

PRACTICE NOTE 22

THE AUDITORS' CONSIDERATION OF FRS 17 'RETIREMENT BENEFITS' – DEFINED BENEFIT SCHEMES

Contents

Introduction

- Background
- The audit approach
- Ethical issues

Planning considerations

- Communication with the entity directors
 - Engagement letters
- Communication with other parties
- Materiality

Audit evidence

- Obtaining an understanding of the retirement benefit schemes
- Scheme assets
 - Using the work of the scheme auditors
 - Multi-employer schemes
- Scheme liabilities
 - The need to use the work of the actuary
 - The competence and objectivity of the actuary
 - The scope of the actuary's work
 - Assessing the work of the actuary as audit evidence
 - Source data
 - Actuarial assumptions
 - Assessing the results of the actuary's work
 - Materiality and the valuation of the scheme liabilities
 - Accounting policies
- Recognition in the balance sheet
 - Going concern
- Recognition in the profit and loss account and the Statement of Total Recognised Gains and Losses (STRGL)
 - Expected return on scheme assets and discount rate
- Disclosures
- Distributable profits

Management representations

Public sector considerations

Appendix 1 – Consideration of retirement benefits in the review of interim reports

Appendix 2 – Examples of risks of materials misstatement in relation to FRS 17

Appendix 3 – Smaller entities with insured schemes

INTRODUCTION

Background

1 This Practice Note gives guidance to auditors on their consideration of and response to the risk of material misstatement of the financial statements of a reporting entity in relation to the requirements of Financial Reporting Standard 17 'Retirement benefits' (FRS 17), in the context of an audit of those financial statements in accordance with Auditing Standards.¹

2 FRS 17 deals with retirement benefits payable under both defined contribution schemes and defined benefit schemes. However, the Auditing Practices Board considers that the issues raised by defined contribution schemes will normally be less complex than in the case of defined benefit schemes and do not require specific auditing guidance. Accordingly, this Practice Note provides auditing guidance only in relation to defined benefit schemes.²

3 As defined in FRS 17, the term 'retirement benefits' includes not only pensions but all other post-retirement benefits (such as health care, life insurance and disability income), irrespective of whether these arrangements:

- are statutory, contractual or implicit in the employer's actions;
- arise in the United Kingdom and the Republic of Ireland or overseas;
- are funded or unfunded;
- are approved or unapproved.

Accordingly, retirement benefits include not only post-retirement benefits payable under a formal trust but also those payable pursuant to an informal agreement, such as a promise, a public statement or a similar commitment by the employer.

4 The requirements of FRS 17 are being introduced in three stages, commencing with accounting periods ending on or after 22 June 2001, for which only certain of the disclosures specified by FRS 17 are to be made. The full requirements of FRS 17 are only to

1 FRS 17 was issued by the Accounting Standards Board in November 2000. It applies to all financial statements that are intended to give a true and fair view of a reporting employer's financial position and profit or loss (or income and expenditure) for a period.

2 The following terms are defined in paragraph 2 of FRS 17:

- **retirement benefits** – all forms of consideration given by an employer in exchange for services rendered by employees that are payable after the completion of employment
- **defined contribution scheme** – a pension or other retirement benefit scheme into which an employer pays regular contributions fixed as an amount or as a percentage of pay and will have no legal or constructive obligation to pay further contributions if the scheme does not have sufficient assets to pay all employee benefits relating to employee service in the current and prior periods
- **defined benefit scheme** – a pension or other retirement benefit scheme other than a defined contribution scheme.

be regarded as standard for accounting periods ending on or after 22 June 2003, although the Accounting Standards Board encourages their early adoption.

5 The requirements of FRS 17 apply only to financial statements. Appendix 1 to this Practice Note gives guidance on the auditors' consideration of retirement benefits in a review of a reporting entity's interim report.

The audit approach

6 For all defined benefit schemes (other than certain multi-employer defined benefit schemes that are required to be accounted for as defined contribution schemes (see paragraph 38 below)), FRS 17 requires:

- (a) the scheme assets and liabilities to be valued using specified methods;
- (b) the surplus (or deficit) to be recognised as an asset (or liability) by the reporting entity;
- (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; and
- (d) certain additional disclosures to be made in the reporting entity's financial statements.

7 It is the entity directors' responsibility to establish a process that will enable the reporting entity to comply with FRS 17 and to designate the individuals within the reporting entity who are responsible for this process. The entity directors may not have immediate access to the records of the scheme assets and so may not be in a position to value those assets themselves. Furthermore, the entity directors do not normally possess the expertise required to undertake the valuation of scheme liabilities on the actuarial basis specified by FRS 17. Accordingly, the process established by the entity directors may involve:

- (a) the scheme assets being valued by the scheme trustees, who may, in turn, obtain valuations of:
 - quoted securities from the fund managers or investment custodians;
 - insurance policies from the insurers; and
 - other types of asset from experts (for example, property valuers); and
- (b) the scheme liabilities being valued by a qualified actuary.

8 The entity auditors' objective in relation to FRS 17 is to consider the appropriateness of the steps that the entity directors have taken to satisfy themselves that the amounts and

disclosures included in the financial statements are sufficiently reliable. In particular, the entity auditors consider the risk that the entity directors may not have devoted sufficient resources to this process. The nature, timing and extent of the entity auditors' procedures depend on their judgement as to the materiality of the amounts involved and the risk of material misstatement of the financial statements.

9 For the scheme assets, the entity auditors may be able to obtain all the audit evidence they consider necessary without performing procedures directly on the records of the scheme assets held by the scheme trustees. In other cases, they may consider that such procedures are necessary and may, where practicable, ask the entity directors to arrange with the scheme trustees for this work to be performed by the scheme auditors. Any procedures in relation to the scheme assets for the purposes of the audit of the reporting entity financial statements are separate from, and additional to, the audit of the scheme financial statements.

10 For the scheme liabilities; the entity auditors normally obtain some of the audit evidence they require by using the results of the work performed by the actuary who has valued the scheme liabilities.

11 The actuary can be expected to co-operate with the entity auditors. Such cooperation is often encouraged in the guidance to actuaries issued by their professional bodies; in other cases, the entity directors, when appointing an actuary, may be able to obtain the actuary's agreement to cooperate with the entity auditors.³

12 It is not the role of the entity auditors to 'second guess' the work performed by the actuary. However, they need to be able to consider whether the steps taken by the entity directors are appropriate and whether, in the context of the financial statements taken as a whole, the accounting entries and disclosures required by FRS 17 (and the trends reported over time) are consistent with their knowledge of the reporting entity.

