



**STATEMENT SUPPORTING DRAFT
PRUDENTIAL STANDARD – REGULATORY
REPORTING REQUIREMENTS AND AUDITED
FINANCIAL STATEMENTS FOR PENSION
FUNDS**

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1 PURPOSE OF THE STATEMENT

- 1.1 This Statement relates to the draft Prudential Standard – Regulatory Reporting Requirements and Audited Financial Statements for Pension Funds (draft Prudential Standard), proposed to be made by the Financial Sector Conduct Authority (FSCA) in terms of section 15 of the Pension Funds Act, 1956 (No. 24 of 1956) (PFA) and section 105(1) of the Financial Sector Regulation Act, 2017 (Act No. 9 of 2017) (FSR Act), read with section 292(2)(b), (3) and (4) of the FSR Act.
- 1.2 This Statement is published in accordance with Section 98(1)(a)(iv) of the FSR Act and is intended to support and give context to the draft Prudential Standard that is published for public comment. The main purpose of this Statement is to explain the need for, the expected impact of, and the intended operation of the draft Prudential Standard.

2 STATEMENT OF NEED - POLICY CONTEXT AND PROBLEM DEFINITION

- 2.1 Internationally it is accepted that the International Financial Reporting Standards (IFRS) and International Accounting Standard (IAS) are not wholly appropriate for the pension funds industry. It is anticipated that if global standards are developed for pension funds specifically, South Africa will follow those standards. However, it is unlikely that such will be developed in the near future. To ensure consistency, transparency and comparability of the financial statements of South African pension funds, it is important that financial reporting requirements for pension funds are, to the extent practical and possible, aligned to the IFRS and IAS. Misalignment with IFRS and IAS has the potential of impacting the credibility of the South African pension fund system.
- 2.2 Auditing and reporting type requirements for pension funds are currently set out in different Board Notices that were issued under the PFA. More specifically:
- Board Notice 14 of 2009¹ (BN 14) sets out the recognition and measurement principles to be used in preparation of the financial statements, and also provides guidance relating to disclosure and presentation in the prescribed format of the financial statements, which serves as an accounting guide for the pension funds industry.
 - Board Notice 77 of 2014² (BN 77) prescribes the financial statements applicable to different categories of funds. BN 77 requires funds with assets above R50 million to have its financial statements audited and reported on by an auditor in terms of section 15(1) of the PFA.
 - BN 77 also exempts funds which have assets less than R50 million at its financial year-end from the requirement to have its financial statements audited and reported on by an auditor in terms of section 15(1) of the PFA. However, funds with assets below R50 million but above R6 million must appoint an auditor in terms of section 9(1) of the PFA to perform agreed upon procedures in line with international standards, as adopted by IRBA.
 - Funds with assets below R6 million need not appoint an auditor.
- 2.3 The regulatory reporting requirements, including the formats for reporting, are to some extent outdated. For example, in March 2018 and 2022 the Independent Regulatory Board for Auditors (IRBA) approved two new illustrative auditor's reports to be used by registered auditors.³ Despite the new formats approved by IRBA, BN 77 still prescribed the old, outdated formats. The only way in which the FSCA could facilitate the use of these new formats was

¹ Published in Government *Gazette* No. 31838 of 4 February 2009.

² Published in Government *Gazette* No. 37844 of 18 July 2014.

³“Auditor’s report template: Audit of the Financial Statements of a Large Retirement Fund (Schedule D)” and “Assurance Report on Compliance with Regulation 28 of the Pension Funds Act”.

by issuing an exemption (see “FSCA RF Notice 5 of 2020”). This is but one example of where the requirements contained in BN 77 were no longer appropriate. Therefore, a need exists to update the regulatory reporting requirements and the format of financial statements, and to consolidate all related requirements into one instrument.

