Pension Fund Investments Panel

AGENDA

DATE: Tuesday 6 March 2012

TIME: 7.30 pm

VENUE: Committee Room 5, Harrow Civic Centre

MEMBERSHIP (Quorum 3)

Chairman: Councillor Mano Dharmarajah

Councillors:

Thaya Idaikkadar (VC)	Tony Ferrari
	Richard Romain

(Non-voting Co-optee): Mr H Bluston

Trade Union Observer(s): Mr R Thomas - UNISON
Mr T Thornton - GMB

Reserve Members:

1. Keith Ferry	1. Stephen Wright
2. Asad Omar	2. Kam Chana

Contact: Mark Doherty, Democratic Services Officer
Tel: 020 8416 8050 **E-mail:** mark.doherty@harrow.gov.uk

Harrow COUNCIL
LONDON

AGENDA - PART I

1. ATTENDANCE BY RESERVE MEMBERS

To note the attendance at this meeting of any duly appointed Reserve Members.

Reserve Members may attend meetings:-

(i) to take the place of an ordinary Member for whom they are a reserve;
(ii) where the ordinary Member will be absent for the whole of the meeting; and
(iii) the meeting notes at the start of the meeting at the item 'Reserves' that the Reserve Member is or will be attending as a reserve;
(iv) if a Reserve Member whose intention to attend has been noted arrives after the commencement of the meeting, then that Reserve Member can only act as a Member from the start of the next item of business on the agenda after his/her arrival.

2. DECLARATIONS OF INTEREST

To receive declarations of personal or prejudicial interests, arising from business to be transacted at this meeting, from:

(a) all Members of the Panel;
(b) all other Members present in any part of the room.

3. MINUTES (Pages 1 - 4)

That the minutes of the meeting held on 9 January 2012 be taken as read and signed as a correct record.

4. PUBLIC QUESTIONS

To receive questions (if any) from local residents/organisations under the provisions of Committee Procedure Rule 17 (Part 4B of the Constitution).

5. PETITIONS

To receive petitions (if any) submitted by members of the public/Councillors under the provisions of Committee Procedure Rule 15 (Part 4B of the Constitution).

6. DEPUTATIONS

To receive deputations (if any) under the provisions of Committee Procedure Rule 16 (Part 4B) of the Constitution.

7. REVIEW OF THE STATEMENT OF INVESTMENT PRINCIPLES (Pages 5 - 18)

Report of the Interim Corporate Director of Resources.

8. REVIEW OF THE FUNDING STRATEGY STATEMENT (Pages 19 - 46)

Report of the Interim Corporate Director of Resources.

9. EXTERNAL AUDIT PLAN 2011-12 (Pages 47 - 68)

Report of the Interim Corporate Director of Resources.

10. EXCLUSION OF THE PRESS AND PUBLIC

To resolve that the press and public be excluded from the meeting for the following items of business, on the grounds that they involve the likely disclosure of confidential information in breach of an obligation of confidence, or of exempt information as defined in Part I of Schedule 12A to the Local Government Act 1972:

Agenda Item No	Title	Description of Exempt Information
11.	Fidelity Fee Proposal	Information under paragraph 3 (contains information relating to the financial or business affairs of any particular person (including the authority holding that information).
12.	INFORMATION REPORT - Investment Manager Monitoring	
13.	BlackRock Presentation	
14.	INFORMATION REPORT - Update Report and Action Points from Previous Meetings	
15.	INFORMATION REPORT - Performance of Fund Managers for Quarter Ended 31 December 2011	

AGENDA - PART II

11. FIDELITY FEE PROPOSAL (Pages 69 - 76)

Report of the Interim Corporate Director of Resources.

12. INFORMATION REPORT - INVESTMENT MANAGER MONITORING (Pages 77 - 126)

Report of the Interim Corporate Director of Resources.

13. BLACKROCK PRESENTATION (Pages 127 - 150)

Report of the Interim Corporate Director of Resources.

14. INFORMATION REPORT - UPDATE REPORT AND ACTION POINTS FROM PREVIOUS MEETINGS (Pages 151 - 156)

Report of the Interim Corporate Director of Resources.

15. INFORMATION REPORT - PERFORMANCE OF FUND MANAGERS FOR QUARTER ENDED 31 DECEMBER 2011 (Pages 157 - 162)

Report of the Interim Corporate Director of Resources.

16. ANY OTHER URGENT BUSINESS

Which cannot otherwise be dealt with.

PENSION FUND INVESTMENTS PANEL

MINUTES

9 JANUARY 2012

Chairman: * Councillor Mano Dharmarajah

Councillors: * Tony Ferrari * Richard Romain
* Thaya Idaikkadar

Co-optee (Non-voting): * Howard Bluston

[Note: Other Attendance: Mr John Harrison and Sahul Patel of Aon Hewitt attended in advisory roles, as the Council's Adviser.]

* Denotes Member present

130. Attendance by Reserve Members

RESOLVED: To note that there were no Reserve Members in attendance at this meeting.

131. Declarations of Interest

Agenda Item 10: INFORMATION REPORT – Investment Manager Monitoring; Agenda Item 11: Presentation by Fidelity

Howard Bluston declared a personal interest on the above items in that he had attended meetings at the Aon Hewitt offices in St. Albans. He also attended a lunch hosted by Fidelity for Independent Advisers. He would remain in the room whilst the matters were considered and voted upon.

132. Minutes

RESOLVED: That the minutes of the meeting held on 15 November 2011 be taken as read and signed as a correct record.

133. Public Questions, Petitions and Deputations

RESOLVED: To note that no public questions were put, or petitions or deputations received at this meeting.

RESOLVED ITEMS

134. Review of the Statement of Investment Principles

An officer introduced a report which set out amendments to the Statement of Investment Principles (SIP). Amendments were required to bring the SIP in line with 2009 Regulations. The officer advised that changes to the SIP included the removal of the names of investment managers as there was no requirement to include them.

Following a discussion, Members suggested the following amendments to the SIP:

- Paragraph 5.2, second sentence, be amended to read: "Principally, these place a limit of 10% on the whole Fund on any…"

- Paragraph 8.1 be amended to read: "Professional advice on investment matters is taken from the investment practice of Aon Hewitt. Hymans Robertson provide actuarial services."

- Paragraph 10.2, second sentence, be amended to read: "The Council encourages its Fund Managers to vote and engage with investee companies worldwide…"

- The title of the table highlighting the asset allocation structure be amended to reflect that data was current, and subject to change.

RESOLVED: That final Statement of Investment Principles, taking account of Members suggestions, be presented to a future meeting of the Panel.

135. Exclusion of the Press and Public

RESOLVED: That in accordance with Part I of Schedule 12A to the Local Government Act 1972, the press and public be excluded from the meeting for the following item for the reasons set out below:

Agenda Item	Title	Reason
10.	INFORMATION REPORT - Valuation of the Fund as at 30 November 2011	Information under paragraph 3 (contains information relating to the financial or business affairs of any particular person (including the authority holding that information).
11.	INFORMATION REPORT - Investment Manager Monitoring	
12.	Presentation by Fidelity	

13.	INFORMATION REPORT - Presentation by Aviva	)
14.	INFORMATION REPORT - Update Report and Action Points from Previous Meetings	)

136. INFORMATION REPORT - Investment Manager Monitoring

The Panel received Aon Hewitt's quarterly report on Harrow's fund managers, detailing strengths and weaknesses and overall rating.

The Aon representative highlighted that BlackRock had been downgraded to a 'hold' rating. This was due to the departure of the Head of UK Fixed Income and other role changes for senior staff. It was suggested by the Aon representative that the Fund Manager be invited to a future meeting of the Panel.

The Aon representative also advised Members that there was little confidence in the Select Funds achieving their performance objective. The fund was excessively diversified. This, combined with recent staffing issues resulted in the 'sell' rating.

RESOLVED: That the report be noted.

137. Presentation by Fidelity

The Panel received a presentation from representatives of Fidelity which reviewed the investment to 30 November 2011. Members were advised that:

- Fidelity employed equity analysts who were responsible for applying ratings to stocks ranging from 'strong buy' to 'avoid';

- The investment process involved constructing portfolios from those stocks rated 'buy' by analysts. These stocks were then subject to a risk management stage, which aimed to match broad characteristics of the benchmark at a regional level.

In response to questions by Members, Fidelity representatives advised that:

- The challenging economic climate had resulted in it not delivering the results the Council were expecting. It offered reassurances that it's employee base and technological resources were continually being improved to enhance performance;

- The Portfolio Management Team of five were based in America. Fidelity was owned by 50% of active employees and 50% family owned;

- Analysts were rotated every two to three years to eradicate complacency and deliver continued improvement.

Following a discussion, an amendment to the Recommendation was proposed by a Member. Following a vote, this amendment was voted on and passed by way of a majority.

RESOLVED: That Fidelity be retained under watch subject to a substantial reduction in fees and further consideration be given to the continuation of the mandate as the revised strategy is developed.

138. INFORMATION REPORT - Presentation by Aviva

A representative from Aviva introduced a presentation which provided Members with an update on the performance of the fund. Since 2009, performance has been on an upward trend, with Fund Mangers implementing strong, risk averse controls.

The representative advised that retail real estate was proving successful, and expressed greater concern in relation to the performance of industrial real estate.

RESOLVED: That the presentation be noted.

139. INFORMATION REPORT - Valuation of the Fund as at 30 November 2011

Members received a report that set out the valuation of the Pension Fund as at 30 November 2011. The valuation at the end of November 2011 had increased compared with 30 September 2011.

RESOLVED: That the report be noted.

140. INFORMATION REPORT - Update Report and Action Points from Previous Meetings

The Panel received a report which provided an update on actions taken since the last meeting.

RESOLVED: That the report be noted.

(Note: The meeting, having commenced at 6.30 pm, closed at 9.55 pm).

(Signed) COUNCILLOR MANO DHARMARAJAH
Chairman

REPORT FOR: **PENSION FUND INVESTMENTS PANEL**

Date of Meeting:	6 March 2012
Subject:	Review of the Statement of Investment Principles
Responsible Officer:	Julie Alderson, Interim Corporate Director of Resources
Exempt:	No
Enclosures:	Statement of Investment Principles.

Section 1 – Summary and Recommendations

A revised Statement of Investment Principles ("SIP") was discussed at the January meeting. The amendments requested have been incorporated and final approval is requested.

RECOMMENDATIONS:

The Panel is asked to approve the updated Statement of Investment Principles.

Section 2 – Report

1. A Statement of Investment Principles ("SIP") is required by the Local Government Pension Scheme (Management and Investment of Funds) (Amendment) Regulations 2009 ("The Regulations") and outlines the principles and policies followed by the Panel in the management of the Fund's investments.

2. A revised SIP was discussed at the meeting and Members suggested the following amendments to the SIP:

- Paragraph 5.2, second sentence, be amended to read: "Principally, these place a limit of 10% on the whole Fund on any…"

- Paragraph 8.1 be amended to read: "Professional advice on investment matters is taken from the investment practice of Aon Hewitt. Hymans Robertson provide actuarial services."