Ethical issues

13 SAS 100 'Objective and general principles governing an audit of financial statements' requires auditors to comply with the ethical guidance issued by their relevant professional bodies. This guidance specifically considers the threat to the auditors' independence and objectivity that may exist when the audit firm (or an associated firm or organisation) provides an audit client with other services, particularly when they directly affect amounts or disclosures in the financial statements.

14 The provision by the audit firm of actuarial services for the purpose of FRS 17 may present (or may reasonably be perceived to present) a threat to their independence and objectivity as entity auditors. The provision of some other form of actuarial services (that is,

³ The Institute and Faculty of Actuaries have jointly developed professional guidance (exposure draft at time of printing) for their members when advising clients in connection with FRS 17.

other than for the purpose of FRS 17) may also compromise their independence and objectivity if the entity directors subsequently decide to use the results of that work for the purpose of FRS 17. In such cases, the nature of the actuarial services requested by the reporting entity may be such that the firm concludes that it cannot adopt safeguards that would adequately address the threat to independence and objectivity that would arise. In such circumstances, the firm would not be able to accept both engagements.

15 SAS 610 (revised) 'Communication of audit matters to those charged with governance' requires the auditors of a listed company:

- (a) to disclose in writing to the audit committee and discuss as appropriate:
 - all relationships that may reasonably be thought to bear upon the firm's independence and the objectivity of the audit engagement partner and the audit staff;
 - and the related safeguards that are in place; and
- (b) to confirm in writing to the audit committee that, in their professional judgement, the firm is independent and that the objectivity of the audit engagement partner and the audit staff is not impaired.⁴

⁴ SAS 610 (revised) was issued in June 2001 and auditors are required to comply with it in respect of audits of financial statements for periods commencing on or after 23 December 2001.

PLANNING CONSIDERATIONS

Communication with the entity directors

16 At the planning stage of the audit, the entity auditors make enquiries in order to understand and assess the process established by the entity directors to enable the financial statements to be prepared in compliance with FRS 17. Issues to be covered in these discussions include ascertaining:

- who is responsible for the process;
- what arrangements have been made for identifying those schemes that are significant to the reporting entity's compliance with FRS 17;
- who is valuing the scheme assets;
- what arrangements have been made for identifying matters of significance affecting the actuarial valuation (for example, matching the treatment in the scheme assets and in the scheme liabilities of large bulk transfers in or out);
- who is valuing the scheme liabilities;
- how the actuarial assumptions are to be developed and approved;
- whether there is a realistic, coordinated timetable, that takes into account the time needed for the entity auditors to complete their work in connection with retirement benefits;
- whether there are arrangements in place to enable effective communication between all of the parties involved.

17 The entity auditors also discuss with the entity directors the risk of material misstatement of the financial statements in relation to the requirements of FRS 17, with particular reference to areas of higher risk. Appendix 2 to this Practice Note gives some illustrative examples of risks of material misstatement of the financial statements in relation to the requirements of FRS 17.

18 Enabling effective communication between all of the parties involved in complying with FRS 17 is the responsibility of the entity directors and an important aspect of the process established by them. Facilitating dialogue between these parties before any of the work is commenced assists the entity directors to ensure that there is a common understanding as to the work each party is to perform and the timetable for its completion. Appendix 3 to this Practice Note gives guidance on some issues that may of particular relevance in the context of smaller reporting entities with insured schemes.

19 Although it is the responsibility of the entity directors to ensure compliance with FRS 17, they normally delegate to one or more members of management the responsibility for managing the process established to achieve this. Accordingly, in this Practice Note, references to the entity auditors communicating with, making enquiries of or holding discussions with the entity directors are to be construed as referring to the relevant members of management, whenever appropriate.

Engagement letters

20 The issuance of FRS 17 does not represent a fundamental change in legal or professional requirements, but it does underline the need for a clear understanding between the entity directors and the entity auditors about, for example, the involvement of other auditors and experts in the audit. These matters can often be satisfactorily addressed in discussion with the entity directors, or clarified with them in writing, at the planning stage of the audit.

Communication with other parties

21 At the planning stage of the audit, having obtained the permission of the entity directors, the entity auditors normally communicate with the actuary who will be valuing the scheme liabilities for the purpose of complying with FRS 17. Depending on the circumstances, they may also communicate with the scheme auditors (particularly if they will be assisting the entity auditors with the audit procedures relating to the scheme assets) and with any fund manager, investment custodian, insurer or expert who will be valuing the scheme assets.

22 Such communications provide the entity auditors with an early opportunity to:

- (a) assess the objectivity, qualifications, experience and resources of the actuary (see paragraphs 43 to 46 below); and
- (b) (where appropriate) consider the qualifications, experience and resources of the scheme auditors and to inform them how their work will be used (see paragraph 37 below).

It also enables them to explore on a preliminary basis the scope of the actuary's work and any specific issues concerning the actuary's work that are of interest to them (see paragraphs 47 to 50 below).

23 The entity auditors consider any engagement letter, correspondence or other document that contains the entity directors' instructions to the actuary or specifies any limitations on the scope of the actuary's work, or that otherwise defines the relationship between the reporting entity and the actuary.

24 Where the reporting entity is preparing consolidated financial statements, there may be a large number of schemes and consequently many different trustees and actuaries with

whom the entity auditors might wish to communicate concerning the audit evidence that is needed. Some of the responsibility for this may in practice be passed to the auditors of the subsidiary undertakings, although (in the case of overseas subsidiaries) it will be important to establish that those auditors are familiar with FRS 17. In some cases, a 'lead actuary' may be identified by the reporting entity, to take on the role of communicating with those involved in the various schemes and of collating the information required under FRS 17.

Materiality

25 SAS 220 requires auditors to consider materiality when determining the nature, timing and extent of their procedures. A matter is material if its omission or misstatement would reasonably influence the decisions of those to whom the auditors' report is addressed. SAS 220 acknowledges that different materiality considerations may be applied depending on the aspect of the financial statements being considered. For example, the auditors may judge that the expected degree of accuracy of note disclosures is lower than for figures included in the primary financial statements and, accordingly, that the level at which an omission or misstatement becomes material is rather higher.

26 These considerations may be of relevance in the two year transitional period during which FRS 17 is being introduced.⁵ In the first two years, the entity auditors' judgements of materiality relating to the required note disclosures may be based principally on the relative significance of the amounts involved in the context of the reporting entity's balance sheet. In making such judgements, however, they recognise that figures in the note disclosures in the first two years will provide the basis of the comparative figures in the financial statements for the third year.

