

**London Borough of Harrow Pension  
Fund**

**Report to the Governance, Audit and  
Risk Management Committee on the  
2012/13 Local Government Pension  
Fund Audit**

**Draft Report**

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# Executive summary

We have pleasure in setting out in this document our report to the Governance, Audit and Risk Management Committee "GARM" of London Borough of Harrow Pension Fund ("the Fund") for the year ended 31 March 2013 for discussion at the meeting scheduled for 16 September 2013. This report summarises the principal matters that have arisen from our audit for the year ended 31 March 2013.

This summary is not intended to be exhaustive but highlights the most significant matters to which we would like to bring your attention. It should, therefore, be read in conjunction with the report and the appendices thereto.

Status	Description	Detail
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## Completion of the audit

### On satisfactory completion of the outstanding items we anticipate issuing an unmodified audit opinion

We are satisfied that the status of the audit is as expected at this stage of the timetable agreed in our audit plan. N/A

We have substantially completed our audit in accordance with our Audit Plan, which was presented to you prior to the commencement of the audit, subject to the satisfactory completion of the matters set out below:

- completion of our procedures around the cash balance;
- completion of final review process on the financial statements;
- receipt of signed management representation letter (see Appendix 1); and
- update of post balance sheet event review.

We will report to you orally in respect of any modifications to the findings or opinions contained in this report that arise on completion of these matters.

At the date of this report, and subject to the satisfactory completion of the outstanding matters referred to above, we expect to issue an unmodified audit opinion.

# Executive summary (continued)

## Key findings on audit risks

We have addressed the risks identified in our planning report

We discuss within Section 1 the results of our work in relation to key audit risks which have been identified as being significant to the 2012/13 accounts, and which were presented in our Audit Plan to the GARM in March 2013, as follows:

Section 1

### Key risks

1. **Contributions:** The risk surrounding identification, calculation and payment of contributions, due to the complexities surrounding admitted bodies has been satisfactorily addressed through our testing. No issues were noted.
2. **Benefits:** Complexities in the calculation of both benefits in retirement and ill health and death benefits have been reviewed during our testing with no issues identified.
3. **Investments:** The private equity investment reports have been reviewed during our testing and we have identified a corrected adjustment. See discussion below. Derivative financial instruments have also been successfully tested.
4. **Management override of controls:** All testing was completed with satisfactory results.

## Identified misstatements

No factual uncorrected misstatements have been identified. We have identified one corrected misstatement above the threshold for reporting to you

Audit materiality was set at £4.4 million (2011/12 £6.3 million). This is a decrease from the £4.8m set out in our audit plan.

N/A

We report all unadjusted misstatements greater than £220,000 (2011/12: £319,000) to you, as well as any misstatements that are qualitatively material.

A misstatement for the amount of £0.5 million was identified in the Pantheon private equity year-end valuation which we wish to report to you. The year-end balance had been rolled forward from the December 2012 valuation by accounting for the cash movements. We obtained the valuation report as at 31 March 2013 directly from the investment manager giving rise to this increase in the private equity valuation. This misstatement was corrected by management.

We also identified a deficiency around the disclosure of the investments greater than 5% of net assets.

There are no identified factual uncorrected misstatements above this level and no qualitatively material misstatements that we wish to bring to your attention, subject to completion of the above procedures.

# Executive summary (continued)

## Accounting and internal control systems

**The internal control systems are very strong, however further improvements could be made**

We previously reported to you in our report on the 2011/12 audit that we identified two areas for improvement in relation to the internal control systems. These improvements related to the authorisation of journal entries and setting up a new bank account for the pension fund. We are pleased to confirm that our recommendations regarding the journal entries have been addressed although there are still improvements that could be made.

Section 2

However, for the latter, the use of the bank account could be improved further to develop a higher level of governance over the Pension Scheme cash and clearly show that provisions of the Local Government Pension Scheme (Management and Investment of Funds) Regulations 2009 are being met.

We have raised two suggestions during the course of this year's audit relating to the segregation of duties around the bank reconciliations and the lack of a pension fund risk register.

We note that there is to be a change in personnel in the pensions accounting function. We recommend that the handover process is appropriately conducted to ensure current good practices and maintained.

## Current accounting and regulatory issues

We have included within this report accounting and regulatory issues that affect the pension fund industry, particularly focus areas of the Pensions Regulator (TPR). Although the London Borough of Harrow Pension Fund is not currently regulated by TPR these are guidelines for improving processes and represent best practice in the industry.

