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London Borough of Harrow Council

Report to the Governance, Audit and Risk Management Committee

Audit Plan for the Pension Fund Audit year ending 31 March 2013

March 2013

Deloitte.

Governance, Audit and Risk Management Committee
Harrow Council
Station Road
Harrow
HA1 2XY

19 March 2013

Dear Sirs

We have pleasure in setting out in this document our planning report to the Governance, Audit and Risk Management Committee of London Borough of Harrow Council for the year ended 31 March 2013, for discussion at the meeting scheduled for 6 April 2013. This report covers the principal matters that we will focus on during our audit for the year ended 31 March 2013.
In summary:

- The major issues, which are summarised in the Executive Summary, and how we plan to address them.
- The scope of our work follows that of previous years

We would like to take this opportunity to thank George Bruce and his team for their assistance and co-operation during the planning of our audit work.

Paul Schofield

Senior Statutory Auditor

Contents

Executive summary

Status	Description	Detail
Audit scope		
Audit scope is unchanged from previous years	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
Materiality		
Materiality is limited by that of the authority	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 £4.8 million (2012: £6.3 million). We will report to the Governance, Audit and Risk Management Committee on all unadjusted misstatements greater than £242,000 (2012: £300,000). We will update our assessment when the year end results become available. 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.	

Executive summary (continued)

Status	Description	Detail
Key audit risks		
Audit risks focus on contributions, benefits and investments	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 ill health and death benefits, we have identified benefits payable as an area of specific risk. 3. The pension fund is invested in unquoted investment vehicles such as the Pantheon private equity fund and the Aviva property fund. The fund is also invested in derivative financial instruments with Record. Such investments can give rise to complexities in accounting, disclosure and measurement; accordingly we will treat the appropriateness of the accounting and disclosure of these investments as a risk. 4. Auditing standards (ISA 240) require auditors to consider management override of controls to be a presumed area of risk for all audit engagements.	Section 2
Other issues		
Changes to the bank account process	Whilst not considered to be a significant audit risk we note that the authority is now using a separate bank account for the pension fund. We set out our response to this in section3	Section 3
Prior year uncorrected misstatements including disclosure misstatements		
No uncorrected misstatements identified in the prior year	There were no significant unadjusted misstatements or uncorrected disclosure deficiencies reported to you in respect of the 2011/12 accounts	

Executive summary (continued)

Status	Description	Detail
Timetable		
Timetable is in line with prior year	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. We plan to finalise our audit report included within the Pension Fund Annual Report at the same time as that included in the Authority's accounts.	Section 5
Independence		
We confirm 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 in our briefing on audit matters. We will reconfirm our independence and objectivity to the Governance, Audit and Risk Management Committee for the year ending 31 March 2013 in our final report. We have discussed our relationships with the Authority in our separate audit plan for the audit of the Authority's financial statements.	
Fees		
Our fee is in line with the Audit Commission scale	Our feefor the audit of the pension fund for the year ending 31 March 2013 is £21,000.The 2012-13 scale fees that the Audit Commission has set include reductions of up to 40% on 2011-12 fees. These result from savings generated from the outsourcing of the Audit Commission's in-house Audit Practice and internal efficiency savings that the Commission is passing on to audited bodies. Under our new arrangements with the Audit Commission, Deloitte's net re-imbursement for external services provided remains unchanged from those previously agreed. The scale fee reductions do not therefore have an impact on our ability to continue offering a high quality service to you.	
Matters for those charged with governance		
Briefing on audit matters	We have included in 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
Engagement team		
Paul Schofield will lead the audit	Paul Schofield will lead the audit and will be supported by David Hobson as Senior Manager and David Boyd who will be the day to day contacts on the engagement.	

1. Scope of work and approach

Overall scope and approach

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.

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 2012/2013 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 fundas 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 £4.8 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, and the level at which known and likely misstatements are tolerated by you in the preparation of the financial statements.

1. Scope of work and approach (continued)

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; and
- 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.

2. Significantaudit risks

Based upon our initial assessment and following discussion with management, we will concentrate specific effort on the significant audit risks set out below.

Contributions		Deloitte response
Tiered contribution rates increases 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 structure with tiered contribution rates, we have identified these areas as specific risks.	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 identified and calculated correctly. • Recalculate contributions for a sample of individual members to ensure that 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.

2. Significantaudit risks (continued)

Benefits		Deloitte response
There are a number of complexities to the calculation of both benefits in retirement and ill health and death benefits	The complexities surrounding the calculation of both benefits in retirement and ill health and death benefits remains a key area of audit risk. 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; and 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 same options as discussed above. The completion of the legislation leading to the change in the revaluation basis to Consumer Price Index added further complexity to the above calculations.	We will perform the following procedures to ensure that the benefits payable have been calculated correctly in accordance with the fund rules. • Review the design and confirm the implementation of key controls present at the Fund for ensuring benefits are calculated correctly. • Recalculate a sample of benefit calculations made in the year • Perform analytical review procedures to gain assurance over the total pensions paid figure in the year.