5 The full requirements of FRS 17 are to be regarded as standard for accounting periods ending on or after 22 June 2003, but for accounting periods ending before that date (but on or after 22 June 2001 and 22 June 2002), only certain of the disclosures required by FRS 17 are to be made. In the first year, these disclosures relate to the closing balance sheet only (without comparative figures for the previous period).

AUDIT EVIDENCE

Obtaining an understanding of the retirement benefit schemes

27 The accounting and disclosure requirements of FRS 17 could have a material impact on the financial statements of some reporting entities. Knowledge of the existence of retirement benefit schemes and familiarity with the general nature of their provisions is therefore important to the entity auditors when assessing the financial statement assertions related to scheme assets and liabilities and the cost of providing retirement benefits.

28 To ascertain the arrangements made for providing retirement benefits, the entity auditors make enquiries of the entity directors and obtain an understanding of the rules of any schemes that appear to be significant to the reporting entity's compliance with FRS 17.

29 An understanding of the rules of a scheme may, in some cases, enable the entity auditors to identify obligations to pay retirement benefits. However, there may also be benefits payable that are not recorded in the rules. For example, there may be:

- legal obligations to pay retirement benefits, which arise from informal agreements rather than from a formal contract;
- 'constructive obligations' (for example, where pension benefits are regularly enhanced beyond the minimum required by statute);⁶ or
- statutory requirements that over-ride the original provisions of a scheme.

The entity auditors make enquiries of the entity directors in order to understand and assess how these issues have been addressed by the process established by the entity directors to enable them to capture the information needed to prepare financial statements in compliance with FRS 17.

30 Procedures performed by the entity auditors to satisfy other objectives of the audit, for example, reviewing minutes of meetings of the board of directors, may also assist them to identify obligations to pay retirement benefits. Depending on the entity auditors' assessment of the risk of material misstatement of the financial statements, they may plan and perform additional procedures specifically designed to identify obligations to pay retirement benefits, for example, reviewing minutes of meetings of the reporting entity's human resources or remuneration committees, or its communications with trades unions and employees (including contracts of employment).

Scheme assets

31 The scheme assets include current assets such as cash deposits, as well as

⁶ Constructive obligations are dealt with at greater length in Financial Reporting Standard 12 'Provisions, contingent liabilities and contingent assets'.

investments: any liabilities, such as accrued expenses, are to be deducted. Investments normally comprise one or more of the following:

- quoted securities (equity and non-equity shares, bonds);
- unquoted securities;
- unitised securities;
- insurance policies;
- loans and debt instruments; and
- freehold or leasehold properties.

Investments occasionally include futures and options, works of art and antiques.

32 The entity auditors may be able to obtain all the audit evidence they consider necessary in relation to the scheme assets without procedures being performed directly on the records of the scheme assets held by the scheme trustees. For example, if the period between the most recent scheme year-end date and the reporting entity balance sheet date is short and if the audited scheme financial statements are available, the entity auditors may consider that sufficient audit evidence can be obtained by:

- asking the entity directors to prepare a reconciliation of the scheme assets valuation at the scheme year-end date with the portfolio valuation at the reporting entity balance sheet date which is being used for FRS 17 purposes;
- obtaining direct confirmation of the scheme assets from the investment custodian; and
- examining the principal reconciling items, such as contributions received; benefits paid; large bulk transfers in and out and estimated investment returns.

Using the work of the scheme auditors

33 In other cases, the entity auditors may consider that procedures do need to be performed directly on the records of scheme assets. They may be able to undertake such procedures themselves, if the entity directors give their permission and if the scheme trustees are willing to allow them access. Alternatively, when planning the audit, the entity auditors may, where practicable, ask the entity directors to arrange with the scheme trustees for the necessary procedures to be performed by the scheme auditors. The entity auditors

use the work of the scheme auditors in accordance with SAS 510 'The relationship between principal auditors and other auditors'.⁷

34 Using the work of the scheme auditors may be necessary if the scheme trustees stipulate that only the scheme auditors may have access to the records of the scheme assets. However, the decision to use the scheme auditors may also result from considerations of efficiency and effectiveness. The scheme auditors normally will be particularly well-placed to assist the entity auditors to obtain audit evidence relating to, for example, the financial statement assertions regarding the:

- existence;
- completeness;
- ownership; and
- valuation

of the scheme assets. They can also be expected to be familiar with the scheme assets and the accounting records held by the scheme trustees and, therefore, to be able to perform the necessary procedures in a cost-effective manner.

35 The scheme auditors may also be able to use some of their work on the audit of the scheme financial statements as a source of evidence for this purpose. In the course of their audit, the scheme auditors will have complied with the requirements of SAS 480 'Service organisations', where applicable. SAS 480 establishes standards and provides guidance on procedures to obtain sufficient appropriate audit evidence where an entity uses service organisations, such as investment custodians. Most scheme assets are held by investment custodians. The procedures include:

- understanding and documenting the contractual terms that apply to investment custodians; and
- assessing whether sufficient appropriate audit evidence concerning the relevant financial statement assertions is available from records held by the scheme and, if it is not, obtaining such evidence either by direct access to the records of the investment custodian or by obtaining information from the investment custodian or reports by its auditors.

⁷ SAS 510 establishes standards and guidance regarding the use by principal auditors, reporting on the financial statements of an entity, of other auditors' work on the financial information of one or more components included in the financial statements of the entity. 'Component' is defined as 'a division, branch, subsidiary undertaking, joint venture, associated undertaking or other entity whose financial information is included in financial statements audited by the principle auditors'. The principles of SAS 510 apply to the entity auditors' use of the scheme auditors' work on the scheme assets.

The scheme auditors normally also obtain direct confirmation in writing from fund managers or investment custodians of the scheme assets as at the scheme year-end date.

36 The scheme auditors will need to perform procedures in addition to those performed for the audit of the scheme financial statements. For example:

- if the reporting entity and the scheme do not share the same accounting period, additional procedures may be needed to update their work on the audit of the scheme financial statements to the reporting entity's balance sheet date; and
- if the reporting entity and the scheme do share the same accounting period but the financial statements of the scheme will not be prepared and audited to the same timetable as those of the reporting entity, additional procedures may be necessary to obtain the evidence needed by the entity auditors on a timely basis.

The scheme auditors may wish to agree a separate engagement letter with the scheme trustees before undertaking this work.