Section 3

# 1. Key audit risks

The results of our audit work on key audit risks are set out below:

## Contributions

### Audit risk

Unlike the position in the private sector, we are not required to issue a separate statement on contributions for the Fund. Nevertheless, in view of the complexity arising from the participation of different employers within the Fund, we have included the identification, calculation and payment of contributions as an area of significant risk.

### Deloitte response

We have performed the following testing to address the significant risks around contributions:

- reviewed the design and confirmed the implementation of controls present at the Fund for ensuring contributions from all Scheduled and Admitted bodies are identified and calculated correctly.
- we performed test of details to test whether each material income stream was calculated in accordance with the actuarial valuation and schedule of rates.
- we developed an expectation based on changes in membership and changes in contribution rates to analytically review the contributions received in the year, the results of which fell within our tolerance level; and
- reconciled the membership movements in the year to the Financial Statements, ensuring that these included members from the admitted bodies.

All testing was completed with satisfactory results.

We note that London Borough of Harrow as the administering authority is not responsible for the calculation of employers' contributions for each of the scheduled and admitted bodies. These are calculated by the payroll departments of the relevant scheduled and admitted bodies. We have therefore performed our testing, where necessary, with the assistance of the individual bodies as necessary.

# 1. Key audit risks (continued)

## Benefits

### Audit risk

Changes were made to the Fund from April 2008 which introduced complexities into the calculation of both benefits in retirement and ill health and death benefits which are in addition to the annual increases required by the 1997 Regulation and Pension (Increases) Act 1971.

### Deloitte response

The following tests were performed to address the risk around benefits:

- we reviewed the design and confirmed the implementation of controls present at the Fund for ensuring the accuracy, completeness and validity of benefits through discussion with the pensions team and testing that controls were in force during the year under review;
- we obtained a schedule of benefits paid in the form of transfers out, lump sums and death grants and using supporting calculations, we tested whether benefits were in accordance with the appropriate rules;
- we performed tests of detail on a sample of benefits paid, by agreement to supporting documentation, to test whether benefits for new pensioners were in all material respects correctly calculated, by reference to their qualifying service, scheme rules and benefit choices made; and
- we developed an expectation based on the prior year balance, adjusted for changes in membership numbers and pension increases to analytically review the pension benefits paid in the year.

All testing was completed with satisfactory results.

# 1. Key audit risks (continued)

## Investments

### Audit risk

The Fund makes some use of private equity investments 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 key audit risk.

The Fund also makes use of derivatives which can be complex in terms of accounting, measurement and disclosure requirements. The fair values of derivatives held at year-end have an asset position of £0.8 million and a liability position of £3.1 million. This gives a net position of -£2.3 million (2012: £1.6 million).

### Deloitte response

The following tests were performed to address the significant risk around investments:

- we reviewed the design and implementation of controls present at the Fund for ensuring investments are valued correctly;
- we reconciled the total value of the investments held by the Fund as reported in the Net Assets Statement to independent confirmations received directly from the investment managers;
- we have performed a test of detail on a sample basis of quoted investments and compared the value to the quoted price obtained from Bloomberg, Datastream or other third party sources;
- we performed an analytical review on the performance of the portfolio;
- we carried out sample testing on sales and purchases made in the year;
- we reviewed the year end portfolio for compliance with the Statement of Investment Principles (SIP);
- we obtained an understanding of the valuation of private equity investments through discussion with the investment manager. The private equity investment manager valuation was obtained for the quarter to 31 December 2012 and this was compared to the audited financial statements for the year ended 31 December 2012 to determine the investment manager's ability to forecast valuations. The percentage difference was extrapolated to the valuation as at 31 March 2013 to determine the possibility of a material misstatement; and
- we engaged our internal experts to review the use of derivatives and to recalculate the value of a sample of open contracts.

A misstatement for the amount of £0.5 million was identified in the Pantheon private equity year-end valuation. The year-end balance had been rolled forward from the December 2012 valuation by accounting for the cash movements. We obtained the valuation report as at 31 March 2013 directly from the investment manager giving rise to this increase in private equity valuation. This misstatement was corrected by management.

We also identified a deficiency around the disclosures of the investments greater than 5% of the net assets. It was noted that the fund values had been disclosed for all other investment managers whereas the total investment value for Fidelity had been disclosed. This was corrected by management in the financial statements.

All other testing was completed with satisfactory results.