- 2.4 It has also become evident that the financial statements of all pension funds must be audited, irrespective of size, to ensure that the FSCA can exercise effective oversight. This is to ensure that all pension funds consistently apply the recognition and measurement criteria contained in the revised accounting guide and the presentation and disclosures contained in the revised prescribed financial statements format. As such, the general standing exemptions contained in BN 77 need to be reconsidered and withdrawn. Other exemptions that need to be withdrawn include the cash basis of reporting and the two general exemptions contained in FSCA RF Notice 5 of 2020 and FSCA RF Notice 5 of 2022. The look-through reporting exclusions for guaranteed policies, contemplated in Regulation 28(8)(b)(iii), are also reconsidered (read with LTIA Ai 157). The withdrawal of the various applicable exemptions will ensure equal protection before the law of members in all funds, irrespective of fund size.
- 2.5 The recent revision of Regulation 28, as gazetted in July 2022, has also required additional reporting requirements in relation to infrastructure assets and amendments to the asset spreading requirements. For further detail kindly consult the National Treasury media release of 8 July 2022 and the Gazette itself. The regulatory reporting requirements for pension funds therefore need to take into account the amendments to Regulation 28 and ensure that pension funds appropriately report on these matters.
- 2.6 Consistency in reporting across the pension fund industry and ensuring that the reporting requirements are robust is important to facilitate comparability of financial statements and to provide a basis for the reliability of financial statements. This is necessary to ensure pension funds are financially sound and conducted in a transparent and responsible manner, thereby contributing to better protection for pension fund members.
- 2.7 Therefore, a need exists to update the regulatory reporting requirements and the prescribed format of financial statements to further align to the IFRS, IAS and local auditing requirements; ensure consistency in the application of financial reporting requirements across all pension funds; and to consolidate all related requirements into one instrument, with the ultimate goal of providing better protection for pension fund members.

3 SUMMARY OF THE DRAFT PRUDENTIAL STANDARD

- 3.1 The draft Prudential Standard proposes to consolidate all audit and regulatory reporting requirements into one instrument by replacing, amongst other aspects, the existing Board Notice 14 and BN 77. Besides providing for prescribed financial statements for funds to be audited, the draft Prudential Standard also incorporates both the regulatory reporting requirements and the format of the financial statements into one document.
- 3.2 A lot of the content of the draft Prudential Standard is based on the content of the existing BN 14 and BN 77. However, the draft Prudential Standard provides enhanced detail relating to reporting concepts, additional definitions and expands certain paragraphs of the regulatory reporting requirements in line with amendments to the relevant sections of IFRS and the IAS.
- 3.3 The purpose of the concepts contained in the Prudential Standard, which relate to the preparation and presentation of the financial statements, is to assist:

- (a) Drafters of the financial statements in applying the regulatory reporting requirements and in dealing with topics that are not specifically dealt with in the regulatory reporting requirements;
- (b) auditors in forming an opinion as to whether financial statements comply with the regulatory reporting requirements; and
- (c) the Authority in interpreting the information contained in financial statements prepared in conformity with the regulatory reporting requirements.

3.4 In terms of Guidance Notice 1 of 2019 that relates to Sustainability of Investments and Assets in the context of a pension fund's Investment Policy Statement (IPS), funds are encouraged to adopt sustainable reporting practices in the interest of transparency, accountability and fair treatment of its members. In this regard, a fund's board will be required to disclose certain information relating to how their IPS is aligned to the Guidance Notice, as per Schedule E of the financial statements.

3.5 It is proposed that the existing exemption exempting specific funds from the requirements to appoint an auditor and to have its financial statements audited and reported on by an auditor, be removed. This means that the draft Prudential Standard will be applicable to all funds, including funds with total assets below R50 million.