- Paragraph 10.2, second sentence, be amended to read: "The Council encourages its Fund Managers to vote and engage with investee companies worldwide…"

3. These amendments have been incorporated and the Panel is invited to approve the revised draft.

4. The SIP will comply with relevant regulations and will be next reviewed on completion of the ongoing strategy review.

Financial Implications

5. The SIP addresses the high level risk and return objectives of the Fund.

Risk Management Implications

6. Risk included on Directorate risk register? No

7. Separate risk register in place? No

8. Setting risk tolerances and measuring outcomes will be addressed in the ongoing strategy review.

Equalities implications

9. Was an Equality Impact Assessment carried out? No

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

Corporate Priorities

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

Section 3 - Statutory Officer Clearance

Name: Julie Alderson Date: 22 February 2012	X	Chief Financial Officer
Name: Matthew Adams Date: 24 February 2012	X	on behalf of the Monitoring Officer

Section 4 - Contact Details and Background Papers

Contact: George Bruce (Treasury and Pension Fund Manager) Tel: 020-8424-1170 / Email: george.bruce@harrow.gov.uk

Background Papers: None

If appropriate, does the report include the following considerations?

1.	Consultation	N/A
2.	Corporate Priorities	N/A

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LONDON BOROUGH OF HARROW PENSION FUND

STATEMENT OF INVESTMENT PRINCIPLES

LONDON BOROUGH OF HARROW PENSION FUND

STATEMENT OF INVESTMENT PRINCIPLES

CONTENTS

This Statement of Investment Principles has been prepared in consultation with the Fund's investment managers and investment advisor. Fund members and other employing authorities will be given the opportunity to comment on the Statement and the Council will consider their views.

Approved by Harrow Council:

Date 6th March 2012

Introduction

1.1 This is the Statement of Investment Principles (SIP) adopted by Harrow Council (the Council) in relation to the investment of assets of the Council's Pension Fund (the Fund). The Council is the Administering Authority of the Fund and, in that role it has responsibility to ensure the proper management of the Fund.

1.2 This SIP meets the requirements of The Local Government Pension Scheme (Management and Investment of Funds) Regulations 2009 ("The Regulations") and has as been prepared after taking appropriate advice.

1.3 The Council, as administering authority, decides on the investment policies most suitable to meet the liabilities of the Pension Fund and has ultimate responsibility for investment strategy. These powers are exercised on its behalf by the Council's Pension Fund Investment Panel. The Panel monitors investments, including manager performance, on a quarterly basis. Advice is received as required from the officers and the professional advisers. In addition, the Panel requires managers to periodically attend its meeting. The Panel is responsible for monitoring compliance with guidance given by the Secretary of State for Communities and Local Government. No exceptions have been identified.

1.4 The Council has delegated the management of the Fund's investments to professional investment managers, appointed in accordance with the LGPS regulations, whose activities are specified in either detailed investment management agreements or subscription agreements and regularly monitored. The Board is satisfied that the appointed fund managers have sufficient expertise and experience to carry out their role

1.5 The LGPS is established by statute. The Pension Fund is a legally distinct account with contributions made by employees (fixed percentage of earnings) and employers. The primary objective of the Fund is to maximise performance and so minimise the level of employer contributions in order to meet the cost of pension benefits as required by statute. A related objective is to minimise the volatility of employer contribution rates as investment returns vary from year to year.

Investment Objectives

2.1 The investment objective of the Fund is to achieve a return that is sufficient to meet the primary funding objective as set out above, subject to an appropriate level of risk (implicit in the target) and liquidity. Over the long-term, it is expected that the Fund's investment returns will be at least in line with the assumptions underlying the actuarial valuation.

Investment style

3.1 It is the Council's current policy that external fund managers are employed to administer the Fund's assets. The current structure as set out in the table below was implemented following the Actuarial Valuation results as at 31 March 2007. The assets of the fund are mostly in "growth assets" i.e. those expected to generate additional ('excess') returns over the long term. These include equity, and private equity. The asset allocation also has a small allocation to "cash flow matching" assets, mainly index linked bonds. Corporate bonds, property and active currency provide both diversification and expected returns in excess of liabilities.

The table below shows the asset allocation structure.

Asset Class	Allocation	Range	Approach
UK Equities	26%		Passive
Overseas Equities	45%		Active Global Strategy
Total Equities	71%	66-76%	
Bonds	13% Corporate bonds 10.4% Index Linked gilts 2.6%	11-15%	Active Sterling aggregate benchmark plus gilts
Alternatives:-			
Property	10%	8-12%	Active Management
Private Equity	3%	N/A	Active Management
Currency	3%	N/A	Active Management
Total	**100%**		

3.2 The above allocations, ranges and the management structure comply with the limits set out in table 1 of The Regulations with the exception that the limit on single insurance contracts has been increased from 25% to the upper limit of 35% to permit investment in a passive UK equity portfolio. This decision will apply until the completion of the next strategic review or if earlier 31st March 2014. The decision to increase the limit complies with The Regulations.

3.3 The investment style is to appoint fund managers with clear performance benchmarks and place maximum accountability for performance against that benchmark with the investment manager. Multiple fund managers are appointed to give diversification of investment style and spread of risk. The fund managers appointed are mainly remunerated through fees based on the value of assets under management. Private equity managers are remunerated through fees based on commitments and also performance related fees.

3.3 The investment strategy is reviewed periodically, with a major review taking place following each triennial actuarial review.

3.4 Cash balances are held either within bank accounts in the name of the Fund or by the Council on behalf of the Fund. Interest on balances held by the Council is allocated to the Fund based on the average interest income earned by the Council.

3.5 Actual asset allocations are monitored against the above structure and rebalanced as appropriate. The Section 151 officer has delegated authority to undertake a quarterly rebalancing of the equity and bond portfolios should they breach the above ranges. Rebalancing within the bond portfolio is delegated to the fund manager.

3.6 Where appropriate, custodians are appointed to provide trade settlement and processing and related services. Where investments are held through funds, the fund appoints its own custodian.

3.7 A currency hedge equal to 50% on the non sterling equity exposure is maintained.

3.8 The Council does not engage in stock lending activities.

Performance

4.1 Performance targets are set on a three-year rolling basis in relation to the benchmark. The investment managers' performance is reviewed at quarterly and annual intervals by the WM Company who provides independent performance statistics.

Types of investments

5.1 A management agreement is in place for each fund manager, setting out, where relevant, the benchmark, performance target and asset allocation ranges. The agreements also set out any statutory or other restrictions determined by the Council. Investment may be made in accordance with the regulations in equities, fixed interest and other bonds, and property, in the UK and overseas markets. The Regulations specify other investment instruments that may be used, e.g. financial futures, traded options, insurance contracts, stock lending, sub-underwriting contracts.

5.2 The Regulations also specify certain limitations on investments. Principally, these place a limit of 10% of the whole fund in any single holding, or deposits with a single bank or institution, or investments in unlisted securities. The Council does however have discretion to adopt a higher statutory limit in respect of specific investments subject to formal agreement by the Council.

Investment Risk

6.1 Whilst the objective of the Council is to maximise the return on its investments, it recognises that this has to be within certain risk parameters and that no investment is without an element of risk. The Council acknowledges that the predominantly equity based investment strategy may entail risk to contribution stability, particularly due to the short term volatility that equity investments can involve. The longer term nature of the fund and the expected higher longer term returns expected of equity investments over bonds mean, however, that a high equity allocation remains an appropriate strategy for the Fund. Total risk arising from the investment strategy and its implementation is monitored as part of the tri-annual strategy review. Control ranges have been set to aid the monitoring of return and risk targets.

6.2 A policy of diversification for its investments and investment managers helps the Council to mitigate overall risk. Benchmarks and targets against which investment managers are expected to perform are further measures put in place to manage the risks for the fund. Manager performance is monitored quarterly with investigation of any significant deviations from untended strategy.

6.3 The fund has a positive cash flow that enables investment in illiquid asset class's e.g. private equity and property. More than 80% of the fund is invested in equities and bonds that are highly liquid.

6.4 The Council has established a currency hedge covering 50% of the global equity portfolio to dampen the effect of foreign currency fluctuations against sterling.

6.5 Demographic factors including the uncertainty around longevity / mortality projections (e.g. longer life expectancies) contribute to funding risk. There are limited options currently available to fully mitigate or hedge this risk. The Council monitors liabilities using a specialist service (Club Vita) which provides a comprehensive analysis of the Fund's longevity data to enable them to understand and manage this issue in the most effective way.

The realisation of investments

7.1 A realisable (liquid) investment is one that can be readily converted into cash, for example to satisfy payments out of the Fund. The majority of the Fund's assets are highly liquid and the Council is satisfied that the Fund has sufficient liquid assets to meet all expected and unexpected demands for cash. Assets in the Fund that are considered to be illiquid include property and private equity. As a long term investor the Council considers it prudent to include illiquid assets in its strategic asset allocation in order to benefit from the additional diversification and extra return this should provide.

7.2 The Council has delegated to the fund managers responsibility for the selection, retention and realisation of assets.

Investment advice

8.1 Professional advice on investment matters is taken from the investment practice of Aon Hewitt. Hymans Robertson provide actuarial services.

Social, environmental or ethical

9.1 The extent to which social, environmental and ethical considerations are taken into account in these decisions is left to the discretion of the fund managers. However, the Council expects that the extent to which social, environmental and ethical issues may have a financial impact on the portfolio will be taken into account by the fund managers in the exercise of their delegated duties. The Council expects the fund managers to positively engage and seek to influence companies in which the Fund invests to take account of key social, environmental and ethical considerations.

Exercise of the rights (including voting rights) attaching to investments

10.1 The Council is an active shareholder and will exercise its rights (including voting rights) to promote and support good corporate governance principles which in turn will feed through into good investment performance.

10.2 In practice, the Fund's equity holdings are wholly invested through pooled funds in which voting and engagement decisions are made by the fund manager. The Council encourages its fund managers to vote and engage with investee companies worldwide to ensure they comply with best practice in corporate governance in each locality. The fund managers provide reports on their voting and engagement activities.

Myners

11.1 The Myners principals codify best practice in investment Decision-making. While they are voluntary, pension fund trustees are expected to consider their applicability to their own fund and report on a 'comply or explain' basis how they used them. The Regulations require administering authorities to publish in their Statement of Investment Principles the extent to which they comply with the six new investment principles set out in the Myners report on Institutional Investment. The principles and best practice guidance are attached in Appendix 1.

11.2 The Council do broadly comply with the principles but will continue to examine the requirements of the Myners principles with a view to ensuring greater compliance. Any changes will be reflected in updated versions of the Statement of Investment Principles

Additional Voluntary Contributions (AVC)

12.1 In line with statute, the Council has to appoint AVC providers and the current providers are Clerical Medical and Prudential.

Compliance

13.1 The Council is responsible for monitoring the Fund's overall investment performance and the performance of each manager**.**

13.2 The Council is responsible for monitoring the qualitative performance of the fund managers to ensure that they remain suitable for the Fund. These qualitative aspects include changes in ownership, changes in personnel, and investment administration.

13.3 The Council will regularly review the Scheme's compliance with this Statement of Investment Principles. The Statement is reviewed at least every three years and in addition a revised version is issued in the event of significant change occurring.

Appendix 1

Myners Principles:
Defined Benefit Pension Schemes

1. Effective decision-making

Trustees should ensure that decisions are taken by persons or organisations with the skills, knowledge, advice and resources necessary to take them effectively and monitor their implementation.

Trustees should have sufficient expertise to be able to evaluate and challenge the advice they receive, and manage conflicts of interest.

Best Principle Guidance

• The board has appropriate skills for, and is run in a way that facilitates, effective decision making.

• There are sufficient internal resources and access to external resources for trustees and boards to make effective decisions.

• It is good practice to have an investment sub-committee, to provide the appropriate focus and skills on investment decision-making.

• There is an investment business plan and progress is regularly evaluated.