37 Having obtained the permission of the entity directors and the scheme trustees, the entity auditors communicate with the scheme auditors at the planning stage of the audit to agree on the audit work to be undertaken by the scheme auditors. In accordance with SAS 510, the entity auditors obtain sufficient appropriate audit evidence that the work of the scheme auditors is adequate for the entity auditors' purposes. The entity auditors confirm in writing the nature and extent of the procedures to be undertaken by the scheme auditors and the level of materiality to be applied. The entity auditors agree with the scheme auditors, and with the scheme trustees and the entity directors, when the results of that work are to be reported to the entity auditors and the manner in which they are to be reported. Where practicable, the entity auditors require the scheme auditors to provide a report on the factual findings resulting from performing the specified procedures.

Multi-employer schemes

38 When more than one employer participates in a defined benefit scheme, it is known as a 'multi-employer scheme'. In some cases the scheme assets are not clearly allocated to specific employers and it may be difficult to identify the share of the underlying assets and liabilities attributable to each participant on a consistent and reasonable basis. In such circumstances, FRS 17 requires the contributions to be accounted for as if the scheme were a defined contribution scheme, provided that there is disclosure in the financial statements of:

- (a) the fact that the scheme is a defined benefit scheme but that the reporting entity is unable to identify its share of the scheme assets and liabilities; and
- (b) any available information about the existence of a surplus or deficit in the scheme and the implications of that surplus or deficit for the reporting entity.

39 In such circumstances, the entity auditors make enquiries of the entity directors regarding the basis for their conclusion that the entity's share of the scheme assets and liabilities cannot be identified and consider any relevant professional advice (for example actuarial or legal advice) that the entity directors may have obtained on this issue. Where different contribution rates apply to different employers participating in the scheme, this may indicate that an allocation of the underlying assets and liabilities is possible. The entity auditors obtain an understanding of the principal provisions of the scheme and of any circumstances (such as the winding-up of the scheme) in which a deficit in the scheme may give rise to either:

- a liability (or contingent liability) in the reporting entity; or
- concern about the reporting entity's ability to continue as a going concern..

Scheme liabilities

The need to use the work of the actuary

40 The scheme liabilities represent the discounted present value of the accrued future retirement benefit obligations based on service up to the reporting entity's balance sheet date. They may be based either on a full actuarial valuation or a more recent actuarial assessment, as at the reporting entity's balance sheet date, or on an update (as at that date) of the most recent full valuation or assessment. (In this Practice Note, 'valuation' refers to a full actuarial valuation, an actuarial assessment or an update.) A full actuarial valuation by a professionally qualified actuary is normally required every three years but will rarely be available as at the reporting entity's balance sheet date. Accordingly, for FRS 17, the actuary will normally review and update the most recent full valuation or subsequent actuarial assessment.⁸

41 The entity auditors are not expected to have the expertise of a person trained for, or qualified to engage in, the practice of another profession or occupation, such as that of a qualified actuary.

42 Except where retirement benefits are not material to the financial statements, the entity auditors will normally use the work of the actuary as audit evidence. SAS 520 'Using the work of an expert' states that auditors, when determining whether to use the work of an expert, review:

- (a) the importance of the matter being considered in the context of the financial statements;
- (b) the risk of misstatement based on the nature and complexity of the matter being considered; and

⁸ The most recent full actuarial valuation will normally have been performed as at the scheme's year-end date in conjunction with the statutory triennial Minimum Funding Requirement valuation.

(c) the quantity and quality of other available relevant audit evidence.

The competence and objectivity of the actuary

43 SAS 520 requires auditors, when planning to use the work of an expert, to assess the expert's objectivity, qualifications, experience and resources. It indicates that this normally involves considering the expert's:

- (a) professional certification, or licensing by, or membership of, an appropriate professional body; and
- (b) experience and reputation.

44 The entity auditors therefore consider whether the actuary is a member of the Institute of Actuaries, the Faculty of Actuaries or the Society of Actuaries, or of a similar professional body of actuaries practising in countries other than the UK and the Republic of Ireland. The Institute, the Faculty and the Society can provide advice on the acceptability of the standards of professional bodies to which foreign actuaries belong.

45 The entity auditors also consider whether there is a risk that the actuary's objectivity may be impaired when the actuary is an employee of, or related in some other manner to, the reporting entity.

46 If the entity auditors are concerned about the competence or objectivity of the actuary they may discuss their reservations with the entity directors and consider whether sufficient appropriate audit evidence can be obtained. They may undertake additional procedures or may request the entity directors to obtain evidence from another actuary. If unable to obtain sufficient appropriate evidence, they consider the implications for their report.

The scope of the actuary's work

47 SAS 520 requires auditors to obtain sufficient appropriate audit evidence that the expert's scope of work is adequate for the purposes of their audit.

48 Having obtained the permission of the entity directors, the entity auditors communicate with the actuary at the planning stage of the audit:

- to inform the actuary that the entity auditors intend to use the work of the actuary as audit evidence;
- to discuss the scope of the actuary's work as agreed between the actuary and the entity directors, for example:

- the steps required to achieve the degree of accuracy required in the valuation within the reporting timescale;⁹
 - the procedures to establish the accuracy, authorisation and completeness of the source data to be used;
 - the possible variation in the liability and costs which the actuary is estimating;¹⁰
 - the impact on the valuation of any significant events of which the entity auditors or the actuary are aware; and
 - the extent to which any events or circumstances indicate that a fuller or more recent valuation might be necessary
- to ascertain the form and content of any reports which the actuary expects to issue for the purpose of FRS 17;
 - to obtain confirmation that the actuary:
 - will comply with the requirements of FRS 17 and with the relevant requirements and guidance of the actuary's professional body;
 - will include all retirement benefits payable under schemes which the actuary has been engaged to advise upon;
 - understands the timetable for the entity directors to prepare the financial statements and for the entity auditors to complete their work in connection with retirement benefits;
 - will advise the entity auditors of any matters which come to the actuary's attention which occur in the period from the reporting entity's balance sheet date up to date on which the valuation is completed that would have a material effect on the valuation of the scheme liabilities; and
 - is content for the entity directors to make available to the entity auditors copies of any draft or final reports for the purpose of FRS 17 that the actuary may provide to them.

The actuary is not under a professional obligation to agree an engagement letter with the entity directors. However, if the actuary's terms of reference have been confirmed in writing,

⁹ Actuarial guidance (exposure draft) requires the actuary to consult with the reporting entity on this matter.

¹⁰ Actuarial guidance (exposure draft) requires the actuary to advise the reporting entity on any aspect of the update likely to lead to material misstatement of liabilities or costs.

the entity auditors may find it helpful to review this documentation in order to obtain an understanding of the actuary's scope of work.