# 1. Key audit risks (continued)

## Management override of controls

### Audit 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 controls.

### Deloitte response

The following tests were performed to address the risk of management override of controls:

- we reviewed analysis and supporting documentation for journal entries, key estimates and judgments;
- we performed substantive testing on journal entries to confirm that they have a genuine, supportable rationale;
- we reviewed ledgers for unusual items and on a test basis investigated the rationale of any such postings;
- we reviewed significant management estimates and judgments such as year-end accruals and provisions and consider whether they are reasonable; and
- we made enquiries of those charged with governance as part of our planning and detailed audit processes.

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All testing was completed with satisfactory results.

## 2. Accounting and internal control systems

### Current year control observation

#### Segregation of duties around bank reconciliations

<b>Observation</b>	As part of our work around the design and implementation of key controls, we identified that there are insufficient controls around the segregation of duties for bank reconciliations. The bank reconciliations are currently not reviewed and signed off by an independent reviewer.
<b>Recommendation</b>	An employee should be responsible for preparing the bank reconciliations on a regular basis and these should be reviewed and signed off by the Head of Pensions or similar, to ensure that all potential errors are identified and corrected on a timely basis.
<b>Management response</b>	We agree with the above observation and recommendations.

#### Risk register

<b>Observation</b>	As part of our audit work around the design and implementation of key controls, we identified that the pension team do not maintain their own risk register.
<b>Recommendation</b>	It is recommended that risks should be recorded in a risk register and should be regularly reviewed to ensure that they are being appropriately monitored and managed. This will promote good governance within the Fund.
<b>Management response</b>	We agree with the above observation and recommendations.

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## 2. Accounting and internal control systems (continued)

### Prior year control observations

During the course of our 2011/2012 audit we identified areas for improvement in the internal control systems which are detailed below:

#### Authorising journals

<b>Observation</b>	There is no policy for authorising journals before they are posted to the general ledger.
<b>Recommendation</b>	The Officers of the Fund should consider implementing a review process to ensure that all journal entries are reviewed and authorised before they are posted to the general ledger.
<b>Management response</b>	Agreed. From August 2012, a paper file has been maintained of all journals processed into SAP for the pension fund. All journals will be authorised in writing by the Treasury and Pension Fund Manager prior to posting to SAP by another member of the Corporate Finance team.
<b>2012/2013 update</b>	The process around the authorisation of journals continues to be an area of improvement for the Fund. All journals over £20,000 aim to be authorised and overseen on an ad-hoc basis. Journals are often authorised after they have been posted, and as such the controls around authorising journals are weak. See also the recommendation in the London Borough of Harrow report.

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## 2. Accounting and internal control systems (continued)

### Separate bank account

#### Observation

Following implementation of The Local Government Pension Scheme (Management and Investment of Funds) Regulations 2009 that apply from 1 April 2011, there is a new requirement for each pension fund to have a separate bank account. This change has been being adopted because it will enable pension fund monies to be clearly ring-fenced from other monies of the local authority, and thus reflects a longstanding Audit Commission view on best practice.

We noted that whilst the scheme has set up the account in line with the required timeframe, it has not been used for all transactions within the pension scheme. The current process is that some transactions such as the employers' contributions from Harrow Council continue to be processed through the main bank account with a regular transfer to the pension scheme bank account.

This means that at any point in time there may be pension scheme cash within the main Council bank account.

#### Recommendation

Whilst this process could be considered to comply with the 2009 regulations, we recommend that it is amended so that this account is utilised for all cash transactions regarding the pension scheme, in particular the receipt of contributions. This will give the Fund greater clarity over the transactions undertaken by the scheme, and demonstrate improved governance and compliance with regulations.

#### Management response

The Fund is now compliant with the regulations concerning pension fund bank accounts. During 2011/12 all pension fund cash movements were processed through Harrow Council bank accounts as discussed in the Report, with monthly (or more frequent) settlements. This approach changed from April 2012 and all contributions from employers other than Harrow Council are now directly banked into the pension fund current account. The IT project to run pension fund BACS transactions for pensions and lump sums against the pension fund bank account has been completed and has been in operation since June 2012.

The small value of cheques that are still processed through the Harrow Council account on cost efficiency grounds and contributions from Harrow Council and expenses paid by Harrow Council remain subject to a monthly aggregation and settlement. No further changes are planned to these procedures.

#### 2012/2013 update

Management comments above have been implemented in the year.