• Consider remuneration of trustees.

• Pay particular attention to managing and contracting with external advisers (including advice on strategic asset allocation, investment management and actuarial issues).

2 Clear objectives

Trustees should set out an overall investment objective(s) for the fund that takes account of the scheme's liabilities, the strength of the sponsor covenant and the attitude to risk of both the trustees and the sponsor, and clearly communicate these to advisers and investment managers.

Best Practice Guidance

• Benchmarks and objectives are in place for the funding and investment of the scheme.

• Fund managers have clear written mandates covering scheme expectations, which include clear time horizons for performance measurement and evaluation.

• Trustees consider as appropriate, given the size of fund, a range of asset classes, active or passive management styles and the impact of investment management costs when formulating objectives and mandates.

• Consider the strength of the sponsor covenant.

3 Risks and Liabilities

In setting and reviewing their investment strategy, trustees should take account of the form and structure of liabilities. These include the strength of the sponsor covenant, the risk of sponsor default and longevity risk.

Best Practice Guidance

• Trustees have a clear policy on willingness to accept underperformance due to market conditions.

• Trustees take into account the risks associated with their liabilities' valuation and management.

• Trustees analyse factors affecting long-term performance and receive advice on how these impact on the scheme and its liabilities.

• Trustees have a legal requirement to establish and operate internal controls.

• Trustees consider whether the investment strategy is consistent with the scheme sponsor's objectives and ability to pay.

4 Performance Assessment

Trustees should arrange for the formal measurement of the performance of investments, investment mangers and advisors. Trustees should also periodically make a formal policy assessment of their own effectiveness as a decision-making body and report on this to scheme members.

Best Practice Guidance

• There is a formal policy and process for assessing individual performance of trustees and managers.

• Trustees can demonstrate an effective contribution and commitment to the role (for example measured by participation at meetings).

• The chairman addresses the results of the performance evaluation.

• State how performance evaluations have been conducted.

• When selecting external advisers take into account relevant factors, including past performance and price.

5 Responsible Ownership

Trustees should adopt, or ensure their investment managers adopt, the Institutional Shareholders' Committee (ISC) Statement of Principles on the responsibilities of shareholders and agents.
A statement of the scheme's policy on responsible ownership should be included in the Statement of Investment Principles.
Trustees should report periodically to members on the discharge of such responsibilities.

<u>Best Practice Guidance</u>

• Policies regarding responsible ownership are disclosed to scheme members in the annual report and accounts or in the Statement of Investment Principles.

• Trustees consider the potential for engagement to add value when formulating investment strategy and selecting investment managers.

• Trustees ensure that investment managers have an explicit strategy, setting out the circumstances in which they will intervene in a company.

• Trustees ensure that Investment consultants adopt the ISC's Statement of Practice relating to consultants.

6 Transparency and Reporting

Trustees should act in a transparent manner, communicating with stakeholders on issues relating to their management of investment, its governance and risks, including performance against stated objectives.
Trustees should provide regular communication to members in the form they consider most appropriate.

<u>Best Practice Guidance:</u>

• Reporting ensures that the scheme operates transparently and enhances accountability to scheme members and best practice provides a basis for the continuing improvement of governance standards.

REPORT FOR:	**PENSION FUND INVESTMENTS PANEL**
Date of Meeting:	6 March 2012
Subject:	Review of the Funding Strategy Statement
Responsible Officer:	Julie Alderson, Interim Corporate Director of Resources
Exempt:	No
Enclosures:	Funding Strategy Statement

Section 1 – Summary and Recommendations

This Funding Strategy Statement reports the Council's strategy to meet the liabilities of the pension fund.

RECOMMENDATIONS:

The Panel is invited to approve the Funding Strategy Statement

Section 2 – Report

1. The Funding Strategy Statement (FSS) is reviewed in detail at least every three years, ahead of triennial valuations being carried out. The purpose of the FSS is to:

   (a) Establish a clear and transparent fund-specific strategy which will identify how employers' pension liabilities are best met going forward;
   (b) Support the regulatory framework to maintain as nearly constant employer contribution rates as possible; and
   (c) Take a prudent longer-term view of funding those liabilities.

2. The FSS sets out how the Administering Authority has balanced the conflicting aims of affordability of contributions, transparency of processes, stability of employers' contributions, and prudence in the funding basis.

3. The FSS is a summary of the Fund's approach to funding liabilities. It is not an exhaustive statement of policy on all issues. The FSS has been drafted by the Actuary, but ownership rests with the Council. It is acknowledged that is longwinded and following the next valuation it will be condensed. Attached to the statement, annex A, is employer specific contribution rates.

4. At the 2010 actuarial valuation the pension scheme liabilities exceeded fund assets by £157 million. The intention is to eliminate this deficit over a period of up to 20 years through earning investment returns in excess of the funding basis of gilts plus 1.6% together with increases in employer contributions. Changes to the structure of benefits and increases in employee contributions currently being consulted on by the Government may also help address the deficit. Prior to finalisation of the March 2013 valuation the Panel will have an opportunity to discuss the methodologies and assumptions to be applied.

5. The changes are mainly descriptive rather than substantive and are highlighted in the report. They reflect mainly the differences in approach between the 2007 and 2010 valuations and the treatment of academy status schools. In particular:

- Para 3.1 – weaker statement on the requirement to pay strain costs.
- Para 3.2 – additional language for academies.
- Para 3.3 – longevity assumptions now reflect the post codes where members live rather than the more general LGPS experience. Also updated assumptions for salary growth and pension increases (RPI to CPI).
- Para 3.7 – greater detail on the manner in which stabilisation is applied.
- Annex A – new schedule of contribution rates.

6. The Panel is invited to comment and approve the FSS.

7. The next update will be undertaken in conjunction with finalising the 2013 actuarial valuation.

Financial Implications

8. The SIP addresses the high level risk and return objectives of the Fund.

Risk Management Implications

9. Risk included on Directorate risk register? No

10. Separate risk register in place? No

11. At the last actuarial valuation the liabilities of the pension fund exceeded the assets by £157 million. The FSS and the Statement of Investment Principles between them establish how this deficit will be eliminated.

Equalities implications

12. Was an Equality Impact Assessment carried out? No

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

Corporate Priorities

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

Section 3 - Statutory Officer Clearance

Name: Julie Alderson Date: 22 February 2012	X	Chief Financial Officer
Name: Matthew Adams Date: 24 February 2012	X	on behalf of the Monitoring Officer

Section 4 - Contact Details and Background Papers

Contact: George Bruce (Treasury and Pension Fund Manager) Tel: 020-8424-1170 / Email: george.bruce@harrow.gov.uk

Background Papers: None

If appropriate, does the report include the following considerations?

1.	Consultation	N/A
2.	Corporate Priorities	N/A

London Borough of Harrow Pension Fund
Funding Strategy Statement
As at 29 February 2012

1. Introduction

This is the Funding Strategy Statement (FSS) of the London Borough of Harrow Pension Fund ("the Fund"), which is administered by Harrow Council, London ("the Administering Authority").

It has been reviewed by the Administering Authority in collaboration with the Fund's Actuary, Hymans Robertson, after consultation with the Fund's employers and investment adviser. This revised version replaces the previous FSS and is effective from 29 February 2012.

1.1 Regulatory Framework

Scheme members' accrued benefits are guaranteed by statute. Members' contributions are fixed in the Regulations at a level that covers only part of the cost of accruing benefits. Employers currently pay the balance of the cost of delivering the benefits to members. The FSS focuses on the pace at which these liabilities are funded and, insofar as is practical, the measures to ensure that employers or pools of employers pay for their own liabilities.

The FSS forms part of a framework, which includes:

- The Local Government Pension Scheme Regulations[1] (Regulations 34, 35 and 36 of the Administration Regulations are particularly relevant);
- the Rates and Adjustments Certificate, which can be found appended to the Fund Actuary's triennial valuation report;
- actuarial factors for valuing early retirement costs and the cost of buying extra service; and
- the Statement of Investment Principles (SIP).

Operating within this framework, the Fund's Actuary carries out triennial valuations to set employers' contributions and provides recommendations to the Administering Authority when other funding decisions are required, for example when employers join or leave the Fund. The FSS applies to all employers participating in the Fund.

1.2 Reviews of FSS

The FSS is reviewed in detail at least every three years, ahead of triennial valuations being carried out; the next full review will fall due to be completed by 31 March 2014. Annex A is updated more frequently to reflect any changes to employers.

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[1] Consisting of The Local Government Pension Scheme (Administration) Regulations 2008, The Local Government Pension Scheme (Benefits, Membership and Contributions) Regulations 2007 ("the Benefits Regulations"), The Local Government Pension Scheme (Administration) Regulations 2007 ("the Administration Regulations") and The Local Government Pension Scheme (Transitional Pensions) Regulations 2007 ("the Transitional Regulations").

London Borough of Harrow Pension Fund
Funding Strategy Statement
As at 29 February 2012

The FSS is a summary of the Fund's approach to funding liabilities. It is not an exhaustive statement of policy on all issues. If you have any queries please contact Julie Alderson in the first instance at julie.alderson@harrow.gov.uk or on tel: 020-8424-1788.

2. Purpose

2.1 Purpose of the FSS

The purpose of the FSS is:

- "to establish a clear and transparent fund-specific strategy which will identify how employers' pension liabilities are best met going forward;
- to support the regulatory framework to maintain as nearly constant employer contribution rates as possible; and
- to take a prudent longer-term view of funding those liabilities."

These objectives are desirable individually, but may be mutually conflicting.

This statement sets out how the Administering Authority has balanced the conflicting aims of affordability of contributions, transparency of processes, stability of employers' contributions, and prudence in the funding basis.

2.2 Purpose of the Fund

The Fund is a vehicle by which scheme benefits are delivered. The Fund:

- receives contributions, transfer payments and investment income;
- pays scheme benefits, transfer values and administration costs.

One of the objectives of a funded scheme is to reduce the variability of pension costs over time for employers compared with an unfunded (pay-as-you-go) alternative.

The roles and responsibilities of the key parties involved in the management of the pension scheme are summarised in Annex B.

2.3 Aims of the Funding Policy

The objectives of the Fund's funding policy include the following:

- to ensure the long-term solvency of the Fund as a whole and the solvency of each of the notional sub-funds allocated to the individual employers or pool of employers;

- to ensure that sufficient funds are available to meet all benefits as they fall due for payment;
- not to restrain unnecessarily the investment strategy of the Fund so that the Administering Authority can seek to maximise investment returns (and hence minimise the cost of the benefits) for an appropriate level of risk;
- to help employers recognise and manage pension liabilities as they accrue;
- to minimise the degree of short-term change in the level of employer's contributions where the Administering Authority considers it reasonable to do so.

3. Solvency Issues and Target Funding Levels

3.1 Derivation of Employer Contributions

Employer contributions are normally made up of two elements:

a) the estimated cost of future benefits being accrued, referred to as the "*future service rate*"; plus

b) an adjustment for the funding position (or "solvency") of accrued benefits relative to the Fund's solvency target, "*past service adjustment*". If there is a surplus there may be a contribution reduction, if a deficit a contribution addition, with the surplus or deficit spread over an appropriate period.

The Fund's Actuary is required by the regulations to report the *Common Contribution Rate*[2], for all employers collectively at each triennial valuation. It combines items (a) and (b) and is expressed as a percentage of pay. For the purpose of calculating the Common Contribution Rate, the surplus or deficit under (b) is currently spread over a period of 20 years.

