

**REPORT FOR: Pension Fund
Investment Panel**

Date of Meeting: 20th September 2012

Subject: INFORMATION REPORT – Annual Pension Scheme Accounts & Auditor’s Report

Responsible Officer: Julie Alderson, Corporate Director, Resources

Exempt: No

Enclosures: Pension Fund Annual Report
Expense Summary
Auditor’s Report
Annual review of operational controls
Review of internal controls reports

Section 1 – Summary

The draft pension fund accounts are attached. The audit is substantially complete and the draft report from the Auditor is attached.

FOR INFORMATION

Section 2 – Report

Annual Accounts

1. The draft pension scheme accounts to 31st March 2012 are attached (appendix 1).
2. The contents of the Accounts are governed by regulations in particular the Code of Practice on Local Authority accounting in the UK 2011/12. The format follows that used in prior years. An additional section concerning the risks faced by the fund and the management of these risks has been added (8.16).
3. The value of the fund increased by £12 million in the year. The fund continues to ‘mature’ in that contributions are broadly in line with benefits. Cash flow is positive when investment income is taken into consideration. The impact of falling membership, longevity and pension increases will reduce future cash inflows, which in the longer term may have to be factored into the investment strategy.
4. The annual accounts and Auditor’s Report will be considered at the GARMC meeting on 24th September.

Auditors Report

5. Attached (appendix 2) is the report issued to GARMC following the audit of the pension fund accounts.
6. The report discusses:
 - a. The key audit risks and how these were addressed.
 - b. Audit finding.
 - c. Recommendations.
 - d. Confirmation of the Auditor’s responsibility.
 - e. Discussion of industry issues.
 - f. Letter of representation from management.
7. No errors were found during the audit and an unqualified audit opinion is expected. One new recommendation was made concerning journal entry authorisation, which has been acted upon. The two prior year recommendations have been resolved.
8. Section 3 of the report discussed topical issues affecting pension schemes. The comments on submitting backdated VAT reclaims on pension fund expenses does not affect Harrow, which is able to recover all its input VAT.

Schedule of Expenses

9. A schedule of expenses incurred by the pension fund in the year is also attached (appendix 3). Aggregate expenses are estimated at £3,629,000 with fund manager fees (£2.7 million) being the largest component. Fund

manager fees are mainly charged direct to the pooled fund, and Harrow's share of such fees take into account any rebates

10. The investments in private equity and property are through fund of funds and incur two layers of fees. For these asset classes, the underlying manager fees have been estimated. The aggregate costs represent around 0.74% of the Scheme value.
11. No provision is shown for private equity performance related fees. These are almost impossible to estimate although in the light of performance to date are not thought to be significant.
12. Within the annual accounts, pooled fund manager fees are shown within the change in market value of investments. For this reason, the value of expenses shown in the annual Accounts is considerably lower at £656,000.
13. Currently, no expense benchmarking information is available. Part of the plans recently outlined by the Government to introduce more transparency in the LGPS includes benchmarking of expenditure

Annual Review of Internal Controls at Fund Managers

14. The Report of the Auditors for the 2010 Accounts recommended that due diligence be carried out on the strength of the operational controls at investment managers both through a review of internal controls reports and visits to key investment managers. At the November 2010 PFIP a template was introduced as a basis for measuring the level of assurance provided by the operational structure supporting each mandate.
15. In essence, concern with the operational controls of investment managers relates to the procedures in place to safeguard the Fund's assets against loss through error or fraud and to ensure that client reporting is accurate. Poor operational controls can also hamper the management of the assets leading to reduced returns or increased costs. Should there be a lack of evidence that controls operated by investment managers are robust, the continued appointment of the manager would be questionable.
16. Operational control reviews focus on the key environmental, business and process issues. A summary of the findings from the most recent reviews is summarised in appendix 4. Three managers are rated as having the strongest levels of assurance, being State Street, Wellington and Fidelity, while the other managers have some weaknesses in the level of assurance available to investors. Further comments are given below:

Fidelity

17. Last year we reported that Fidelity did not provide audited accounts for their pooled funds. Accounts, audited by PwC for the year to 30 June 2011 have been received. Unlike most other pooled funds, Fidelity uses an internal rather than external independent administrator to maintain the funds accounting reports. However, the independent custodian does undertake an overview of the functions relating to pricing and dealing in units in the fund. No action is deemed necessary.

Longview

18. The annual controls report excludes four important aspects of the business as these functions are provided by agents or affiliates:

- Accepting clients
- Reporting
- Safeguarding assets
- Information technology

19. Representations will be made to Longview to include these areas in future annual controls reports.

BlackRock

20. The contract covering the BlackRock managed assets is a 1993 investment management agreement signed with Mercury Asset Management. At that time the mandate was a segregated multi asset mandate, where as currently the mandate is pooled bonds. The contract doesn't reflect regulatory changes in the last 20 years and requires updating. Discussions will be commenced with BlackRock post completion of the strategic review.

Aviva & Pantheon

21. Both Aviva (property) and Pantheon (private equity) are fund of funds that ultimately invest in difficult to value and illiquid investments. For these reasons, the level of assurance, with particular regard to valuations, will be limited. In both cases the managers provide audited accounts for the pooled funds and independently reviewed reports on internal controls, although in the case of Pantheon, there was no testing of the operation of the controls.

22. Although there are no quoted prices for private equity and property, both have robust processes for valuing investments.

23. Both funds will include an element of performance related fees that are impossible to verify and reliance falls on the funds' auditors to ensure that fees are paid in accordance with the legal documentation.

24. None of the weaknesses identified are sufficiently serious to propose termination of the mandate. Aon Hewitt's manager monitoring reports include ratings and comments on the operational environment and all the Harrow managers are rated a "pass".

25. Also attached (appendix 5) is a summary of the findings from the independent reviews of each manager's internal controls report. For Pantheon, no testing of controls in operation has been undertaken. For all other managers, the auditor's opinion is that the control environment is free from significant weakness, although a number of failures of individual controls are identified, which are listed in appendix 5. Each of the exceptions will be discussed when officers next meet with the fund manager.

Section 3 – Further Information

N/A

Section 4 – Financial Implications

26. The level of costs incurred will have a significant impact on the net returns earned by the fund.

Section 5 - Risk Management Implications

27. Risk included on Directorate risk register? No

28. Separate risk register in place? No.

29. The audit is one element of the risk management processes and the review of internal controls operated by investment managers also forms a significant risk mitigation process.

Section 6 - Equalities implications

30. Was an Equality Impact Assessment carried out? Yes

31. There are no direct equalities implications relating to the pension fund

Section 7 – Corporate Priorities

32. Corporate Priorities are not applicable to Pension Fund as it does not have a direct impact on Council's resources.

Name: Julie Alderson	<input checked="" type="checkbox"/>	Chief Financial Officer
Date: 17 September 2012		
Name: Matthew Adams	<input type="checkbox"/>	on behalf of the Monitoring Officer
Date: 17 September 2012		

Section 8 - Contact Details and Background Papers

Contact: George Bruce (Treasury and Pension Scheme Manager)
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Background Papers: None