

London Borough of Harrow Council

Report to the Governance, Audit and  
Risk Management Committee

Plan for the 2009/10 Pension Fund  
Annual Report Audit

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# 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 2010.

## Audit scope

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

Our audit of the pension scheme 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 schemes. However, this only extends to the audit of the accounts and there is no requirement for a value for money conclusion on the pension scheme 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 scheme.

The pension scheme 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 scheme, which should incorporate the annual accounts. Our audit report on the Authority accounts will continue to cover the pension scheme section of that document.

In addition, we are asked by the Commission to issue an audit report for inclusion in the annual pension scheme report.

## Materiality

We calculate materiality on the basis of the net assets of the scheme, 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 £4,434,000 (2009: £4,347,000). We will report to the Governance, Audit and Risk Management Committee (“GARM”) on all unadjusted misstatements greater than £222,000 (2009: £217,000) unless they are qualitatively material. 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)

## Key audit risks

The key audit risks which we have identified as part of our overall audit strategy are detailed below:

- In view of the complexity arising from the participation of different employers within the Pension Fund, we have included the calculation and payment of contributions as areas of specific risk.
- There are a number of complexities to the calculation of both benefits in retirement and ill health and death benefits introduced by changes to the local government pension scheme last year, as such we have identified benefits payable as an area of specific risk.
- The pension fund invests in private equity investments and derivative financial instruments. These investments are more complex to measure, account for and disclose; accordingly we will treat the appropriateness of the accounting for these investments as a risk.

## Prior year uncorrected misstatements and disclosure deficiencies

There were no unadjusted misstatements or disclosure deficiencies on the prior year Net Asset Statement.

# Executive summary (continued)

## Timetable

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 the inclusion in the Authority's annual report.

## 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 to the GARM for the year ending 31 March 2010 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

We propose a fee of £38,500 (PY: £38,000) which is in line with the fee scale advised by the Audit Commission.

## Audit team

Paul Schofield will continue be the Engagement Lead and will be supported by Helen Perkins, a director, and David Hobson as manager for this work.

## Matters for those charged with governance

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.

# 1. Scope of work and approach

## **Overall scope and approach**

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

LGPS schemes 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 schemes. However, this only extends to the audit of the accounts and there is no requirement for a value for money conclusion on the pension scheme 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 scheme.

We will conduct our audit in accordance with International Standards on Auditing (UK and Ireland) (“ISA (UK and Ireland)”) as adopted by the UK Auditing Practices Board (“APB”). Our audit objectives are set out in our “Briefing on audit matters” document in 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 scheme. This is the Code of Practice on Local Authority Accounting in England and Wales 2009: A Statement of Recommended Practice (“SORP”) and Regulation 34 of LGPS (Administration) Regulations 2009.

# 1. Scope of work and approach (continued)

For the Pension Fund Annual Report, 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 £4,434,000 (2009: £4,347,000). 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.

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 scheme 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 scheme accounts included in the financial statements.

The financial statements included in the pension scheme annual report are prepared on the basis of the same proper practices - the Local Government SORP - as the financial statements included in the statement of accounts.

## 2. Key audit risks

Based upon our initial assessment for the 2009/10 audit we will concentrate specific audit effort on the following areas:

### Contributions

#### **Risk and response**

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 scheme we have identified this as a specific risk.

We will perform procedures to ascertain whether expected contributions have been identified, scheduled and paid in accordance with the schedule.

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## 2. Key audit risks (continued)

### Benefits

#### Risk and response

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 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.

We will perform procedures to ascertain whether benefits payable have been calculated correctly in accordance with the fund rules.

## 2. Key audit risks (continued)

### Investments

#### Risk and response

The pension scheme makes some use of investments in private equity and derivative financial instruments. Nationally, a number of private equity funds have suffered significant losses over the last two years.

Private equity funds are complex to value and include an element of judgement on the part of the investment manager. Officers should understand the assumptions made by the investment manager.

Private equity funds form a material balance within the pension fund accounts and therefore the valuation of these funds is regarded as a specific risk.

We will understand the valuation method adopted to value these investments and assess the appropriateness thereof. We will perform additional procedures to confirm that these investments have been valued correctly at year end.

The pension fund also makes use of derivatives which 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 SORP.

### 3. Consideration of fraud

The primary responsibility for the prevention and detection of fraud rests with the officers 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.

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 the officers’ processes for identifying and responding to the risks of fraud in Harrow Council and its local government pension scheme and the internal control that the officers have established to mitigate these risks.

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

- Whether the GARM has knowledge of any fraud, alleged or suspected fraud.
- The role that the GARM exercises in oversight of:
  - Harrow Council’s assessment of the risks of fraud in respect of the pension scheme; and
  - the design and implementation of internal control to prevent and detect such fraud.
- The GARM’s assessment of the risk that the pension scheme financial statements and annual report may be materially misstated as a result of fraud.

We will be seeking representations in this area from the Corporate Director of Finance in due course.