49 As noted above, for most FRS 17 calculations, the most recent full valuation for the scheme will be updated by the actuary to the reporting entity's balance sheet date to reflect current conditions. FRS 17 notes that some aspects of the valuation will need to be updated at each balance sheet date (for example, the financial assumptions, such as the discount rate); other assumptions may not need to be up-dated annually (for example, the mortality rate).¹¹

50 In many cases, the changes since the most recent full actuarial valuation (for example, routine changes in benefits and market conditions) can be adequately reflected by updating that valuation. However, where significant changes have taken place (for example, large bulk transfers in or out, or major new early retirement programmes) or where there is a significant level of uncertainty relating to aspects of the valuation (for example, as a result of a court decision or a change in legislation), the actuary may not be confident that the resulting figures will fall within the materiality limits specified by the entity.¹² If the entity auditors become aware of events or circumstances that appear to indicate that there might be material misstatement of liability or costs, they discuss their concerns with the entity directors and with the actuary and, if necessary, request the entity directors to instruct the actuary to undertake the additional work.

Assessing the work of the actuary as audit evidence

51 SAS 520 requires auditors to assess the appropriateness of the expert's work as audit evidence regarding the financial statement assertions being considered. It states that this involves consideration of, amongst other matters:

- the source data used;
- the assumptions and methods used; and
- the results of the expert's work in the light of the auditors' overall knowledge of the business and the results of other audit procedures.

Source data

52 Source data used by the actuary usually include:

- information as to eligibility, including the number and types of participants covered (active, inactive and former members or beneficiaries), their ages, length of service

¹¹ Similar requirements exist for a triennial funding valuation of the scheme. However the assumptions and measurement methods used for the funding valuation may be different from those for the actuarial valuation required by the FRS.

¹² Actuarial guidance (exposure draft) requires the actuary to advise the reporting entity on any aspect of the update likely to lead to material misstatement of liabilities or costs.

and gender, salary and earnings history of participants and employee contributions (if any), turnover data and employee future benefit credits accrued since the previous valuation; and

- scheme assets, their values, underlying cash transactions, and items of income and expense.

53 The entity directors are responsible for the source data used by the actuary. The entity auditors make enquiries of the entity directors and of the actuary regarding the procedures undertaken to establish the sufficiency, relevance and reliability of the source data used.¹³ If the entity auditors have concerns about the scope of these procedures, they discuss their concerns with the directors and with the actuary and may decide to perform their own procedures.

54 The entity auditors' procedures relating to source data are a matter of judgement; factors they would consider in deciding on the nature, extent and timing of procedures include:

- the nature of the data and sensitivity of the actuarial valuation to the data;
- the source of the data, whether supplied to the actuary by the reporting entity client or by a service organisation, and the extent to which the source data have already been subjected to audit procedures, the nature of those audit procedures (tests of controls or substantive procedures) and by whom (external or internal auditor or the service organisation's auditor) those audit procedures have been applied; and
- the approach taken by the actuary with respect to verifying the validity and completeness of the data.

Actuarial assumptions

55 Actuarial assumptions are estimates of future events that will affect the valuation of the scheme liabilities and the reporting entity's costs of retirement benefits. Examples include such items as mortality rates, termination rates, disability claim rates, retirement age, changes in salary and benefit levels, administrative expenses, discount rates to reflect the time value of money, and return on scheme assets. FRS 17 states that the assumptions are ultimately the responsibility of the entity directors but should be set upon advice given by the actuary.

56 The entity auditors do not have the same expertise as the actuary and cannot necessarily challenge the appropriateness and reasonableness of the assumptions.

13 For members of the Institute of Actuaries and of the Faculty of Actuaries undertaking any actuarial valuation, the Professional Conduct Standards state that the actuary must carry out appropriate investigations to assess the accuracy and reasonableness of any data being used or state why this has not been done.

However, through discussion with the entity directors and, where practicable, with the actuary, the entity auditors:

- obtain a general understanding of the assumptions and review the process used to develop them;
- compare the assumptions with those used by the entity directors in prior years; and
- consider whether, based on their knowledge of the business of the reporting entity and of the scheme and on the results of other audit procedures, the assumptions appear to be reasonable and compatible with those used for the preparation of the financial statements.

Assessing the results of the actuary's work

57 The entity auditors consider whether the results of the actuary's work are consistent with their overall knowledge of the business and the results of other procedures.

58 There is no prescribed form of report for the actuary to deliver to the entity the results of the work performed: normally the figures required for inclusion in the balance sheet, the profit and loss account and the notes to the financial statements are provided in some form of letter or written report. The actuary may also provide a commentary on other matters, such as:

- the movements since the previous valuation in the figures required for inclusion in the balance sheet and the profit and loss account;
- the possible variation in the valuation of the scheme liabilities and the implications for the financial statements and the audit; and
- the sensitivity of the results, funding level, scheme maturity and investments to variations in the source data and assumptions.

The entity auditors obtain copies of all written communications from the actuary to the entity directors concerning the findings of the work performed.

59 The entity auditors enquire of the entity directors whether the actuary has indicated to them that:

- any matters came to his or her attention which occurred in the period from the reporting entity's balance sheet date up to date on which the valuation was completed that would have a material effect on the valuation; or
- he or she had to depart from relevant professional requirements or guidance issued by his or her professional body.

The entity auditors may request the actuary to provide specific confirmation on these points and may enquire as to his or her views on the degree of precision attaching to the valuation and factors giving rise to potential material misstatement. They may also ask the actuary to indicate whether he or she is satisfied that the amounts and disclosures included in the financial statements that relate to retirement benefits adequately reflect the results of his or her work.¹⁴

60 If the results of the actuary's work are not consistent with other audit evidence, the entity auditors attempt to resolve the inconsistency by discussions with the entity directors and with the actuary. Applying additional procedures, including requesting the entity directors to obtain evidence from another actuary, may also assist in resolving the inconsistency.

Materiality and the valuation of the scheme liabilities

61 The defined benefit asset (or liability) is based on the surplus (or deficit) of the value of the scheme assets over the value of scheme liabilities. Although the value of the scheme liabilities may sometimes be material to the financial statements, the figure is an estimate and cannot be stated with certainty. Using generally accepted actuarial techniques, there may be a range of acceptable values. In some circumstances, the entity auditors may not be satisfied that the risk of the scheme liabilities being materially misstated has been reduced to an acceptable level. This might occur, for example, if:

- events or circumstances give rise to an irreducible inherent uncertainty in the valuation; or
- the entity directors have not established an appropriate process with the necessary resources to enable the reporting entity to comply with FRS 17 with the consequence that the actuary has not, in the time available, been able to perform all the procedures that might be necessary to develop a more precise valuation.