The Fund's Actuary is also required to adjust the Common Contribution Rate for circumstances that are deemed "peculiar" to an individual employer[3]. It is the adjusted contribution rate which employers are actually required to pay. The sorts of peculiar factors which are considered are discussed in Section 3.5.

In effect, the *Common Contribution Rate* is a notional quantity. Separate future service rates are calculated for each employer or pool together with individual past service adjustments according to employer (or pool) -specific spreading and phasing periods.

[2] See Regulation 36 (5) of the Benefits Regulations
[3] See Regulation 36 (7) of the Benefits Regulations

For some employers it may be agreed to pool contributions, see Section 3.7.8.

Annex A contains a breakdown of each employer's contributions following the 2010 valuation for the financial years 2011/12, 2012/13 and 2013/14. It also identifies which employers' contributions have been pooled with others.

Any costs of early retirements other than on the grounds of ill-health must be paid as lump sum payments at the time of the employer's decision in addition to the contributions described above (or by instalments shortly after the decision where requested by the Administering Authority).

Employers' contributions are expressed as minima, with employers able to pay regular contributions at a higher rate. Employers should discuss with the Administering Authority before making one-off capital payments.

3.2 Solvency and Target Funding Levels

The Fund's Actuary is required to report on the "solvency" of the whole fund at least every three years.

'Solvency" for ongoing employers is defined to be the ratio of the market value of assets to the value placed on accrued benefits on the Fund Actuary's *ongoing funding basis*. This quantity is known as a funding level.

The ongoing funding basis is that used for each triennial valuation and the Fund Actuary agrees the financial and demographic assumptions to be used for each such valuation with the Administering Authority.

The Fund operates the same target funding level for all ongoing employers of 100% of its accrued liabilities valued on the ongoing basis. Please refer to paragraph 3.8 for the treatment of departing employers.

Where an admission agreement for an admission body, that is not a Transferee Admission Body and with no guarantor, is likely to terminate within the next 5 to 10 years or lose its last active member within that timeframe, the fund reserves the right to set contribution rates by reference to liabilities valued on a gilts basis (i.e. using a discount rate that has no allowance for potential investment outperformance relative to gilts). The target in setting contributions for any employer in these circumstances is to achieve full funding on a gilts basis by the time the agreement terminates or the last active member leaves in order to protect other employers in the Fund. This policy will increase regular contributions and reduce, but not entirely eliminate, the possibility of a final deficit payment being required when a cessation valuation is carried out.

The Fund also reserves the right to adopt the above approach in respect of those admission bodies with no guarantor, where the strength of covenant is considered to be weak but there is no immediate expectation that the admission agreement will cease.

3.3 Ongoing Funding Basis

(a) Life expectancy

The demographic assumptions are intended to be best estimates of future experience in the Fund based on past experience of LGPS funds advised by the actuary.

The longevity assumptions that have been adopted at this valuation are a bespoke set of "VitaCurves", produced by the CLUBVITA's detailed analysis, which are specifically tailored to fit the membership profile of the Fund. These curves are based on the data provided by the Fund for the purposes of this valuation.

It is acknowledged that future life expectancy and, in particular, the allowance for future improvements in life expectancy, is uncertain. There is a consensus amongst actuaries, demographers and medical experts that life expectancy is likely to improve in the future. Allowance has been made in the ongoing valuation basis for future improvements in line with "medium cohort" and a 1% pa minimum underpin to future reductions in mortality rates.

The combined effect of the above changes from the 2007 valuation approach, is to add around one year of life expectancy on average. The approach taken is considered reasonable in light of the long term nature of the Fund and the assumed level of security underpinning members' benefits.

(b) Investment return / discount rate

The key financial assumption is the anticipated return on the Fund's investments. The investment return assumption makes allowance for an anticipated out-performance of returns from equities relative to Government bonds. There is, however, no guarantee that equities will out-perform bonds. The risk is greater when measured over short periods such as the three years between formal actuarial valuations, when the actual returns and assumed returns can deviate sharply.

Given the very long-term nature of the liabilities, a long term view of prospective returns from equities is taken.

For the purpose of the triennial funding valuation at 31 March 2010 and setting contribution rates effective from 1 April 2011, the Fund actuary has assumed that future investment returns earned by the Fund over the long term will be 1.6% per annum greater than the return available from investing in government bonds at the time of the valuation (this is the same as that used at the 2007 valuation). The long term in this context would be 20 to 30 years or more. In the opinion of the Fund actuary, based on the current investment strategy of the Fund, an asset out-performance assumption (AOA) of 1.6% per annum is within a range that would be considered acceptable for the purposes of the funding valuation.

(c) Salary growth

Pay for public sector employees will be frozen by Government until 2012, with a flat increase of £250 being applied to all those earning less than £21,000 pa. Although this "pay freeze" does not officially apply to local government employers, it has been suggested that they are expected to show similar restraint in respect of pay awards. Based on an analysis of the membership in LGPS funds, the average expected increase in pensionable pay across all employees should be around 1% pa for the next couple of years. Therefore the salary increase assumption at the 2010 valuation has been set to 1% pa for 2010/11, 2011/12 and 2012/13 in the expectation that pay growth will be limited until March 2013. After this point, the assumption will revert back to RPI plus 1.0% p.a. This is lower than the assumption adopted at the 2007 valuation of RPI plus 1.5% p.a.

(d) Pension increases

The Chancellor of the Exchequer announced in his Emergency Budget on 22 June 2010 that the consumer prices index (CPI) rather than the retail prices index (RPI) will be the basis for future increases to public sector pensions in deferment and in payment. This proposed change has been allowed for in the valuation calculations as at 31 March 2010.

At the previous valuation, we derived our assumption for RPI from market data as the difference between the yield on long-dated fixed interest and index-linked government bonds. For the 2010 valuation, this market-derived rate has been adjusted downwards by 0.5% pa to allow for the "formula effect" of the difference between RPI and CPI. Basing pension increases on CPI rather than RPI will serve to reduce the value placed on the Fund's liabilities.

(e) General

The same financial assumptions are adopted for all employers for whom the ongoing basis is deemed to be appropriate. All employers have the same asset allocation as described in Section 3.6.

The demographic assumptions vary by type of member and so reflect the different membership profiles of employers.

3.4 Future Service Contribution Rates

The future service element of the employer contribution rate is calculated on the ongoing valuation basis, with the aim of ensuring that there are sufficient assets built up to meet future benefit payments in respect of future service. For the 2010 valuation, the future service rate has been calculated separately for all the employers although employers within a pool will pay the contribution rate applicable to the pool as a whole.

Where it is considered appropriate to do so, the Administering Authority reserves the right to set a future service rate by reference to liabilities valued on a lower discount rate (most usually for Admission Bodies in the circumstances outlined in 3.2).

The approach used to calculate the employer's future service contribution rate depends on whether or not new entrants are being admitted in line with the approach described below. Employers should note that it is only Admission Bodies that may have the power not to admit automatically all eligible new staff to the Fund, depending on the terms of their Admission Agreements and employment contracts.

3.4.1 Employers that admit new entrants

The employer's future service rate will be based upon the cost (in excess of members' contributions) of the benefits which employee members earn from their service each year. Technically these rates will be derived using the *Projected Unit Method* of valuation with a one-year control period.

If future experience is in line with assumptions, and the employer's membership profile remains stable, this rate should be broadly stable over time. If the membership of employees matures (e.g. because of lower recruitment) the rate would rise.

3.4.2 Employers that do not admit new entrants

Where Admission Bodies have closed the scheme to new entrants, this is expected to lead to the average age of employee members increasing over time and hence, all other things being equal, the future service rate is expected to increase as the membership ages.

To give more long-term stability to such employers' contributions, the *Attained Age* funding method is normally adopted. This will limit the degree of future contribution rises by paying higher rates at the outset.

Both funding methods are described in the Actuary's report on the valuation.

Both future service rates include an allowance for expenses of administration to the extent that they are borne by the Fund and include an allowance for benefits payable on death in service and ill health retirement.

3.5 Adjustments for Individual Employers

Adjustments to individual employer contribution rates are applied both through the calculation of employer-specific future service contribution rates and the calculation of the employer's funding position.

The combined effect of these adjustments for individual employers applied by the Fund Actuary relate to:

- past contributions relative to the cost of accruals of benefits;
- different liability profiles of employers (e.g. mix of members by age, gender, part-time/full-time, manual/non manual);
- the effect of any differences in the valuation basis on the value placed on the employer's liabilities;
- any different deficit/surplus spreading periods or phasing of contribution changes;
- the difference between actual and assumed rises in pensionable pay;
- the difference between actual and assumed increases to pensions in payment and deferred pensions;
- the difference between actual and assumed retirements on grounds of ill-health from active status;
- the difference between actual and assumed amounts of pension ceasing on death;
- the additional costs of any non ill-health retirements relative to any extra payments made;

over the period between each triennial valuation period.

Actual investment returns achieved on the Fund between each valuation are applied proportionately across all employers. Transfers of liabilities between employers within the Fund occur automatically within this process, with a sum broadly equivalent to the reserve required on the ongoing basis being exchanged between the two employers, unless the circumstances dictate otherwise.

The Fund Actuary does not allow for certain relatively minor events occurring in the period since the last formal valuation including, but not limited to:

- the actual timing of employer contributions within any financial year;
- the effect of the premature payment of any deferred pensions on grounds of incapacity.

These effects are swept up within a miscellaneous item in the analysis of surplus, which is split between employers in proportion to their liabilities.

3.6 Asset Share Calculations for Individual Employers

The Administering Authority does not account for each employer's assets separately. The Fund's Actuary apportions the assets of the whole Fund between the employers (or pools of employers) at each triennial valuation using the income and expenditure figures provided for certain cash flows for each employer (or pool of employers). This process adjusts for transfers of liabilities between employers participating in the Fund, but does make a number of simplifying assumptions. The split is calculated using an actuarial technique known as "analysis of surplus". The methodology adopted means that there will inevitably be some difference between the asset shares calculated for individual employers and those that would have resulted had they participated in their own ring-fenced section of the Fund. The asset apportionment is capable of verification but not to audit standard.

The Administering Authority recognises the limitations in the process, but having regard to the extra administration cost of building in new protections, it considers that the Fund Actuary's approach addresses the risks of employer cross-subsidisation to an acceptable degree.

3.7 Stability of Employer Contributions

3.7.1 Solvency Issues and Target Funding Levels

A key challenge for the Administering Authority is to balance the need for stable, affordable employer contributions with the requirement to take a prudent, longer-term view of funding and ensure the solvency of the Fund. With this in mind, there are a number of prudential strategies that the Administering Authority may deploy in order to maintain employer contribution rates at as nearly a constant rate as possible. These include:-

- capping of employer contribution rate increases / decreases within a pre-determined range ("Stabilisation")
- the pooling of contributions amongst employers with similar characteristics
- the use of extended deficit recovery periods
- the phasing in of contribution increases / decreases

3.7.2 Stabilisation

There can be occasions when, despite the deployment of contribution smoothing mechanisms such as pooling, phasing and the extension of deficit recovery periods, the theoretical employer contribution rate is not affordable or achievable. This can occur in times of tight fiscal control or where budgets have been set in advance of new employer contribution rates being available.

The more secure the employer, the more emphasis can be placed on stability of employer contributions without jeopardising the Administering Authority's commitment to prudent stewardship of the Fund. For the most secure, long term employers an explicit stabilisation overlay based on a risk-based, stochastic valuation approach is used.