# 3. Consideration of fraud (continued)

## **Management override of controls**

In addition to the procedures above we are required to design and perform audit procedures to respond to the risk of officers override of controls which will include:

- having understood and evaluated the financial reporting process and the controls over journal entries and other adjustments made in the preparation of the financial statements, test the appropriateness of a sample of such entries and adjustments;
- a review of accounting estimates for bias that could result in material misstatement due to fraud, including whether any differences between estimates best supported by evidence and those in the financial statements, even if individually reasonable, indicate a possible bias on the part of the officers. We will also perform a retrospective review of officers' judgements and assumptions relating to significant estimates reflected in last year's financial statements; and
- obtain an understanding of the business rationale of significant transactions that we become aware of that are outside the normal course of business or that otherwise appear to be unusual given our understanding of the Authority and its environment.

## 4. Internal control

### **Obtaining an understanding of internal control relevant to the audit**

As set out in "Briefing on audit matters" attached at Appendix 1, 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 scheme administration, although we will report to the officers any recommendations on controls that we may have identified during the course of our audit work.

### **Liaison with internal audit**

We will liaise with the Authority's internal audit function on a constructive and complementary basis to maximise our combined effectiveness and eliminate duplication of effort. This co-ordination will enable us to derive full benefit from the Authority's internal audit functions, their systems documentation and risk identification during the planning of the external audit.

Following an assessment of the organisational status, scope of function, objectivity, technical competence and due professional care of the internal audit function we will review any findings relevant to the pension fund and adjust the audit approach as is deemed appropriate.

## 5. Timetable

		2009		2010											
		Nov	Dec	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	
<b>Deloitte</b>	Prepare plan based on discussions with officers				■										
	Early discussion of Authority's approach to risks areas				■										
	Audit fieldwork/audit issues meetings									■	■				
	Review of pension scheme annual report									■	■				
	Preparation of our report on the 2009/10 audit										■				
	Deadline for signing the accounts											■			
<b>GARM</b>	Report to the GARM on the audit plan						■								
	Report to the GARM on the 2009/10 accounts audit											■			

Our work during these visits will be closely co-ordinated with the work carried out on other parts 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

8 April 2010

# 7. 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".



# 7. Appendix 1: Briefing on audit matters (continued)

## Approach and scope of the audit

### Primary audit objectives

We have been appointed as auditor to Harrow Council by the Audit Commission, the body responsible for appointing auditors to local public bodies in England, including local authorities. Our responsibility in respect of the Local Government Pension Scheme administered by Harrow Council is to carry out an audit in accordance with the Audit Commission's Code of Audit Practice and additional guidance issued by the Audit Commission in respect of the audit of Local Government Pension Schemes and to express an opinion on whether the information on the pension scheme required to be included in the financial statements of Harrow Council, presents fairly in accordance with the Statement of Recommended Practice on Local Authority Accounting in the United Kingdom applicable to the relevant year, the financial transactions of the pension scheme and the amount and disposition of the scheme's assets and liabilities, other than liabilities to pay pensions and other benefits after the end of the scheme year. The Audit Commission has determined that auditors should also give an opinion in accordance with guidance issued by the Commission on the financial statements included in the pension scheme annual report. This entails the following additional work over and above giving an opinion on the pension scheme accounts included in the Authority's statement of accounts:

- comparing the accounts to be included in the pension scheme annual report with those included in the statement of accounts;
- reading the other information published with the pension scheme annual report for consistency with the pension scheme accounts; and
- where the pension scheme 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 scheme accounts included in the financial statements.

# 7. Appendix 1: Briefing on audit matters (continued)

## 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 officers. This will include key business process improvements and significant controls weaknesses identified during our audit.

## 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 planning 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 determine planning 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.

## 7. Appendix 1: Briefing on audit matters (continued)

**Materiality (Continued)** 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, officers 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.

# 7. Appendix 1: Briefing on audit matters (continued)

## Audit methodology

Our audit methodology takes into account the changing requirements of auditing standards and the Audit Commission and adopts a risk based approach. We utilise technology in an efficient way to provide maximum value to Authority's members and create value for officers and the Authority 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);
- 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.

# 7. Appendix 1: Briefing on audit matters (continued)

## 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
210	Terms of audit engagements
240	The auditor's responsibility to consider fraud in an audit of financial statements
250	Consideration of laws and regulations in an audit of financial statements
315	Obtaining an understanding of the entity and its environment and assessing the risks of material misstatement
320	Audit materiality
545	Auditing fair value measurements and disclosures
550	Related parties
560	Subsequent events
570	Going concern
580	Management representations
720 (revised)	Section A: Other information in documents containing audited financial statements Section B: The auditor's statutory reporting responsibility in relation to directors' reports

# 7. 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.
- 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.

## 7. Appendix 1: Briefing on audit matters (continued)

### Safeguards and procedures (cont'd)

- 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 organisations.

## 7. 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 closely-related person) 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 closely-related person) 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 closely related persons) 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.



## 7. Appendix 1: Briefing on audit matters (continued)

### 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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