# 3. Current Accounting and Regulatory Issues

## Upcoming financial reporting developments

For reference, the following developments in the pension industry may impact the governance arrangements and financial statements of the London Borough of Harrow Pension Fund. Whilst we appreciate that the Local Government Pension Scheme is not regulated by the Pensions Regulator, we consider their guidance to be indicative of what is currently considered to be best practice in the pensions sector.

Pensions Act 2013	
	<p>The Pensions Act received Royal Assent in parliament and hence will come into force from 2015. The key changes of the bill are:</p> <ul style="list-style-type: none"><li>• reform the State Pension system through the introduction of a single-tier pension;</li><li>• manage future changes to the State Pension age including bringing forward the increase in State Pension age to 67;</li><li>• reform the range of benefits associated with bereavement;</li><li>• boost the consolidation of small pension pots;</li><li>• introduce a new statutory objective for the Pensions Regulator; and</li><li>• strengthen existing legislation relating to occupational pensions.</li></ul> <p>It is anticipated that LGPS will begin to be regulated by the Pension Regulator as part of this bill from 2015. This will mean that the schemes will need to consider the guidance put in place by the regulator and comply with the best practice advice from 2015.</p> <p>Further information can be found at: <a href="https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/197840/pensions-bill-ia-summary.pdf">https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/197840/pensions-bill-ia-summary.pdf</a></p>

## 4. Other matters for communication

As part of our obligations under International Standards on Auditing (UK & Ireland), we are required to report to you on the matters listed below

<b>Independence</b>	We confirm that we comply with APB Revised Ethical Standards for Auditors and that, in our professional judgement, we are independent and our objectivity is not compromised.
<b>Non-audit services</b>	In our opinion there are no inconsistencies between APB Revised Ethical Standards for Auditors and the Fund's policy for the supply of non-audit services or of any apparent breach of that policy. To confirm we have not performed any non-audit services in the year or previous year.
<b>Fees</b>	<p>Our fee for the audit of the pension fund for the year ending 31 March 2013 is £21,000 (2012: £35,000). 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.</p> <p>Under our new arrangements with the Audit Commission, Deloitte's net reimbursement 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.</p>
<b>Relationships</b>	We are required to provide written details of all relationships between us and the audited entity, its trustees and senior management and its affiliates, including all services provided by us and the DTTL network to the audited entity, its trustees and senior management and its affiliates that we consider may reasonably be thought to bear on our objectivity and independence and the related safeguards that have been put in place. We can confirm that we are not aware of any such relationships.

## 5. 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 in this report is prepared on the basis of, and our audit work is carried out, in accordance with that statement.

Our audit was not designed to identify all matters that may be relevant to London Borough of Harrow Pension Fund and this report is not necessarily a comprehensive statement of all deficiencies which may exist in internal control or of all improvements which may be made.

This report has been prepared for the London Borough of Harrow, 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  
16 September 2013

# Appendix 1: Draft representation letter

Deloitte LLP

**Our Ref:**     *DWB/PJS/2013*

**Date:**

Dear Sirs

## **London Borough of Harrow Pension Fund (the “Fund”)**

This representation letter is provided in connection with your audit of the financial statements of the fund for the year ended 31 March 2013 for the purpose of expressing an opinion as to whether the financial statements give a true and fair view of the financial position of the Fund, in accordance with the Code of Practice on Local Authority Accounting in the United Kingdom 2012/13, the financial transactions of the Pension Fund during the year ended 31 March 2013, and the amount and disposition of the fund’s asset and liabilities as at 31 March 2013, other than liabilities to pay pensions and other benefits after the end of the fund year.

We acknowledge as members of London Borough of Harrow Pension Fund our responsibilities for ensuring that the financial statements are prepared which give a true and fair view, for keeping records in respect of active members of the Fund and for making accurate representations to you.

We confirm, to the best of our knowledge and belief, the following representations.

1. All the accounting records have been made available to you for the purpose of your audit and all the transactions undertaken by the Fund have been properly reflected and recorded in the accounting records. All other records and related information, including minutes of Officer and Committee member meetings, have been made available to you.
2. We acknowledge our responsibilities for the design, implementation and operation of internal control to prevent and detect fraud and error.
3. 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.
4. We are not aware of any significant facts relating to any frauds or suspected frauds affecting the Fund involving:
  - (i). management;
  - (ii). employees who have significant roles in internal control; or
  - (iii). others where the fraud could have a material effect on the financial statements.
5. We have disclosed to you our knowledge of any allegations of fraud, or suspected fraud, affecting the Fund’s financial statements communicated by members, former members, employers, regulators or others.
6. We are not aware of any actual or possible instances of non-compliance with laws and regulations, the effects of which should be considered when preparing financial statements.