For less secure and shorter term employers (principally, but not exclusively, the admission bodies) it is generally not possible to achieve the same degree of stability in employer contribution rates without compromising on prudent stewardship.

In view of this possibility, the Administering Authority has commissioned the Fund Actuary to carry out extensive modelling to explore the long term effect on the Fund of capping future contribution increases. The results of this modelling indicate that it is justifiable to limit employer contribution rate changes to +0.25% / -2% of employers' contributions per annum for the six years from 1 April 2008, for employers where the Administering Authority is satisfied that the status of the employer merits adoption of a stabilised approach.

Circumstances in which eligibility for stabilisation will be reviewed

- The Administering Authority may review an employer's eligibility for stabilisation at any time in the event of significant changes in the employer's membership (due for example to redundancies or outsourcing) or if there is a significant change in the Administering Authority's assessment of an employer's security. Possible actions may include increases in contributions expressed as a percentage of pay or revised deficit contributions expressed as monetary amounts.

- Stabilisation rules and eligibility may be reviewed at any time in the event of changes to scheme benefits. Changes in scheme benefits may arise because of changes in regulations or other events that have a material impact (such as the change with effect from 22 June 2010 from RPI to CPI for increases to pensions in payment).

- The stabilisation rules and eligibility criteria will be reviewed no later than at the 31 March 2013 valuation, with any changes in contribution strategy taking effect from 1 April 2014. The review will take into account factors including, but not necessarily restricted to, market conditions (the long-term risk-based analysis will be recalibrated to market conditions as at 31 March 2013), the Administering Authority's assessment of employer's security and the maturity of each employer's membership profile.

Setting the parameters of the stabilisation overlay

The parameters for the stabilisation overlay have been determined by carrying out an asset liability modelling exercise. This allows for the future uncertainty in investment returns, interest rates and inflation using a stochastic modelling technique. The actuary tested the contribution stabilisation rules to ensure that they were compatible with the current investment strategy. The actuary has advised the Administering Authority that the stabilisation overlay for secure long term employers satisfies the requirement for the funding strategy to take a prudent longer-term view.

The actuarial modelling discloses that there is only around a 60% chance of the Fund having a funding level of at least 100% on an ongoing basis after 18 years, and this is slightly lower if stabilisation is applied. The actuary believes that there is a sufficiently high likelihood of achieving the long term funding objective (a funding level of 100% on a sufficiently prudent basis) where contributions are paid at the stabilised rate over a longer period.

In the interests of stability and affordability of employer contributions, the Administering Authority, on the advice of the Fund Actuary, believes that the results of the modelling demonstrate that stabilising contributions can still be viewed as a prudent longer-term approach. However, employers whose contribution rates have been “stabilised” and are therefore paying less than their theoretical contribution rate should be aware of the risks of this approach and should consider making additional payments to the Fund if possible.

The list of employers whose rates have been stabilised is set out in Annex A.

The Fund currently has a net cash inflow and can therefore take a medium to long term view on determining employer contribution rates to meet future liabilities through operating a fund with an investment strategy that reflects this long term view. It allows short term investment markets volatility to be managed so as not to cause volatility in employer contribution rates. However, this net cash inflow is reducing over time and so should be kept under review.

The LGPS regulations require the longer term funding objectives to be to achieve and maintain assets to meet the projected accrued liabilities. The role of the Fund Actuary in performing the necessary calculations and determining the key assumptions used, is an important feature in determining the funding requirements. The approach to the actuarial valuation and key assumptions used at each triennial valuation forms part of the consultation undertaken with the FSS.

3.7.3 Deficit Recovery Periods

The Administering Authority instructs the Actuary to adopt specific deficit recovery periods for all employers when calculating their contributions.

The Administering Authority normally targets the recovery of any deficit over a period not exceeding 20 years. However, these are subject to the maximum lengths set out in the table below.

Type of Employer	***Maximum* Length of Deficit Recovery Period**
Statutory bodies with tax raising powers	A period to be agreed with each employer not exceeding 20 years.
Community Admission Bodies with funding guarantees	A period to be agreed with each employer not exceeding 20 years.
Transferee Admission Bodies	The period from the start of the revised contributions to the end of the employer's contract or the date when it is expected that all employee members will have left active membership of the Fund, if earlier.
Academies	A period to be agreed with each employer not exceeding 20 years. Any recovery period in excess of 7 years will only be applicable for as long as the academy or Department of Education does not give notice of exiting its status. On receiving 7 years notice of exiting academy status, the outstanding deficit be spread over the remainder of the notice period.
Community Admission Bodies that are closed to new entrants e.g. Bus Companies, whose admission agreements continue after last active member retires	A period equivalent to the expected future working lifetime of the remaining scheme members allowing for expected leavers
All other types of employer	A period equivalent to the expected future working lifetime of the remaining scheme members

This maximum period is used in calculating each employer's minimum contributions. Employers may opt to pay higher regular contributions than these minimum rates.

The deficit recovery period starts at the commencement of the revised contribution rate (1 April 2011 for the 2010 valuation). The Administering Authority would normally expect the same period to be used at successive triennial valuations, but would reserve the right to propose alternative spreading periods, for example to improve the stability of contributions.

3.7.4 *Surplus Spreading Periods*

Any employers deemed to be in surplus may be permitted to reduce their contributions below the cost of accruing benefits, by spreading the surplus element over the maximum periods shown above for deficits in calculating their minimum contributions.

However, to help meet the stability requirement, employers may prefer not to take such reductions.

3.7.5 *Phasing in of Contribution Rises*

Any contribution rate rises will be subject to the 'stabilisation mechanism' set out in Section 3.7.2. Transferee Admission Bodies are not eligible for phasing in of contribution rises. Other employers may opt to phase in contribution rises by phasing in the rise in contributions over a period of up to seven years.

3.7.6 *Phasing in of Contribution Reductions*

Any contribution reductions will be subject to the 'stabilisation mechanism' set out in Section 3.7.2. Transferee Admission Bodies can take the reduction with immediate effect.

3.7.7 *The Effect of Opting for Longer Spreading or Phasing-In*

Employers which are permitted and elect to use a longer deficit spreading period than other employers or to phase-in contribution changes will be assumed to incur a greater loss of investment returns on the deficit by opting to defer repayment. Thus, deferring paying contributions will lead to higher contributions in the long-term.

However any adjustment is expressed for different employers the overriding principle is that the discounted value of the contribution adjustment adopted for each employer will be equivalent to the employer's deficit.

3.7.8 *Smaller Employers*

The Administering Authority allows smaller employers of similar types to pool their contributions as a way of sharing experience and smoothing out the effects of costly but relatively rare events such as ill-health retirements or deaths in service.

Transferee Admission Bodies are ineligible for pooling.

Smaller employers may choose to Pool funds in future – As stated above. Transferee Admission Bodies, are not eligible for pooling.

Employers who are eligible for pooling at the 2010 valuation have consented to participate in the pool.

3.8 Admission Bodies ceasing

Admission Agreements for Transferee Admission Bodies are assumed to expire at the end of the contract.

Admission Agreements for other employers are generally assumed to be open-ended and to continue until the last pensioner dies. Contributions, expressed as capital payments, can continue to be levied after all the employees have retired. These Admission Agreements can however be terminated at any point.

If an Admission Body's admission agreement is terminated, the Administering Authority instructs the Fund Actuary to carry out a special valuation under Regulation 38 of the Administration Regulations to determine whether there is any deficit.

The assumptions adopted to value the departing employer's liabilities for this valuation will depend upon the circumstances. For example:

(a) For Transferee Admission Bodies, the assumptions would usually be those used for an ongoing valuation to be consistent with those used to calculate the initial transfer of assets to accompany the active member liabilities transferred.

(b) For non Transferee Admission Bodies that elect to voluntarily terminate their participation, the Administering Authority must look to protect the interests of other ongoing employers and will require the Actuary to adopt valuation assumptions which, to the extent reasonably practicable, protect the other employers from the likelihood of any material loss emerging in future. This could give rise to significant payments being required.

(c) For Admission Bodies with guarantors, it is possible that any deficit could be transferred to the guarantor in which case it may be possible to simply transfer the former Admission Bodies members and assets to the guarantor, without needing to crystallise any deficit.

Under (a) and (b), any shortfall would be levied on the departing Admission Body as a capital payment.

3.9 Early Retirement Costs

3.9.1 Non Ill Health retirements

The Actuary's funding basis makes no allowance for premature retirement except on grounds of ill-health. All employers, irrespective of whether or not they are pooled, incur additional costs whenever an employee retires "early" (see below) with no reduction to their benefit or receives an enhanced pension on retirement. The current costs of these are specified in the latest early retirement manual from Hymans Robertson. Annex A indicates which employers pay additional lump sums into the Fund.

The additional costs of premature retirement are calculated by reference to these ages.

3.9.2 Ill health monitoring

The number of ill health retirements is carefully monitored against the assumptions included in the valuation.

4. Links to Investment Strategy

Funding and investment strategy are inextricably linked. Investment strategy is set by the Administering Authority, after consultation with the employers and after taking investment advice.

4.1 Investment Strategy

The investment strategy currently being pursued is described in the Fund's Statement of Investment Principles.

The investment strategy is set for the long-term, but is reviewed from time to time, normally every three years, to ensure that it remains appropriate to the Fund's liability profile. The Administering Authority has adopted a benchmark, which sets the proportion of assets to be invested in key asset classes such as equities, bonds and property. As at 31 March 2010, the proportion held in equities and property was 86% of the total Fund assets.

The investment strategy of lowest risk would be one which provides cashflows which replicate the expected benefit cashflows (i.e. the liabilities). Equity investment would not be consistent with this.

The lowest risk strategy is not necessarily likely to be the most cost-effective strategy in the long-term.

The Fund's benchmark includes a significant holding in equities in the pursuit of long-term higher returns than from a liability matching strategy. The Administering Authority's strategy recognises the relatively immature liabilities of the Fund, the security of members' benefits and the secure nature of most employers' covenants.

The same investment strategy is followed for all employers. The Administering Authority does not have the facility to operate different investment strategies for different employers.

4.2 Consistency with Funding Basis

The funding basis adopts an asset outperformance assumption of 1.6% per annum over and above the redemption yield on index-linked gilts. Both the Fund's Actuary and its investment adviser consider that the funding basis does conform to the requirement to take a "prudent longer-term" approach to funding, based on the Fund's current investment strategy.

The Administering Authority is aware that in the short term – such as the three yearly assessments at formal valuations – the proportion of the Fund invested in equities brings the possibility of considerable volatility and there is a material chance that in the short-term and even medium term, asset returns will fall short of the outperformance target. The stability measures described in Section 3 will damp down, but not remove, the effect on employers' contributions.

The Fund does not hold a contingency reserve to protect it against the volatility of equity investments.

4.3 Balance between risk and reward

Prior to implementing its current investment strategy, the Administering Authority considered the balance between risk and reward by altering the level of investment in potentially higher yielding, but more volatile, asset classes like equities. This process was informed by the use of Asset-Liability techniques to model the range of potential future solvency levels and contribution rates.

4.4 Intervaluation Monitoring of Funding Position

The Fund is subject to an actuarial valuation every 3 years, which reviews assets and liabilities and assesses the funding level. Between these valuations the Administering Authority monitors investment performance on a quarterly basis. It reports back to employers by annual reports.

5. Key Risks & Controls

5.1 Types of Risk

The Administering Authority has an active risk management programme in place. The measures that the Administering Authority has in place to control key risks are summarised below under the following headings:

- financial;
- demographic;
- regulatory; and
- governance.