3.6 The table below contains a summary of proposed changes to the current prescribed annual financial statements – changes relate mainly to notes in the financial statements, rather than the main components of the financial statements):

ITEM	SCHEDULE IN AFS	DESCRIPTION	NOTE NUMBER	DETAILS
1	Schedule A	Regulatory information	n/a	Additional Trustee statistical information e.g. race, gender, etc. Additional columns and legends
4	Schedule D	Report by the independent auditor	n/a	Hyperlink to IRBA website for the illustrative ISRS 4400 (revised) reports as per type of fund
5	Schedule E	Report by the board of fund	n/a	Removing of reconciliation of membership from schedule E to schedule HA (see note 8.3 on Schedule HA)
8.3	Schedule HA (continued)	Notes to the financial statements	1.3 Plant & Equipment (subject to operating lease) (Current period)	New note on Operating leases to be added
8.4	Schedule HA (continued)	Notes to the financial statements	1.4 Plant & Equipment (Right of use assets) (Current period)	New note on Operating leases to be added
8.5	Schedule HA (continued)	Notes to the financial statements	1.5 Plant & Equipment (subject to operating lease) (previous period)	New note on Operating leases to be added
8.6	Schedule HA (continued)	Notes to the financial statements	1.6 Plant & Equipment (Right of use assets) (previous period)	New note on Operating leases to be added
8.7	Schedule HA (continued)	Notes to the financial statements	1.7 Impairment	New note on Impairment to be added
8.17	Schedule HA (continued)	Notes to the financial statements	8.1 Benefits – current members	Additional column for number of members to be added
8.18	Schedule HA (continued)	Notes to the financial statements	8.2 Benefits – Benefits in terms of surplus apportionment	Additional column for number of members to be added
8.19	Schedule HA (continued)	Notes to the financial statements	8.3 Reconciliation of membership	To be moved from Schedule E and added as a new note on Schedule HA
8.20	Schedule HA (continued)	Notes to the financial statements	9 Unclaimed benefits	Additional column for number of members to be added
8.24	Schedule HA (continued)	Notes to the financial statements	13 Net investment income	A new item "Other" to be added
8.25	Schedule HA (continued)	Notes to the financial statements	13.1 Other income	A new item "Other" to be added

ITEM	SCHEDULE IN AFS	DESCRIPTION	NOTE NUMBER	DETAILS
8.27	Schedule HA (continued)	Notes to the financial statements	14.1 Board of fund expenses	More detail to be added to the note
8.30	Schedule HA (continued)	Notes to the financial statements	14.4 Deputy principal officer expenses	A new note "Deputy principal officer expenses" to be added
8.32	Schedule HA (continued)	Notes to the financial statements	16.1 Financial liabilities	More detail to be added to the note
8.33	Schedule HA (continued)	Notes to the financial statements	16.2 Provisions	A new note for "Provisions" to be added separately
8.41	Schedule HA (continued)	Notes to the financial statements	24 Cash at bank	A new note "Cash at bank" to be added
10	Schedule I	Report of the independent auditor	n/a	Hyperlink to the IRBA website for the section 5 agreed upon procedures reports for different types of funds
12.6	Schedule IA	Notes to the investment schedule	F Security Lending	New columns for "initial margin" and "variation margin" to be added
12.7	Schedule IA	Notes to the investment schedule	G1 Derivative positions without residual risk	New columns for "initial margin" and "variation margin" to be added
12.8	Schedule IA	Notes to the investment schedule	G2 Derivative positions without residual risk	New columns for "initial margin" and "variation margin" to be added
12.11	Schedule IA	Notes to the investment schedule	J Hedge funds	New columns for "initial margin" and "variation margin" to be added
12.17	Schedule IA	Notes to the investment schedule	P Reconciliation between the investments in Schedule H2 and Schedule IA	Infrastructure investments column to be added
13	Schedule IB	Assets held in compliance with regulation 28	Regulation 28(8) Exclusions	The investments excluded from reporting in terms of regulation 28(8) to be removed.
13.1	Schedule IB	Assets held in compliance with regulation 28	8.1 Hedge funds	The item "Hedge funds" to be disclosed separately as paragraph 8.1
13.2	Schedule IB	Assets held in compliance with regulation 28	9.1 Private equity funds	The item "Private equity funds" to be disclosed separately as paragraph 9.1
13.3	Schedule IB	Assets held in compliance with regulation 28	10.1 Other assets not referred to in this schedule	The item "Other assets not referred to in this schedule" to be disclosed separately as paragraph 10.1
13.4	Schedule IB	Assets held in compliance with regulation 28	11.1 Overall limit for infrastructure across all classes	The item "Overall limit for infrastructure across all classes" to be added as paragraph 11.1
13.5	Schedule IB	Assets held in compliance with regulation 28	11.2 Overall limit for all instruments per entity/issuer	The item "Overall limit for all instruments per entity/issuer" to be added as paragraph 11.2
13.6	Schedule IB	Notes to the investment schedule	New Table for Infrastructure	A new Table "Reporting in respect of infrastructure assets" to be added
14	Schedule IB	Report of the independent auditor on compliance with Regulation 28	n/a	Hyperlink to IRBA website for the reg 28 dual audit report