# Appendix 1: Draft representation letter (continued)

7. Where required, the value at which assets and liabilities are recorded in the net asset statement is, in the opinion of the Authority, the fair value. We are responsible for the reasonableness of any significant assumptions underlying the valuation, including consideration of whether they appropriately reflect our intent and ability to carry out specific courses of action on behalf of the Fund. Any significant changes in those values since the balance sheet date have been disclosed to you.
8. We confirm the completeness of the information provided regarding the identification of related parties, and the adequacy of related party disclosures in the financial statements.

We have made enquiries of any key managers or other individuals who are in a position to influence, or who are accountable for the stewardship of the Fund and confirm that we have disclosed in the financial statements all transactions relevant to the Fund and we are not aware of any other such matters required to be disclosed in the financial statements, whether under Statement of Recommended Practice – Financial Reports of Pension Schemes (revised May 2007) (“Pensions SORP 2007”), Code of Audit Practice on Local Authority Accounting in the United Kingdom in 2012/13: based on International Financial Reporting Standards or other regulations.

9. We confirm that the financial statements have been prepared on the going concern basis. We do not intend to wind up the fund. We are not aware of any material uncertainties related to events or conditions that may cast significant doubt upon the Fund’s ability to continue as a going concern. We confirm the completeness of the information provided regarding events and conditions relating to going concern at the date of approval of the financial statements, including our plans for future actions.
10. You have been informed of all changes to the Fund rules during the year and up to the current date.
11. We have not commissioned advisory reports which may affect the conduct of your work in relation to the Fund’s financial statements.
12. No claims in connection with litigation have been or are expected to be received.
13. We have no plans or intentions that may materially affect the carrying value or classification of assets and liabilities reflected in the financial statements.
14. There have been no events subsequent to 31 March 2013 which require adjustment of or disclosure in the financial statements or notes thereto.
15. There have been no irregularities involving management or employees who have a significant role in the accounting and internal control systems or that could have a material effect on the financial statements.

# Appendix 1: Draft representation letter (continued)

16. The pension fund accounts and related notes are free from material misstatements, including omissions.
17. The Fund has complied with all aspects of contractual agreements that could have a material effect on the financial statements in the event of non-compliance. There has been no non-compliance with requirements of regulatory authorities that could have a material effect on the financial statements in the event of non-compliance.
18. The Fund has satisfactory title to all assets.
19. We have recorded or disclosed, as appropriate, all liabilities, both actual and contingent.
20. No transactions have been made which are not in the interests of the members of the Fund during the Fund year or subsequently.
21. We confirm that:
  - 1 all retirement benefits and schemes, including UK, foreign, funded or unfunded, approved or unapproved, contractual or implicit have been identified and properly accounted for;
  - 1 all settlements and curtailments have been identified and properly accounted for;
  - 1 all events which relate to the determination of pension liabilities have been brought to the actuary's attention;
  - 1 the actuarial assumptions underlying the valuation of the scheme liabilities (including the discount rate used) accord with the directors' best estimates of the future events that will affect the cost of retirement benefits and are consistent with our knowledge of the business;
  - 1 the actuary's calculations have been based on complete and up to date member data as far as appropriate regarding the adopted methodology; and
  - 1 the amounts included in the financial statements derived from the work of the actuary are appropriate.
22. All trades in complex financial instruments are in accordance with our risk management policies, have been conducted on an arm's length basis and have been appropriately recorded in the accounting records, including consideration of whether the complex financial instruments are held for hedging, asset/liability management or investment purposes. None of the terms of the trades have been amended by any side agreement and no documentation relating to complex financial instruments (including any embedded derivatives and written options) and other financial instruments has been withheld.
23. We confirm that the Pension Fund Annual Report is compliant with the requirements of Regulations 34(1)(e) of the Local Government Pension Scheme (Administration) Regulations 2008 and related guidance.

# Appendix 1: Draft representation letter (continued)

24. We confirm that the information that is contained within the Pension Fund Annual Report and Accounts for the year to 31 March 2013 is complete, accurate and consistent with the information that is contained within the Accounts.

We confirm that the above representations are made on the basis of adequate enquiries of other officials of the Fund (and where appropriate, inspection of evidence) sufficient to satisfy ourselves that we can properly make each of the above representations to you.

Yours faithfully

Signed on behalf of London Borough of Harrow Pension Fund

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