5.2 Financial Risks

Risk	**Summary of Control Mechanisms**
Fund assets fail to deliver returns in line with the anticipated returns underpinning valuation of liabilities over the long-term	Only anticipate long-term return on a relatively prudent basis to reduce risk of under-performing.Short term (quarterly) investment monitoring analyses market performance. This gives an early warning of contribution rises ahead. In the short term, volatility is damped down by stability measures on contributions. However, if underperformance is sustained over a period, contributions would rise by more. Analyse progress at three yearly valuations for all employers.
Inappropriate long-term investment strategy	Set Fund-specific benchmark, informed by Asset-Liability modelling of liabilities.
Fall in risk-free returns on Government bonds, leading to a rise in value placed on liabilities	Some investment in bonds helps to mitigate this risk.
Active investment manager under-performance relative to benchmark	Short term (quarterly) investment monitoring analyses market performance and active managers relative to their index benchmark.
Actual pay and price inflation significantly more than anticipated	The focus of the actuarial valuation process is on real returns on assets, net of price and pay increases. Some investment in index-linked bonds also helps to mitigate this risk. Employers pay for their own salary awards and are reminded of the geared effect on pension liabilities of any bias in pensionable pay rises towards longer-serving employees.
Effect of possible increase in employer's contribution rate on service delivery and	Seek feedback from employers on scope to absorb short-term contribution rises.

Risk	**Summary of Control Mechanisms**
admission/scheduled bodies	Mitigate impact through deficit spreading and phasing in of contribution rises. Incorporate a stabilisation mechanism for employers where appropriate.

5.3 Demographic Risks

Risk	**Summary of Control Mechanisms**
Ill health retirements significantly more than anticipated	Monitoring of each employer's ill health experience on an ongoing basis. The employer may be charged additional contributions if this exceeds the ill health assumption built in.
Pensioners living longer	Set mortality assumptions with some allowance for future increases in life expectancy. Sensitivity analysis in triennial valuation calculations helps employers understand the potential impact of life expectancy. Fund Actuary monitors combined experience of around 50 LGPS funds to look for early warnings of lower pension amounts ceasing than assumed in funding. Administering Authority encourages any employers concerned at costs to promote later retirement culture. Each 1 year rise in the average age at retirement would save roughly 5% of pension costs.
Deteriorating patterns of early retirements	Employers are allocated the extra capital cost of non ill health retirements following each individual decision and may be required to make a capital payment. Employer ill health retirement experience is monitored.

5.4 Regulatory

<table>
<tr><th>Risk</th><th>Summary of Control Mechanisms</th></tr>
<tr><td>Changes to LGPS regulations, e.g. more favourable benefits package, potential new entrants to scheme, e.g. part-time employees or effect of tiered contribution rates with effect from 1 April 2008</td><td rowspan="2">The Administering Authority is alert to the potential creation of additional liabilities and administrative difficulties for employers and itself.

It considers all consultation papers issued by the DCLG and comments where appropriate.

The results of the Hutton review are not expected to affect the Fund until after the 2013 valuation, and so will be incorporated at that time. Any changes to member contribution rates or benefit levels will be carefully communicated with members to minimise possible opt-outs or adverse actions.

The Administering Authority will consult employers where it considers that it is appropriate.</td></tr>
<tr><td>Changes to national pension requirements and/or HM Revenue & Customs rules</td></tr>
</table>

5.5 Governance

Risk	Summary of Control Mechanisms
Administering Authority unaware of structural changes in an employer's membership (e.g. large fall in employee members, large number of retirements).	The Administering Authority monitors membership movements on a quarterly basis. The Actuary may be instructed to consider revising the Rates and Adjustments certificate to increase an employer's contributions (under Regulation 38 of the Administration Regulations) between triennial valuations
Administering Authority not advised of an employer closing to new entrants.	
Administering Authority failing to commission the Fund Actuary to carry out a termination valuation for a departing Admission Body and losing the opportunity to call in a debt.	In addition to the Administering Authority monitoring membership movements on a quarterly basis, it requires employers with Transferee Admission contracts to inform it of forthcoming changes. It also operates a diary system to alert it to the forthcoming termination of Transferee Admission Agreements.
An employer ceasing to exist with insufficient funding or adequacy of a bond.	The Administering Authority believes that it would normally be too late to address the position if it was left to the time of departure. The risk is mitigated by: • Seeking a funding guarantee from another scheme employer, or external body, wherever possible. • Alerting the prospective employer to its obligations and encouraging it to take independent actuarial advice. • Vetting prospective employers before admission. • Where permitted and appropriate under the regulations requiring a

Risk	Summary of Control Mechanisms
	bond to protect the scheme from the extra cost of early retirements on redundancy if the employer failed.

Annex A: Employers' Contributions, Spreading and Phasing Periods

The Common Rate of Contribution payable by each employing authority under regulation 36(4)(a) of the Administration Regulations for the period 1 April 2011 to 31 March 2014 is 25.7% of pensionable pay (as defined in Appendix B).

Individual Adjustments are required under regulation 36(4)(b) of the Administration Regulations for the period 1 April 2011 to 31 March 2014 resulting in Minimum Total Contribution Rates expressed as a percentage of pensionable pay are as set out below:

Employer code	Employer name	Contributions currently being paid in 2010/11	Minimum Contributions for the Year Ending		
			31 March 2012	31 March 2013	31 March 2014
1	London Borough of Harrow	18.6%	18.85%	19.10%	19.35%
2	North London Collegiate School	18.6%	18.85%	19.10%	19.35%
5	Stanmore College	18.6%	18.85%	19.10%	19.35%
7	Harrow College	18.6%	18.85%	19.10%	19.35%
8	Employer 8	18.6%	18.85%	19.10%	19.35%
10	Harrisons Catering	21.6%	22.50% *	22.50% *	22.50% *
11	St Dominic's Sixth Form College	18.6%	18.85%	19.10%	19.35%
16	Vaughan F&M School	18.6%	18.85%	19.10%	19.35%
18	Kier Support Services	18.1%	19.90% *	19.90% *	19.90% *
19	Mears Care Ltd	20.0%	20.00% *	20.00% *	20.00% *
20	Care UK	19.5%	22.30% *	22.30% *	22.30% *

* Early retirement strain payments are in addition

Further comments

Ill health liability insurance

Note that, if an employer has ill health liability insurance in place with a suitable insurer and provides satisfactory evidence to the administering authority, then their Minimum Total Contribution Rate may be reduced by their insurance premium, for the period the insurance is in place.

Stabilisation

The following employers have had their contribution rates stabilised following a separate modelling exercise that I [the Actuary] carried out on their behalf:

- London Borough of Harrow
- North London Collegiate School
- Stanmore College
- Harrow College
- Employer 8
- St. Dominic's Sixth Form College

- Vaughan F&M School

Annex B: Responsibilities of Key Parties

The Administering Authority should:

- collect employer and employee contributions;
- invest surplus monies in accordance with the regulations;
- ensure that cash is available to meet liabilities as and when they fall due;
- manage the valuation process in consultation with the Fund's Actuary;
- prepare and maintain a FSS and a SIP, both after proper consultation with interested parties; and
- monitor all aspects of the Fund's performance and funding and amend FSS/SIP.

The Individual Employer should:

- deduct contributions from employees' pay correctly;
- pay all contributions, including their own as determined by the Actuary, promptly by the due date;
- exercise discretions within the regulatory framework;
- make additional contributions in accordance with agreed arrangements in respect of, for example, augmentation of scheme benefits, early retirement strain; excess ill health early retirements if appropriate;
- notify the administering authorities promptly of all changes to membership or, as may be proposed, which affect future funding; and
- comply with the valuation timetable where required and respond to communications as necessary to complete the process.

The Fund Actuary should:

- prepare valuations including the setting of employers' contribution rates after agreeing assumptions with the Administering Authority and having regard to the FSS;
- agree a timetable for the valuation process with the Administering Authority to provide timely advice and results; and
- prepare advice and calculations in connection with bulk transfers and individual benefit-related matters.

REPORT FOR: PENSION FUND INVESTMENTS PANEL

Date of Meeting:	6 March 2012
Subject:	External Audit Plan 2011-12
Responsible Officer:	Julie Alderson, Interim Corporate Director of Resources
Exempt:	No
Enclosures:	Deloitte's Audit Plan

Section 1 – Summary and Recommendations

Deloitte will undertake an audit of the pension fund's financial statements. Attached is their audit plan. There are no significant changes from the prior year. The plan will be presented to GARM Committee.

RECOMMENDATIONS:

The Panel is invited to note the audit plan.

Harrow COUNCIL LONDON

Section 2 – Report

1. The pension fund is required to prepare financial statements for the year to 31st March 2012. These will be audited by Deloittes, whose audit plan is attached.

2. The plan has no significant changes from the prior year. The key audit risks are identified as contributions, benefits, private equity, derivatives and management overriding controls. Materiality is set at £5.3 million although all unadjusted errors above £260,000 will be reported.

3. The audit fee is unchanged at £35,000. The partner and manager continue from 2011.

4. The plan will be presented to GARM Committee.

5. It is anticipated that the accounts will be completed by end June 2012 and the audit report issued in August. Both will be presented to the Panel.

Financial Implications

6. None.

Risk Management Implications

7. Risk included on Directorate risk register? No

8. Separate risk register in place? No

9. The audit is intended to identify misstatements both unintended and deliberate.

Equalities implications

10. Was an Equality Impact Assessment carried out? No

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

Corporate Priorities

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

Section 3 - Statutory Officer Clearance

Name: Julie Alderson Date: 22 February 2012	X	Chief Financial Officer
Name: Matthew Adams Date: 24 February 2012	X	on behalf of the Monitoring Officer

Section 4 - Contact Details and Background Papers

Contact: George Bruce (Treasury and Pension Fund Manager) Tel: 020-8424-1170 / Email: george.bruce@harrow.gov.uk

Background Papers: None

If appropriate, does the report include the following considerations?

1.	Consultation	N/A
2.	Corporate Priorities	N/A

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Deloitte.

London Borough of Harrow Council

Report to the Governance, Audit and Risk Management Committee

Audit Plan for the 2011/12 Pension Fund Annual Report Audit

January 2012

Deloitte.

Contents

Executive summary

We have pleasure in setting out in this document details of our proposed audit scope for the London Borough of Harrow Pension Fund for the year ending 31 March 2012.