62 Where events or circumstances give rise to an irreducible inherent uncertainty in the valuation, this may represent a fundamental uncertainty. In this case, provided the entity auditors are satisfied that the entity directors have included an adequate description of the fundamental uncertainty in the notes to the financial statements, the entity auditors consider adding an explanatory paragraph referring to the fundamental uncertainty in the section of their report setting out the basis of their opinion (see SAS 600 'The auditors' report on financial statements' (paragraphs 54 to 67)).

63 Where the actuary could, in principle, develop a more precise valuation but has not had sufficient time to do so, this absence of audit evidence may be critical and may represent a limitation in the scope of the audit. This may result in the entity auditors issuing

¹⁴ Actuarial guidance (exposure draft) requires that a clear statement of 'remit, information provided all relevant assumptions, results and analysis are made available to assist the auditor'.

a qualified opinion or a disclaimer of opinion (see SAS 600 'The auditors' report on financial statements' (paragraphs 68 to 73)).

Accounting policies

64 Financial Reporting Standard 18 'Accounting policies' (FRS 18) requires disclosures in the financial statements concerning the accounting policies adopted by the reporting entity, including a description of those estimation techniques adopted that are significant in terms of the range of reasonable monetary amounts. FRS 18 states that this description will include details of those underlying assumptions to which the monetary amount is particularly sensitive.

65 FRS 17 itself specifically requires each of the main financial assumptions used to be disclosed, including:

- the inflation assumption;
- the rate of increase in salaries;
- the rate of increase for pensions in payment and deferred pensions; and
- the rate used to discount liabilities.

In many cases, these disclosures will be sufficient to meet any disclosure requirements arising from FRS 18. In some circumstances, however, additional disclosures may be made, for example:

- to provide additional information regarding the estimation techniques used (such as in the case of certain insured schemes (see Appendix 3)); or
- to provide additional contextual information regarding where the estimate falls in relation to the range of reasonable monetary amounts.

The entity auditors carefully consider the adequacy of all such disclosures.

66 Where the entity directors present an Operating and Financial Review (OFR), this may include discussion of the overall performance for the year, including any significant pensions-related gains and losses recognised in the STRGL, and of the principal risks and uncertainties in the business, including any relating to the reporting entity's pension arrangements. Thus, for example, in the case of a deficit in a scheme, the OFR may include the directors' comments on the reasons for the deficit and details of any actions they intend to take. The entity auditors' consideration of the OFR is governed by SAS 160 'Other information in documents containing audited financial statements' (revised).

67 If the entity auditors have concerns regarding the disclosures in the financial

statements or in the OFR, they discuss their views with the directors. If this does not lead to the matter being resolved, the entity auditors may decide to communicate their concerns to those charged with governance, in accordance with SAS 610 (revised) 'Communication of audit matters to those charged with governance' and consider the effect on their audit opinion.

Recognition in the balance sheet

68 FRS 17 requires that a surplus of the value of scheme assets over the value of scheme liabilities be recognised in the reporting entity's balance sheet as an asset; any related deferred tax liability is offset against this asset, rather than included with other deferred tax liabilities. However, the amount that may be recognised as an asset is restricted to the amount of the surplus that can be recovered by the reporting entity, either through reduced contributions or through refunds from the scheme that have been agreed by the scheme trustees.

69 This restriction will typically arise in circumstances where:

- the scheme is a closed scheme; or
- there are only a small number of active members.

70 A deficit in the value of scheme assets below the value of the scheme liabilities is to be recognised as a liability, to the extent that it reflects a legal or constructive obligation; any related deferred tax asset is offset against this liability. If the scheme rules require members' contributions to be increased to help fund a deficit, the present value of the required additional contributions are treated as reducing the deficit to be recognised by the reporting entity.¹⁵

Going concern

71 In considering going concern, the entity directors take account of all relevant information of which they are aware at the time they approve the financial statements, including events known or expected to occur more than a year beyond the date on which they approve the financial statements. This would include, for example, the fact that a scheme is inadequately funded to a significant extent (or an arrangement is entirely unfunded) and the defined benefit liability to be recognised in the balance sheet may be material. In such circumstances, the entity auditors:

- make enquiries into the expected timing of the cash flows likely to arise as result of this liability and into the entity directors' plans for funding these payments, whether from the reporting entity's own resources or otherwise; and

¹⁵ For the purpose of the report required by auditors under section 40, Companies (Amendment) Act, 1983, in the Republic of Ireland, the assets and liabilities recorded in the balance sheet determine whether a financial situation exists. No differentiation is made between pension liabilities and other liabilities.

- consider whether the recognition of the defined benefit liability may cause the reporting entity to breach any existing loan covenant, such that the loan creditor might take immediate steps to recover the loan.

In accordance with SAS 130 'The going concern basis in financial statements', the entity auditors assess the adequacy of the means by which the directors have satisfied themselves that the going concern basis and any related disclosures are appropriate.

Recognition in the profit and loss account and the Statement of Total Recognised Gains and Losses (STRGL)

72 The change in the defined benefit asset or liability is required to be analysed into a number of specified components. The nature, timing and extent of the entity auditors' procedures in relation to these components depend on their judgement as to the materiality of the amounts involved and the risk of material misstatement of the financial statements:

(a) charged to operating profit (current service cost, past service cost, gains and losses on settlements and curtailments)

The entity auditors discuss with the entity directors and with the actuary the factors that affect current service cost. For example, it may increase year on year as a percentage of pay if the average age of the workforce is increasing, as is likely where the scheme is closed to new entrants. Benefit improvements may result in higher current service costs and an increased liability for past service relating to current and former employees of the entity.

(b) charged/credited to finance costs/income (expected return on scheme assets, interest on scheme liabilities)

The entity auditors consider whether the interest costs reflect an average of the liabilities at the beginning of the year and movements during the year. They also discuss with the entity directors and with the actuary whether the discount rate reflects the appropriate high quality corporate bond rate at the start of the year and is the same as the rate at which the scheme liabilities were measured at the end of the previous year.

For quoted fixed interest and index-linked securities, the entity auditors compare the expected return with market indices. Where the trustees have significantly changed the risk profile of the investments (switching from equities to corporate bonds, for example), this will be reflected in the expected rate of return calculations. Where the actual return shows a consistent pattern (for example, always less than the expected return) the auditor may wish to discuss with the entity directors and with the actuary whether the equity risk premium (in a scheme with a majority of equities) is being over-estimated in the current year.