2. Significantaudit risks (continued)

Financial instruments		Deloitte response
The fund is invested in some non-quoted investment vehicles	The majority (70%) of the portfolio is invested in pooled equity investments, these are typically easy to value as it is possible to obtain independently quoted values. The fund also invests in non-quoted investment vehicles, such as the Pantheon private equity investments and the Aviva property fund of funds. Private equity funds and property fund of 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.	For the private equity funds and property fund of funds we will seek to understand the approach adopted in the valuation of such investments and inspect 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. Derivatives can be complex in terms of accounting, measurement and disclosure requirements. We will first understand the rationale for the use of the derivatives and then test compliance with the accounting, measurement and disclosure requirements of the Code of Practice. The use of expert advice may be required for testing these balances.

2. Significantaudit risks (continued)

Management override of controls		Deloitte response
Management override of controls is a presumed risk	We are required by ISA 240 'The auditors' responsibility to consider fraud in an audit of the financial statements' to presume there is a significant risk of management override of the system of internal control.	Our audit work will include: • Reviewing analysis and supporting documentation for journal entries, key estimates and judgements. • We will perform substantive testing on journal entries to confirm that they have a genuine, supportable rationale; • We will review ledgers for unusual items and on a test basis investigate the rationale of any such postings; • We will review significant management estimates and judgements such as year end accruals and provisions and consider whether they are reasonable; and We will make enquiries of those charged with governance as part of our planning and detailed audit processes.

3. Other issues

Whilst not considered to be a specific audit risk we set out our response to the significant change to the accounting systems this year

New bank account in operation		Deloitte response
The new bank account has required changes to the accounting system	In line with the Local Government Pension Scheme (Management and Investment of Funds) Regulations 2009 the authority opened a separate bank account for the pension fund in 2011. The authority has now changed the accounting systems so that cash flows relating to the pension fund areprocessedthroughthe fund's own account.	We understand from discussions with the officers, during our planning work, that the changes to the software are not complete and as such there are a number of manual reconciliations performed on balance sheet accounts. We will review these reconciliations as part of our audit process.

4. Consideration of fraud

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 auditor, 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.

ISA (UK and Ireland) 240 – 'The auditor's responsibility to consider fraud in an audit of financial statements' requires us to document an understanding of how those charged with governance exercise oversight of management's processes for identifying and responding to the risks of fraud in London Borough of Harrow Pension Fund and the internal control that management has established to mitigate these risks.

We will make inquiries of management, internal audit and others within the Authority as appropriate, regarding their knowledge of any actual, suspected or alleged fraud affecting the Authority. In addition we are required to discuss the following with the Governance, Audit and Risk Management Committee:

- Whether the Committee has knowledge of any fraud, alleged or suspected fraud?
- The role that the Committee exercises in oversight of:
    - London Borough of Harrow Authority's assessment of the risks of fraud in respect of the pension fund; and
    - the design and implementation of internal control to prevent and detect such fraud?
- The Governance, Audit and Risk management Committee's assessment of the risk that the pension fund financial statements and annual report may be materially misstated as a result of fraud.

5. Internal control

Obtaining an understanding of internal control relevant to the audit

As set out in "Briefing on audit matters", for controls considered to be ‘relevant to the audit’ we are required to evaluate the design of the controls and determine whether they have been implemented (“D & I”). The results of our work in obtaining an understanding of controls and any subsequent testing of the operational effectiveness of controls will be collated and the impact on the extent of substantive audit testing required will be considered. Our audit is not designed to provide assurance as to the overall effectiveness of the controls operating within the Authority or its pension fund administration, although we will report to management any recommendations on controls that we may have identified during the course of our audit work.

6. Timetable

		2012			2013									
		Nov	Dec	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov
Management	Prepare plan based on discussions with officers													
	Early discussion of Authority's approach to risks areas													
	Performance of detailed planning work													
	Audit fieldwork													
	Audit close meetings													
	Review of pension fund annual report													
GARM Committee	Audit plan													
	Report to the GARM Committee on the 2012/13 accounts audit													

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

7. 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 the London Borough 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
19 March 2013

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 trustees 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; and
- 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; and
- 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.

Audit methodology (cont'd)

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 objectivity, 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 takes place of key decisions 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.

Safeguards and procedures (cont'd)

- 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 Financial Reporting Council (FRC). The Firm's policies and procedures are subject to external monitoring by both the Audit Quality Review Team (AQRT, formerly known as the Audit Inspection Unit), which is part of the FRC's Conduct Division, and the ICAEW's Quality Assurance Department (QAD). The AQRT 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.

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.