Audit scope		
Our audit scope is unchanged from last year	Based on guidance issued by the Audit Commission, auditors are again asked, for audit purposes, to treat the Local Government Pension Fund (LGPS) as a stand-alone body, with separate audit plan and reports to those charged with governance. Our audit of the pension fund is planned in accordance with the Code of Audit Practice issued by the Audit Commission and in accordance with additional guidance issued by the Commission in relation to the audit of pension funds. However, this only extends to the audit of the accounts and there is no requirement for a value for money conclusion on the pension fund accounts specifically. Aspects of the use of resources framework will inform the value for money conclusion for the Authority and cover issues relating to the pension fund. The pension fund accounts remain part of the accounts of the Authority as a whole. The LGPS Regulations require administering authorities to prepare an annual report for the pension fund, which should incorporate the annual accounts. Our audit report on the Authority accounts will continue to cover the pension fund section of that document. In addition, we are asked by the Commission to issue an audit report for inclusion in the annual pension fund report.	Section 1

Key audit risks		
We summarise the key audit risks identified at this stage	The key audit risks which we have identified as part of our overall audit strategy are: 1. In view of the complexity arising from the participation of different admitted bodies within the fund, together with the fact that members may pay different rates depending on their pensionable pay, we have included the calculation and payment of contributions as areas of audit risk. 2. As there are a number of complexities to the calculation of both benefits in retirement and benefits paid on ill health and death, we have identified benefits payable as an area of specific risk. 3. Previously, the pension fund has invested in private equity and derivative financial instruments. Such investments can give rise to complexities in accounting, disclosure and measurement; accordingly we will treat the appropriateness of the accounting for these investments as a risk. 4. Management override of key controls. This is a presumed area of risk within auditing standards.	Section 2

Timetable		
Our work will be carried out at the same time as our audit of the Authority	The timetable is set out in Section 5. The fieldwork will be carried out at the same time as our work on the Authority's financial statements in order for us to have completed the audit of the financial statements in time for inclusion in the Authority's annual report.	Section 5

Executive summary (continued)

Materiality and prior year uncorrected misstatements and disclosure deficiencies		
Planning materiality set at £5.3m **Reporting threshold set at £0.22m**	We calculate materiality on the basis of the net assets of the fund, but have restricted this to the materiality established for the audit of the Authority's financial statements as a whole. We estimate materiality for the year to be £5.3 million (2011: £6.1 million). We will report to the Governance, Audit and Risk Management ("GARM") Committee on all unadjusted misstatements greater than £0.26 million (2011: £0.23 million). Further details on the basis used for the calculation of materiality are given in our audit plan for the audit of the Authority's financial statements.	

Prior year uncorrected misstatements and disclosure deficiencies		
No prior year issues	There were no significant unadjusted misstatements or uncorrected disclosure deficiencies reported to you in respect of the 2010/11 accounts.	

Independence		
We reconfirm our independence	Deloitte have developed important safeguards and procedures in order to ensure our independence and objectivity. These are set out in the "Independence policies and procedures" section included at Appendix 1. We will reconfirm our independence and objectivity for the year ending 31 March 2012 in our final report to the GARM Committee. We have discussed our relationships with the Authority in our separate audit plan for the audit of the Authority's financial statements.	Appendix 1

Fee		
Fee in line with prior year	We propose a fee of £35,000 excluding VAT (PY: £35,000) which is in line with the fee scale advised by the Audit Commission.	

Engagement team		
	Paul Schofield will lead the audit and will be supported by David Hobson who will be the day to day contact on the engagement.	

Matters for those charged with governance		
Briefing on audit matters	We have attached at Appendix 1 our "Briefing on audit matters" which includes those additional items which we are required to report upon in accordance with International Standards on Auditing (UK & Ireland). We will report to you at the final audit stage any matters arising in relation to those requirements.	Appendix 1

1. Scope of work and approach

Overall scope and approach

Audit objectives are explained in more detail in our "Briefing on audit matters" document attached as Appendix 1.

Based on guidance issued by the Audit Commission, auditors are again asked, for audit purposes, to treat the Local Government Pension Fund (LGPS) as a stand-alone body, with separate audit plan and reports to those charged with governance.

Local LGPS funds administered by administering authorities are not statutory bodies in their own right. Therefore, it is not possible for separate audit appointments to be made for LGPS audits. We are therefore appointed to the audit of the LGPS through the existing Audit Commission appointment arrangements.

Our audit of the pension fund is planned in accordance with the Code of Audit Practice issued by the Audit Commission and in accordance with additional guidance issued by the Commission in relation to the audit of pension funds. However, this only extends to the audit of the accounts and there is no requirement for a value for money conclusion on the pension fund accounts specifically. Aspects of the use of resources framework will inform the value for money conclusion for the Authority and cover issues relating to the pension fund.

Our audit objectives are set out in our "Briefing on audit matters" document attached as Appendix 1.

The audit opinion we intend to issue as part of our audit report on the Authority's financial statements will reflect the financial reporting framework adopted by the pension fund. This is the CIPFA/LASAAC Code of Practice on Local Authority Accounting in the United Kingdom (the "Code of Practice").

For pension fund statements, we have initially considered the net assets of the fund as the benchmark for our materiality assessment as this benchmark is deemed to be a key driver of business value, is a critical component of the financial statements and is a focus for users of those statements. However, we have restricted our estimate of materiality to the amount set for the Authority's financial statements as a whole, which is £5.3 million. Our separate audit plan for the audit of the Authority's financial statements includes further information on how we derived this estimate. The concept of materiality and its application to the audit approach are set out in our Briefing on audit matters document. The extent of our procedures is not based on materiality alone but also on the quality of systems and controls in preventing material misstatement in the financial statements.

The Audit Commission has also determined that auditors should give an opinion in accordance with auditing standards on the financial statements included in the pension fund annual report. This entails the following additional work over and above giving an opinion on the pension fund accounts included in the statement of accounts:

- Comparing the accounts to be included in the pension fund annual report with those included in the statement of accounts.
- Reading the other information published within the pension fund annual report for consistency with the pension fund accounts.
- Where the pension fund annual report is not available until after the auditor reports on the financial statements, undertaking appropriate procedures to confirm that there are no material post-balance sheet events arising after giving the opinion on the pension fund accounts included in the financial statements.
- The financial statements included in the pension fund annual report are prepared on the basis of the same proper practices - the Code of Practice - as the financial statements included in the statement of accounts.
- Consider whether the annual report has been prepared in accordance with the Regulation 34 of the Local Government Pension Scheme (Administration) Regulations 2008.

2. Key audit risks

Based upon our initial assessment we will concentrate specific audit effort in 2011/12 on the following areas:

Contributions	
Tiered contribution rates increase complexity	Unlike the position in the private sector, we are not required to issue a statement about contributions in respect of the LGPS. However, this remains a material income stream for the pension fund and in view of the complexity introduced by the participation of more than one employer in the fund, and a benefit structure with tiered contribution rates, we have identified this as a specific risk.
Deloitte response	We will perform the following procedures to ascertain whether employer and employee contributions have been calculated, scheduled and paid in accordance with the schedule: • Review the design and confirm the implementation of key controls present at the Fund for ensuring contributions from all Scheduled and Admitted bodies are identified and calculated correctly. • Recalculate contributions for a sample of individual members to ensure they are calculated in accordance with the schedule of rates. • Perform analytical review procedures to gain assurance over the total contributions received in the year. • Reconcile the membership movements in the year to the Financial Statements, ensuring that these include members from the admitted bodies. We note that the Authority is not responsible for the calculation of contributions and will therefore perform such tests with the assistance of the other scheduled and admitted bodies.

Benefits	
There are a number of complexities to the calculation of both benefits in retirement and ill health and death benefits.	Changes were made to the local government pension fund from April 2008 which introduced complexities into the calculation of both benefits in retirement and benefits paid on ill health and death. In respect of benefits in retirement, benefits are accumulated on two different bases for service pre and post 1 April 2008. The calculation of the pensionable pay on which benefits will depend may be varied by the individual opting to take account of pay earned in any of the 10 years prior to retirement. Also individuals now enjoy greater flexibility in their choice of the mix of pension and lump sum. In respect of ill health and death benefits, the calculation of the pensionable pay on which benefits will depend may be varied by the individual opting to take account of pay earned in any of the 10 years prior to retirement. Some employers may not have retained all the necessary records. The Government has also completed the process to amend the revaluation and index factors for statutory minimum uplift from the Retail Price Index to the Consumer Price Index. This change has further increased the complexity of benefit calculations.
Deloitte response	We will perform the following procedures to ascertain whether benefits payable have been calculated correctly in accordance with the fund rules. • Review the design and confirm the implementation of controls present at the Fund for ensuring the accuracy, completeness and validity of benefits. • Test a sample of new pensioner calculations and other benefits paid by tracing to supporting documentation and reviewing the calculation, to ensure it is in line with the scheme rules. • Perform analytical review procedures over the pensions paid in the year based on prior year audited numbers adjusted for changes in pensioner numbers and any pension increases.

2. Key audit risks (continued)

Financial instruments	
Private equity and derivatives are complex to value	The pension fund makes some use of investments in private equity and derivative financial instruments. Private equity funds are complex to value and include an element of judgement on the part of the investment manager. Given that these funds form a material balance within the pension fund accounts, we have identified the valuation of these funds as a specific risk. The fund also makes use of derivatives which can be complex in terms of accounting, measurement and disclosure requirements.
Deloitte response	For the private equity investments we will seek to understand the approach adopted in the valuation of such investments and inspect supporting documentation such as cash flow reports, quarterly investment advisor reports and audited financial statements. We will tailor further procedures depending on the outcome of that work and our assessment of the risk of material error taking into account the fund's investment holding at the year end. We will update our understanding of the rationale for the use of the derivatives and then test compliance with the accounting, measurement and disclosure requirements of the Code of Audit Practice on Local Authority Accounting. The use of expert advice may be required for testing these balances.

Management override of controls	
Audit guidance includes a presumed risk of management override of key controls.	Auditing standards recognise that management may be able to override controls that are in place to present inaccurate or even fraudulent financial reports. They include a presumption of a risk of management override of key controls.
Deloitte response	We will focus our work on testing of journals, significant accounting estimates and any unusual transactions, including those with related parties.

3. Consideration of fraud

3.1 Characteristics

Misstatements in the financial statements can arise from either fraud or error. The distinguishing factor between fraud and error is whether the underlying action that results in the misstatement of the financial statements is intentional or unintentional. Two types of intentional misstatements are relevant to us as auditors – misstatements resulting from fraudulent financial reporting and misstatements resulting from misappropriation of assets.

We are aware that management has the following processes in place in relation to the prevention and detection of fraud which include:

- Anti-fraud and corruption policy
- Codes of conduct
- Whistle-blowing procedures

3.2 Responsibilities

The primary responsibility for the prevention and detection of fraud rests with management and those charged with governance, including establishing and maintaining internal controls over the reliability of financial reporting, effectiveness and efficiency of operations and compliance with applicable laws and regulations. As auditors, we obtain reasonable, but not absolute, assurance that the financial statements as a whole are free from material misstatement, whether caused by fraud or error.

3.3 Fraud inquiries

We will make the following inquiries regarding fraud:

Management	Internal Audit	Those charged with governance
Management's assessment of the risk that the financial statements may be materially misstated due to fraud including the nature, extent and frequency of such assessments; Management's process for identifying and responding to the risks of fraud in the entity; Management's communication, if any, to those charged with governance regarding its processes for identifying and responding to the risks of fraud in the entity; Management's communication, if any, to employees regarding its views on business practices and ethical behaviour; and Whether management has knowledge of any actual, suspected or alleged fraud affecting the entity.	Whether internal audit has knowledge of any actual, suspected or alleged fraud affecting the entity, and to obtain its views about the risks of fraud.	How those charged with governance exercise oversight of management's processes for identifying and responding to the risks of fraud in the entity and the internal control that management has established to mitigate these risks; and Whether those charged with governance have knowledge of any actual, suspected or alleged fraud affecting the entity.

3. Consideration of fraud (continued)

We will make inquiries of others within the Authority as appropriate. We will also inquire into matters arising from your whistling blowing procedures.

3.4 Process and documentation

We will gather this information through meetings and review of relevant documentation, including meeting minutes.

3.5 Representations

We will ask for you and management to make the following representations towards the end of the audit process:

- We acknowledge our responsibilities for the design, implementation and maintenance of internal control to prevent and detect fraud and error.

- We have disclosed to you the results of our assessment of the risk that the financial statements may be materially misstated as a result of fraud.