(c) recognised in the STRGL (actuarial gains and losses, comprising: actual return less expected return on scheme assets, experience gains and losses arising on scheme liabilities, effects of changes in assumptions underlying scheme liabilities)

The external auditors discuss with the entity directors and with the actuary the underlying

reasons for actuarial gains and losses: relevant factors may include employee turnover rates, mortality, early retirements, unexpected changes in salaries or medical costs, and changes in the discount rate.

73 The analysis of the change in the defined benefit asset or liability into these components is usually supplied by the actuary. The entity auditors apply analytical procedures to these figures, for example by comparing them with the corresponding amounts for previous periods and make such enquiries of the entity directors and of the actuary as may be necessary to be satisfied that the figures are consistent with the entity auditors' knowledge of the business of the reporting entity and of the scheme and that any significant changes can be adequately explained in terms of changes in the scheme.

Expected return on scheme assets and discount rate

74 The entity auditors pay particular attention to the amounts to be disclosed as the expected return on scheme assets and the rate used to discount the scheme liabilities. These figures are determined by the entity directors' judgement as to the expected rate of return over the long term for each category of scheme assets and the current rate of return on a high quality corporate bond of equivalent currency and term to the scheme liabilities.

75 FRS 17 states that the rate of return expected over the long term will vary according to market conditions, but that it is expected that the amount of the return will be reasonably stable. The expected rate of return is required to be set by the entity directors having taken advice from an actuary. This decision involves a degree of subjectivity and effectively determines the amount of the actual return on scheme assets and interest cost which pass into the profit and loss account and the amounts that are recognised in the STRGL, and can have an important influence on total finance costs in the profit and loss account. Similarly, the entity directors will seek the advice of the actuary when selecting the discount rate.

76 FRS 17 requires disclosure of a 5-year table of the history of amounts recognised in the STRGL: a review of this table may help the entity auditors to identify any systematic bias in the assumptions regarding the expected rate of return. The entity auditors therefore obtain explanations from the entity directors and the actuary to support the expected rate of return for all significant asset categories and consider whether any changes are consistent with, for example, changes in investment strategy. They also discuss the choice of discount rate and seek explanations for any change in the rate from one year to the next.

Disclosures

77 FRS 17 allows that, where a reporting entity has more than one defined benefit scheme, disclosures may be made in total, separately for each scheme or in such groupings as are considered to be most useful. It suggests that useful groupings, for this purpose, may be based on:

(a) the geographical location of the schemes; and

(b) whether the schemes are subject to significantly different risks.

78 FRS 17 allows aggregated disclosure of amounts and assumptions relating to different schemes, although surpluses and deficits must be shown separately. The entity auditors consider whether such aggregation results in:

- surpluses and deficits of different schemes being 'netted-off';
- important information about arrangements whose costs are significantly different or more volatile compared with others being 'lost' by the presentation of averaged rates or aggregated values.

The entity auditors consider whether disaggregation is necessary in order for the financial statements to give a true and fair view.

Distributable profits

79 Whether a surplus (or deficit) in a scheme represented by a defined benefit asset (or liability) recognised in the balance sheet in accordance with FRS 17 is a realised profit (or loss) for the purposes of determining the amount of profits available for distribution is an accounting and (in some cases) a legal matter that is beyond the scope of this Practice Note (and beyond the remit of the Auditing Practices Board). FRS 17 suggests that a problem will arise only when the individual financial statements of the reporting entity show a defined benefit liability so large that it reduces realised profits below that needed to cover any intended distribution.¹⁶

80 SAS 120 'Consideration of law and regulations' requires auditors to obtain sufficient appropriate audit evidence about compliance with those laws and regulations which relate directly to the preparation of, or the inclusion or disclosure of specific items in, the financial statements. Such laws and regulations include those which specify that a distribution cannot be made except out of profits available for the purpose (for example, in the case of a limited company, section 263 of the Companies Act 1985¹⁷). If the entity auditors become aware that there may not be sufficient realised profits to make a proposed distribution, they normally communicate their concerns to the entity directors and advise them of the potential consequences of making what may be an unlawful distribution. The entity directors and the entity auditors may wish to consult their respective legal advisers. If the entity directors are unable to dispel the entity auditors' concerns and do not modify the proposed distribution, the entity auditors consider the implications of this disagreement for their report on the

¹⁶ The FRS advises that the entity directors find appropriate solutions with the help of their legal advisers; actuarial advice may also be helpful.

¹⁷ The equivalent statutory reference for Northern Ireland is Article 271 of the Companies (Northern Ireland) Order, 1986 and for the Republic of Ireland is section 45 of the Companies (Amendment) Act, 1983.

financial statements. This may result in the entity auditors issuing a qualified or adverse opinion (see SAS 600 'The auditors' report on the financial statements' (paragraphs 74 to 75)).¹⁸

Management representations

81 SAS 440 'Management representations' requires auditors to obtain written confirmation of representations from management on matters material to the financial statements when those representations are critical to obtaining sufficient appropriate audit evidence. However, management representations cannot be a substitute for other audit evidence that the entity auditors expect to be available. With regard to retirement benefits, the entity auditors obtain the entity directors' written confirmation that, on the basis of the process established by them and having made appropriate enquiries, they are satisfied that the actuarial assumptions underlying the valuation of scheme liabilities are consistent with their knowledge of the business. They may also obtain such confirmation that:

- all significant retirement benefits, including any arrangements that:
 - are statutory, contractual or implicit in the employer's actions;
 - arise in the UK and the Republic of Ireland or overseas;
 - are funded or unfunded;
 - are approved or unapproved

have been identified and properly accounted for; and

- all settlements and curtailments have been identified and properly accounted for.

PUBLIC SECTOR CONSIDERATIONS

82 The requirements of FRS 17 apply equally to reporting entities in the public sector and the guidance in this Practice Note is intended to apply to the auditors of all such entities. However, there is a wide range of schemes in the public sector, many of which are unfunded; these can give rise to complex accounting issues which require careful consideration.¹⁹

¹⁸ In the case of limited companies in both the United Kingdom and the Republic of Ireland, where the auditors have issued a 'qualified report' on the last financial statements, company legislation states that the company cannot proceed to make a distribution by reference to those financial statements unless the auditors have made a statement in the form specified by the legislation on the company's ability to do so.

