control environment?
6. Did the auditor provide details of significant weaknesses in the accounting and internal control systems found during the audit, and were any recommendations for improvement considered to be practical and effective?
7. Did the auditor consider the appropriateness and effectiveness of the trustees' broader risk management processes and governance of the scheme, and were any recommendations for improvement considered to be practical and effective?
8. Has there been any disagreement between the trustees and the auditor and, if so, was this resolved satisfactorily?
9. Are the accounts prepared using the latest version of the Statement of Recommended Practice 'Financial Reports of Pension Schemes'? Does the auditor refer to Practice Note 15 'The Audit of Occupational Pension Schemes in the UK (Revised)'?
10. Does the auditor provide the trustees with an update on any relevant accounting developments, financial reporting issues, and any other relevant regulatory changes?
11. Has the auditor actively sought feedback on the audit service provided to the trustees?

Overall Evaluation

1. Did the auditor keep to budget? Were any variations or fee additions discussed with the trustees and properly justified?
2. Are the audit fees reviewed for reasonableness?
3. Do the trustees consider that the annual audit was effective, of good quality and value for money?

Summary

In assessing the audit service, the trustees should evaluate:

- The independence and objectivity of the auditor;
- Whether there is an effective audit strategy in place prior to audit commencement;
- Whether the auditor has worked professionally with the trustees and other advisers and whether the auditor has met the objectives and level of service agreed at the outset with the trustees; and
- Overall, whether the annual audit was conducted efficiently and effectively, offering value for money.

If the trustees are satisfied with the audit, they can then decide if they wish to re-appoint the auditor for the following year. Re-appointment should not simply be by default. If the trustees are not satisfied with the audit process they need to decide the main reasons for this and take steps to address them. Issues may be resolved by a meeting with the auditor and/or the sponsoring employer. Otherwise the trustees may decide to consider appointing a different auditor and to test the service, quality, and cost levels of other firms by putting the audit out to tender.

Checklist 2: The Selection and Appointment of a New Auditor

The trustees may decide to benchmark or compare the service, quality and cost levels of the audit by putting it out to tender. Audit tenders are costly exercises for both the pension scheme and the audit firms. The process may tie up significant amounts of resources and both parties can incur significant costs. That said, a change of auditor is unlikely to be required on a frequent basis and, when a change is required, the time and cost of a tender process should be fully justified by the trustees. Prior to entering into a tender process, careful consideration needs to be given as to what the pension trustees are seeking to achieve in relation to both cost and quality of service.

Having determined the purpose of any potential change in auditor and the possible list of contenders, the pension trustees will need to reduce this to a feasible number of audit firms which are to be invited to tender. It is suggested that less than three participants would not normally provide a sufficiently robust tender, particularly if the current auditor is part of the process.

In considering the selection and appointment of a new audit firm, the pension trustees will require to engage support from various functions such as the accounts team, the administrators, and possibly other advisers.

When considering the selection of a new auditor the following questions should be addressed:

Initial Considerations

1. Do the trustees have a policy stating how often they review professional adviser appointments?
2. Have the reasons for putting the audit out to tender been clearly debated so that all trustees know why this course of action is proposed?
3. Has an analysis been performed to ascertain which audit firms have the necessary pensions expertise and which it would be appropriate to invite to participate in the process? Does this include: reputation of audit firm; industry knowledge; any past experience of working with the particular audit firm; financial stability, risk profile and litigation record. Have the trustees considered any personal references?
4. Do any potential conflicts exist, such as existing relationships or engagements with the sponsoring employer or with one or more of the trustees or the administrators? If so, have the potential conflicts of interest been evaluated and decisions made regarding which potential conflicts the trustees are prepared to accept and manage?
5. Have the trustees prepared an invitation to tender with specifications of the desired content of the proposals to be received from each firm?
6. Has a timetable been prepared for the tendering process and is it realistic?
7. Have all costs associated with the tendering and handover process been assessed?
8. How will each tender offer be evaluated and by whom?

In an invitation to tender the trustees may find it useful to provide the following information, subject to confidentiality agreements, to the prospective audit firms:

- Size and nature of the pension scheme;
- The parties involved, such as administrators and other advisers;
- Prior year accounts;
- Future plans of trustees for ongoing management of the scheme, such as change of investment structure, investment managers or administrators;
- Trust deed and rules;
- Members' booklets and information;
- Any significant matters arising from previous audits;
- Relevant information about the sponsoring employer(s); and
- Future funding plans.

Selecting an Auditor

1. Has a list of questions been prepared which are to be addressed in the presentations by the prospective audit firms, for example, will the short-listed auditors be asked to comment on the scheme's accounts or other relevant documentation?
2. Has it been decided which trustees, or if all of the trustees, should attend the audit firm presentations, and whether anyone else should attend? Have dates been circulated for these meetings? Has it been decided which trustees will consider the prospective audit firms' final written submissions?
3. Has a methodology for assessing/scoring each firm's submission or presentation been prepared?
4. Does the audit team presenting to the pension trustees include those who will actually conduct the audit?
5. Are expected audit hours and scale rates comparable with other firms? Is the audit firm willing to disclose its percentage recovery on chargeable time, and if so, what does this indicate?
6. Have references been sought from two or three other pension scheme clients of the chosen audit firm?

The following factors should be considered in making the final decision on the appointment of the auditor:

- Reputation and financial stability of the audit firm;
- Feedback from references;
- Previous experience and recommendations from others;
- Value for money;
- Personality and experience of the key audit staff;
- Depth of audit team expertise and technical back-up;
- Pensions audit expertise;
- Independence and objectivity;
- Procedures for ensuring continuing independence and objectivity; and
- Any proposed liability limitation agreement.

The pension trustees should properly document their conclusions.

Summary

In order to conduct a rigorous audit tender process the pension trustees should consider:

- The reasons for putting the audit out to tender and what is required from the audit service;
- Which firms should be invited to tender, what information is sought, and a timetable for delivery; and
- How to evaluate each tender bid.

Appointment of a New Auditor

If the trustees decide to change the current auditor and appoint a new auditor, there will be various legal and procedural matters for which professional advice may need to be sought.

Appendix

Sources of Further Information

- ICAS** Pensions Trustees: Assessing and Managing Risks www.icas.org.uk/business
- APB** Auditing Practices Board www.frc.org.uk/apb which publishes Practice Note 15 'The Audit of Occupational Pensions Schemes in the United Kingdom (Revised)' and 'Ethical Standards for Auditors'
- DWP** Department for Work and Pensions www.dwp.gov.uk
- FRC** Financial Reporting Council www.frc.org.uk
- NAPF** National Association of Pensions Funds www.napf.co.uk
- PMI** Pensions Management Institute www.pensions-pmi.org.uk
- PPF** Pension Protection Fund www.pensionprotectionfund.org.uk
- PRAG** Pensions Research Accountants Group www.prag.org.uk which publishes the Statement of Recommended Practice 'Financial Reports of Pension Schemes'
- TPR** The Pensions Regulator www.thepensionsregulator.gov.uk

The Pensions Regulator has issued a number of guidance documents, which can be found on its website, and the following have relevance to working effectively with the auditor:

Regulatory Guidance: Relations with Advisers

Regulatory Guidance: Conflicts of Interest

Code of Practice 01: Reporting Breaches of the Law

Code of practice 09: Internal Controls

This booklet can be downloaded without charge from the Institute's website at:
www.icas.org.uk/business

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