- We are not aware of any fraud or suspected fraud / We have disclosed to you all information in relation to fraud or suspected fraud that we are aware of and that affects the entity and involves:
  - officers;
  - employees who have significant roles in internal control; or
  - others where the fraud could have a material effect on the financial statements.
- We have disclosed to you all information in relation to allegations of fraud, or suspected fraud, affecting the entity's financial statements communicated by employees, former employees, analysts, regulators or others.

4. Internal control

Obtaining an understanding of internal control relevant to the audit

As set out in "Briefing on audit matters" (Appendix 1), our risk assessment procedures will include obtaining an understanding of controls considered to be 'relevant to the audit'. This involves evaluating the design of the controls and determining whether they have been implemented ("D & I"). Our audit approach consists of the following:

- Obtain and refresh our understanding of the entity and its environment including the identification of relevant controls
- Identify risks and any controls that address those risks
- Carry out 'design and implementation' work on relevant controls
- If considered necesary, test the operating effectiveness of selected controls
- Design and perform a combination of substantive analytical procedures and tests of details that are most responsive to the assessed risks

The results of our work in obtaining an understanding of controls will be collated and the impact on the extent of substantive audit testing required will be considered. At this stage, we do not propose to carry out tests on the operating effectiveness of controls and will obtain our assurance wholly from substantive testing procedures. We have selected this approach as the most efficient.

Our audit is not designed to provide assurance as to the overall effectiveness of the controls operating within the Authority, although we will report to management any recommendations on controls that we may have identified during the course of our audit work.

5. Timetable

		2012								
		Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep
Management	Prepare plan based on discussions with management									
	Early discussion of Authority's approach to risks areas									
	Performance of detailed audit planning fieldwork									
	Audit fieldwork/audit issues meetings									
	Review of pension fund annual report									
	Preparation of our report on the 2011/12 audit									
Pensions Committee	Audit plan									
	Report to the GARM Committee on the 2011/12 accounts audit									

Our work during these visits will be closely co-ordinated with the work carried out on other parts of main audit of Harrow Council.

6. Responsibility statement

The Statement of Responsibilities of Auditors and Audited Bodies issued by the Audit Commission explains the respective responsibilities of auditors and of the audited body and this report is prepared on the basis of, and our audit work is carried out, in accordance with that statement.

This report should be read in conjunction with the "Briefing on audit matters" attached at Appendix 1 and sets out those audit matters of governance interest which came to our attention during the audit to date. Our audit was not designed to identify all matters that may be relevant to members and this report is not necessarily a comprehensive statement of all weaknesses which may exist in internal control or of all improvements which may be made.

This report has been prepared for the Members of Harrow Council, as a body, and we therefore accept responsibility to you alone for its contents. We accept no duty, responsibility or liability to any other parties, since this report has not been prepared, and is not intended, for any other purpose.

Deloitte LLP
Chartered Accountants

St Albans
January 2012

Appendix 1: Briefing on audit matters

Published for those charged with governance

This document is intended to assist those charged with governance to understand the major aspects of our audit approach, including explaining the key concepts behind the Deloitte Audit methodology including audit objectives and materiality.

Further, it describes the safeguards developed by Deloitte to counter threats to our independence and objectivity.

This document will only be reissued if significant changes to any of those matters highlighted above occur.

We will usually communicate our audit planning information and the findings from the audit separately. Where we issue separate reports these should be read in conjunction with this "Briefing on audit matters".

Approach and scope of the audit

Primary audit objectives

We conduct our audit in accordance with International Standards on Auditing (UK & Ireland) as adopted by the UK Auditing Practices Board ("APB"). Our statutory audit objectives are:

- To express an opinion in true and fair view terms to the members on the financial statements;
- To express an opinion as to whether the accounts have been properly prepared in accordance with the relevant financial reporting framework; and
- To form an opinion as to whether the financial statements contain the information specified in regulation 3 and the schedule to the Occupational Pension Schemes (Requirement to obtain Audited Accounts and a Statement from the Auditor) Regulations 1996;

Other reporting objectives

Our reporting objectives are to:

- Present significant reporting findings to those charged with governance. This will highlight key judgements, important accounting policies and estimates and the application of new reporting requirements, as well as significant control observations.
- Provide timely and constructive letters of recommendation to management. This will include key business process improvements and significant controls weaknesses identified during our audit.

Appendix 1: Briefing on audit matters (continued)

Materiality

The concept of materiality is fundamental to the preparation of the financial statements and the audit process and applies not only to monetary misstatements but also to disclosure requirements and adherence to appropriate accounting principles and statutory requirements.

"Materiality" is defined in the International Accounting Standards Board's "Framework for the Preparation and Presentation of Financial Statements" in the following terms:

"Information is material if its omission or misstatement could influence the economic decisions of users taken on the basis of the financial statements. Materiality depends on the size of the item or error judged in the particular circumstances of its omission or misstatement. Thus, materiality provides a threshold or cut-off point rather than being a primary qualitative characteristic which information must have if it is to be useful."

We determine materiality based on professional judgment in the context of our knowledge of the audited entity, including consideration of factors such as stakeholder expectations, sector developments, financial stability and reporting requirements for the financial statements. We use a different materiality for the examination of the summary contributions to that used for the financial statements as a whole.

We determine materiality to:

- Determine the nature, timing and extent of audit procedures.
- Evaluate the effect of misstatements.

The extent of our procedures is not based on materiality alone but the quality of systems and controls in preventing material misstatement in the financial statements, and the level at which known and likely misstatements are tolerated by you in the preparation of the financial statements.

The materiality in relation to the audit of the pension scheme's financial statements will not necessarily coincide with the expectations of materiality of an individual member of the scheme in relation to his or her expected benefits. Our judgments about materiality are made in the context of the financial statements as a whole and the account balances and classes of transactions reported in those statements, rather than in the context of an individual member's designated assets, contributions or benefits.

Uncorrected misstatements

In accordance with International Standards on Auditing (UK and Ireland) ("ISAs (UK and Ireland)") we will communicate to you all uncorrected misstatements (including disclosure deficiencies) identified during our audit, other than those which we believe are clearly trivial.

ISAs (UK and Ireland) do not place numeric limits on the meaning of 'clearly trivial'. The Audit Engagement Partner, management and those charged with governance will agree an appropriate limit for 'clearly trivial'. In our report we will report all individual identified uncorrected misstatements in excess of this limit and other identified errors in aggregate.

We will consider identified misstatements in qualitative as well as quantitative terms.

Appendix 1: Briefing on audit matters (continued)

Audit methodology

Our audit methodology takes into account the changing requirements of auditing standards and adopts a risk based approach. We utilise technology in an efficient way to provide maximum value to trustees and create value for management and those charged with governance whilst minimising a "box ticking" approach.

Our audit methodology is designed to give trustees the confidence that they deserve.

For controls considered to be 'relevant to the audit' we evaluate the design of the controls and determine whether they have been implemented ("D & I"). The controls that are determined to be relevant to the audit will include those:

- Where we plan to obtain assurance through the testing of operating effectiveness;
- Relating to identified risks (including the risk of fraud in revenue recognition, unless rebutted and the risk of management override of controls);
- Where we consider we are unable to obtain sufficient audit assurance through substantive procedures alone; and
- To enable us to identify and assess the risks of material misstatement of the financial statements and design and perform further audit procedures.

Other requirements of International Standards on Auditing (UK and Ireland)

ISAs (UK and Ireland) require we communicate the following additional matters:

ISA (UK & Ireland)	Matter
ISQC 1	Quality control for firms that perform audits and review of financial statements, and other assurance and related services engagements
240	The auditor's responsibilities relating to fraud in an audit of financial statements
250	Consideration of laws and regulations in an audit of financial statements
265	Communicating deficiencies in internal control to those charged with governance and management
450	Evaluation of misstatements identified during the audit
505	External confirmations
510	Initial audit engagements – opening balances
550	Related parties
560	Subsequent events
570	Going concern
600	Special considerations – audits of group financial statements (including the work of component auditors)
705	Modifications to the opinion in the independent auditor's report
706	Emphasis of matter paragraphs and other matter paragraphs in the independent auditor's report
710	Comparative information – corresponding figures and comparative financial statements
720	Section A: The auditor's responsibilities relating to other information in documents containing audited financial statements

Appendix 1: Briefing on audit matters (continued)

Independence policies and procedures

Important safeguards and procedures have been developed by Deloitte to counter threats or perceived threats to our objectiv
which include the items set out below.

Safeguards and procedures

- Every opinion (not just statutory audit opinions) issued by Deloitte is subject to technical review by a member of our independent Professional Standards Review unit.
- Where appropriate, review and challenge of key decisions takes place by the Second Partner and by the Independent Review Partner, which goes beyond ISAs (UK and Ireland), and ensures the objectivity of our judgement is maintained.
- We report annually to those charged with governance our assessment of objectivity and independence. This report includes a summary of non-audit services provided together with fees receivable.
- There is formal consideration and review of the appropriateness of continuing the audit engagement before accepting reappointment.
- Periodic rotation takes place of the audit engagement partner and, where appropriate, the independent review partner and key partners involved in the audit in accordance with our policies and professional and regulatory requirements.
- In accordance with the Revised Ethical Standards issued by the APB, there is an assessment of the level of threat to objectivity and potential safeguards to combat these threats prior to acceptance of any non-audit engagement. This would include particular focus on threats arising from self-interest, self-review, management, advocacy, over-familiarity and intimidation.
- In the UK, statutory oversight and regulation of auditors is carried out by the Professional Oversight Board (POB) which is an operating body of the Financial Reporting Council. The Firm's policies and procedures are subject to external monitoring by both the Audit Inspection Unit (AIU), which is a division of POB, and the ICAEW's Quality Assurance Directorate (QAD). The AIU is charged with monitoring the quality of audits of economically significant entities and the QAD with monitoring statutory compliance of audits for all other entities. Both report to the ICAEW's Audit Registration Committee. The AIU also reports to POB and can inform the Financial Reporting Review Panel of concerns it has with the accounts of individual entities.

Appendix 1: Briefing on audit matters (continued)

Independence policies

Our detailed ethical policies' standards and independence policies are issued to all partners and employees who are required to confirm their compliance annually. We are also required to comply with the policies of other relevant professional and regulatory bodies.

Amongst other things, these policies:

- State that no Deloitte partner (or any immediate family member) is allowed to hold a financial interest in any of our UK audited entities;
- Require that professional staff may not work on assignments if they (or any immediate family member) have a financial interest in the audited entity or a party to the transaction or if they have a beneficial interest in a trust holding a financial position in the audited entity;
- State that no person in a position to influence the conduct and outcome of the audit (or any immediate family member) should enter into business relationships with UK audited entities or their affiliates;
- Prohibit any professional employee from obtaining gifts from audited entities unless the value is clearly insignificant; and
- Provide safeguards against potential conflicts of interest.

Remuneration and evaluation policies

Partners are evaluated on roles and responsibilities they take within the firm including their technical ability and their ability to manage risk.

APB Revised Ethical Standards

The Auditing Practices Board (APB) has issued five ethical standards for auditors that apply a 'threats' and 'safeguards' approach.

The five standards cover:

- Maintaining integrity, objectivity and independence;
- Financial, business, employment and personal relationships between auditors and their audited entities;
- Long association of audit partners and other audit team members with audit engagements;
- Audit fees, remuneration and evaluation of the audit team, litigation between auditors and their audited entities, and gifts and hospitality received from audited entities; and
- Non-audit services provided to audited entities.

Our policies and procedures comply with these standards.

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