3.7 The FSCA acknowledges that the content of the draft Prudential Standard is very detailed in nature. Ideally the requirements should, potentially, be streamlined further by simply referencing an agreed accounting and auditing framework. However, at this stage such may not be possible, noting the unsuitability of the existing frameworks to retirement funds. Accordingly, the FSCA has published the detailed framework for comment, noting that stakeholder input is specifically requested on the nature and level of detail of content. Alternative proposals regarding how the reporting framework can be streamlined further are welcomed.

4 STATEMENT OF IMPACT OF THE PRUDENTIAL STANDARD

4.1 In sum, the revised and consistent approach will promote consistency, transparency and comparability of the financial statements of South African pension funds, to support the credibility of the South African pension fund system and, ultimately, protect members.

- 4.2 The Prudential Standard will have an immediate financial impact on all funds that were not previously subject to the audit requirements, for example funds that are terminating and those that had previously been exempt from the audit requirements as they had total assets that did not exceed R50 million. No significant financial impact is envisaged in respect of funds that were not previously exempted, as the above-mentioned changes relate mainly to the notes to the financial statements and the new limits in the regulation 28 disclosures.
- 4.3 Funds that were not previously subject to the audit requirements will therefore have to make adequate provision for audit expenses relating to financial statements required in terms of section 15(1) of the PFA.
- 4.4 Funds should therefore plan their audit engagements appropriately and ahead of time to ensure that audits will not delay submission of financial statements to the FSCA, as required in terms of section 15(1) of the PFA.
- 4.5 Funds with under R6 million in assets have the option of moving to umbrella funds to share costs but the FSCA also expects proportionality in audit fees charges based on size and complexity of funds. For example, a smaller and simpler structured fund is expected to have lower audit fees than a larger, more complex structured fund. In addition, supervisory experiences have shown that smaller funds have less stringent governance and oversight requirements.
- 4.6 Further, for funds with assets below R50 million and above R6 million, although a full scope audit was not required before, these funds have already appointed an auditor to conduct the agreed upon procedures (section 15 factual findings report). These funds may use the same auditor to conduct the full scope audit.
- 4.7 The FSCA does not expect a major financial impact of this Prudential Standard on funds with above R50 million in assets. The impact on smaller funds should be manageable for most funds, however it's imperative for such funds to make a provision for the audit fees timeously to avoid having no sufficient funds left for an audit to be performed.

5 STATEMENT OF INTENDED OPERATION OF THE PRUDENTIAL STANDARD

- 5.1 The draft Prudential Standard is consistent with the objects of the FSR Act and PFA, and specifically the mandate of the FSCA. It is intended to support the FSCA in achieving its objectives of promoting and enhancing the safety and soundness of pension funds and protecting pension fund members.
- 5.2 Once made, it is proposed that the draft Prudential Standard will become effective **6** months after the final date of publication.
- 5.3 Following the implementation of the Prudential Standard, the FSCA will assess and evaluate the effect of the Prudential Standard on a continuous basis as part of its regulatory and supervisory responsibilities.