¹⁹ The Auditing Practices Board is aware that the method of application of FRS 17 to specific types of public sector entity is currently under debate and will consider the need for additional guidance for auditors when the outcome of these discussions is known.

Consideration of retirement benefits in the review of interim reports

The Accounting Standards Board's Statement on Interim Reports (paragraph 27) states that 'it should not usually be necessary to obtain a new actuarial valuation for pension costs, unless a significant event, such as a change in benefits, has rendered the previous estimate misleading. If, however, a more recent actuarial valuation is available at an interim date, this should be used in the interim accounts.'

The Statement, which was published in September 1997 (thus pre-dating FRS 17), is non-mandatory; it is designed to be a guide to best practice. Auditors are often asked by listed companies to review their interim reports and guidance for auditors is given by the Auditing Practices Board in Bulletins 1999/4 and 2001/2.

Where the entity auditors become aware that there has been a significant event affecting the measurement of assets or liabilities in the interim report, they discuss with the entity directors the steps they have taken to review, with the actuary's advice, the impact of that event and how the impact is to be reflected in the interim report.

Appendix 2

Examples of risks of materials misstatement in relation to FRS 17

The following are examples of how a risk of material misstatement of the financial statements might arise in relation to the requirements of FRS 17. The risks illustrated will not necessarily exist in every case, nor is this intended to be comprehensive listing of all the risks that could exist.

General

The entity directors may not have devoted sufficient resources to establishing a process that will enable the reporting entity to comply with FRS 17.

Completeness of retirement benefit arrangements

The entity directors may not be aware of all schemes and obligations to pay retirement benefits.

Information in respect of overseas schemes may not be well documented or understood by the entity directors.

Subsidiary entities

The requirements of FRS 17 may not be fully understood by the directors of subsidiary entities (or, in the case of overseas subsidiary entities, by their auditors).

Scheme changes

Important changes in schemes (e.g. changes in benefit structures) may not be adequately identified and notified to the actuary.

Consistency

The treatment of scheme assets and liabilities related to bulk transfers and any other settlements or curtailments may be inconsistent (leading to 'cut-off' errors).

Actuarial assumptions

Key assumptions may not be consistent (e.g. the discount rate and the expected return on assets) or may be inappropriate (e.g. benefit improvements).

There may be pressure on the actuary to modify assumptions.

Timetable

The timetable for providing information for scheme asset and liability valuations may not be compatible with the reporting entity's reporting timetable.

Surpluses

The entity directors may not have considered the recoverability of a surplus or may argue that it will be used for future benefit improvements and so should not be accounted for in full.

Deficits

The entity may be in breach of loan covenants when the deficit is taken into account and this may bring the going concern basis into question.

Distributable profits

The entity directors may not have considered the impact of any deficits in the group on distributable profits.

Where an asset is recognised in an individual company, the entity directors may not have considered whether an equivalent amount of reserves can be considered a realised profit available for distribution.

Actuarial updates

There is a risk of imprecise calculations of liabilities in the actuarial update due to changes since the most recent full actuarial valuation.

Source data

There is a risk that the source data used by the actuary (in particular, the membership records) may be inaccurate or incomplete.

Asset values

The scheme trustees may not provide a timely, appropriate report on scheme assets (e.g. investments may not be complete or may not be stated at their fair value).

Multi-employer schemes

In a multi-employer scheme, the assets and liabilities may be capable of allocation to an individual reporting entity within that scheme but this may have not been identified.

Measurement and disclosure

There may be misallocation between the profit and loss account and the STRGL.

Deferred taxation

The entity directors may not have considered how to allocate deferred tax between the profit and loss account and the STRGL.

Appendix 3

Smaller entities with insured schemes

The guidance in this Practice Note is intended to apply to the auditors of all reporting entities and all types and sizes of defined benefit scheme, although some of the guidance may be more relevant to the auditors of larger reporting entities with significant and complex retirement benefit arrangements. Such entities often have available well-resourced actuaries but are often also subject to tight reporting deadlines (for example, in the case of listed companies).

The circumstances of smaller reporting entities are often quite different. On the one hand, their retirement benefit arrangements are often less complex and they generally enjoy a more relaxed reporting timetable: this may allow more time for the entity and the actuary to perform the work required in order to comply with FRS 17; this also allows the entity auditors more time to obtain the audit evidence they require.

However, in the case of smaller reporting entities, the occupational pension scheme may be administered by an insurance company and the only scheme asset may be an insurance policy (a 'fully insured scheme'); typically, the scheme actuary will be an employee of the insurance company and it is likely that the entity directors will look to the insurance company and its in-house actuary to provide the information required for compliance with FRS 17.

In such circumstances, the entity auditors consider such matters as whether:

- the insurance company will be able to supply the entity directors with values of the scheme assets and liabilities as at the entity balance sheet date, where that differs from the scheme year-end date; and
- it will be appropriate for them to communicate with the insurance company's actuary, as envisaged in this Practice Note;
- the basis to be used by the insurance company to value the insurance policies will represent 'the best approximation to fair value', as envisaged by FRS 17: for this purpose, a surrender value will not suffice unless the trustees have taken the decision to surrender the policy or to wind up the scheme;
- 'earmarked' insurance policies which are excluded from the accounts of the scheme in accordance with statutory exemptions, for example, deferred annuity policies, will have been valued and included in the fair value of scheme assets for the purpose of compliance with FRS 17; and

- evidence will be available to support the basis of valuation of the insurance policy as at the reporting entity balance sheet date.

Where the insurance company cannot provide a valuation of an insurance policy as at the reporting entity balance sheet date, the directors might decide to adjust the most recently obtained valuation for contributions received and benefits paid, with allowance also being made for investment returns. The basis of this technique would need to be clearly disclosed in the notes to the financial statements (see paragraphs 64 to 67).

The fact that the entity auditors were not able to discuss matters with the actuary, does not of itself give rise to a need to qualify the auditors' opinion on the financial statements.

NOTICE TO READERS

© The Accountancy Foundation Limited

This document has been obtained from the website of The Accountancy Foundation Limited and its subsidiary companies (The Review Board Limited, The Auditing Practices Board Limited, The Ethics Standards Board Limited, The Investigation and Discipline Board Limited). Use of the website is subject to the WEBSITE TERMS OF USE, which may be viewed at <http://www.accountancyfoundation.com/terms>. Readers should be aware that, although The Accountancy Foundation Limited and its subsidiary companies seek to ensure the accuracy of information on the website, no guarantee or warranty is given or implied that such information is free from error or suitable for any given purpose: the published hard copy of the document alone constitutes the definitive text.