

London Borough of Harrow Pension Fund

**Report to the Governance, Audit and Risk
Management Committee on the 2010/11 Local
Government Pension Scheme Audit**

Final Report

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Key findings

We have pleasure in setting out in this document our report to the Governance, Audit and Risk Management Committee "GARM" for the year ended 31 March 2011 for discussion at the meeting scheduled for 21 September 2011. This report summarises the principal matters that have arisen from our audit for the year ended 31 March 2011.

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.

Key findings on audit risks and other matters

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 2010/11 accounts, and which were presented to the GARM on 29 March 2011.

Key risks

1. **Contributions:** the risk surrounding accurate calculation and payment of contributions, due to the complexities relating to having multiple admitted bodies, has been successfully covered and all testing was completed with satisfactory results;
2. **Benefits:** complexities of the calculation of benefits in retirement, ill health and death have been reviewed during our testing and all testing was completed with satisfactory results;
3. **Investments:** the private equity investment reports have been reviewed during our testing with no issues identified. Derivative financial instruments have also been successfully revalued on a sample basis; and
4. **Accounting for International Financial Reporting Standards ('IFRS'):** management have elected to disclose the actuarial liability in notes to the accounts as permitted by CIPFA/LASAAC Code of Practice on Local Authority Accounting in the United Kingdom 10/11. The note to the financial statement on the actuarial liability of the scheme as at 31 March 2011 complies with the requirements of the Code.

Other risk area

Management Override of Controls: under ISA 240 management override of controls is deemed to be a risk on all audits for periods ending after 15 December 2010. All testing was completed with satisfactory results.

Key findings (continued)

Audit status	<p>We have substantially completed our audit in accordance with our Audit Plan which was presented to you on 29 March 2011 subject to the satisfactory completion of the matters set out below:</p> <ul style="list-style-type: none"> • receipt of signed management representation letter; and • update of post balance sheet event review. <p>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.</p> <p>Subject to the satisfactory completion of the outstanding matters referred to above, we expect to issue an unmodified audit opinion on the truth and fairness of the Fund's accounts.</p>
Identified misstatements	<p>As explained in our planning report, audit materiality is limited to the finalised materiality of the Authority accounts. This was set at £6.1m (2009/10 £5.5m).</p> <p>As set out in our planning report we report all unadjusted misstatements greater than £230,000 (2009/10 £270,000) to the GARM.</p> <p>There are no identified uncorrected misstatements above this level and no qualitatively material misstatements that we wish to bring to your attention.</p>
Accounting and internal control systems	<p>During the audit we identified two areas for improvement in relation to the accounting control systems:</p> <ul style="list-style-type: none"> • requirement for a pension fund bank account; and • non-compliance with the Statement of Investment Principles ("SIP") <p>Please see section 3 for more details.</p>
Current accounting and regulatory issues	<p>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 regulated by TPR these are guidelines for improving process and represent best practice in the industry.</p>

1. Key audit risks

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

Contributions	
Audit risk	In view of the complexity arising from the participation of different employers within the Fund, we have included the accurate calculation and payment of contributions as an area of significant risk.
Deloitte response	<p>We have performed the following testing to address the significant risks around contributions:</p> <ul style="list-style-type: none"> • We reviewed the design and confirmed the implementation of controls present at the Fund for ensuring contributions from all Scheduled and Admitted bodies are calculated and paid correctly; • we recalculated contributions for a sample of individual members to ensure they were calculated in accordance with the schedule of rates; • we performed analytical review procedures to gain assurance over the contributions received in the year, the results of which fell within our tolerance level; and • we reconciled the membership movements in the year to the Financial Statements, ensuring that these included members from the admitted bodies. <p>All testing was completed with satisfactory results.</p>

1. Key audit risks (continued)

Benefits	
Audit risk	<p>The regulations governing the calculation of benefits are complex and therefore benefits is an area of significant risk.</p> <p>On 8 July 2010 the Government announced its intention to move to the Consumer Price Index (CPI) as the measure of inflation for pension increase purposes. This change will come into effect for the increases in 2011/12.</p>
Deloitte response	<p>The following tests were performed to address the risk around benefits:</p> <ul style="list-style-type: none"> • 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 tested a sample of new pensioner calculations and other benefits paid in the year. The sample was tested through agreement to supporting documentation, and review of the calculation, by reference to the qualifying service, scheme rules and benefit choices made by the member; • we have reviewed the actuarial valuation indicating the impact of the change to CPI discussed above, whilst having little impact on the current year this change will impact the future increases and therefore level of benefits being paid out of the scheme; and • we performed analytical review procedures over the pension payments made in the year based on prior year audited numbers adjusted for changes in pensioner numbers. <p>All testing was completed with satisfactory results.</p>

Key audit risks (continued)

Investments**Audit risk**

The Fund makes some use of investments in private equity and derivative financial instruments.

Private equity funds are complex to value and include an element of judgement on the part of the investment manager. Given that these funds form a material balance within the Pension Fund accounts, we have identified the valuation of these funds as a key audit risk.

The Fund also makes use of derivatives which can be complex in terms of accounting, measurement and disclosure requirements.

Deloitte response

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

- we have reviewed the design and implementation of controls present at the Fund for ensuring investments are valued correctly;
- we have 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 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 2010 and this was compared to the audited financial statements for the year ended 31 December 2010 to determine the investment manager's ability to forecast valuations. The percentage difference was extrapolated to the valuation as at 31 March 2011 to determine the possibility of a material misstatement;
- we have found that private equity investments amounted to £21.6m, which represents 4.7% of all investments but this is above the benchmark as set out in the SIP of 3%. Therefore this has been noted as a control observation;
- we engaged our internal experts to review the use of derivatives and to recalculate the value of a sample of open contracts.

Except for investment allocations not being in line with the SIP (see section 3 for more details) all testing was completed with satisfactory results.

1. Key audit risks (continued)

Accounting for International Financial Reporting Standards (IFRS)

Audit risk

The Code of Practice on Local Authority Accounting sets out how Local Government Pension Schemes should apply IFRS. The main implications for the London Borough of Harrow Pension Fund are as follows:

- The requirement for the actuarial present value of promised retirement benefits to be disclosed, with three options for disclosure:
 - Option A – in the Net Asset Statement disclosing the resulting surplus or deficit;
 - Option B – in the notes to the Financial Statements; or
 - Option C – by referring to the actuarial information in an accompanying actuarial report.
- Additional note disclosures required around the actuarial positions of the fund and the significant assumptions made.

The London Borough of Harrow Pension Fund have adopted Option B in their 2010/11 financial statements which involved the disclosure of the year end actuarial value of benefits calculated under IAS 19 assumptions.

Deloitte response

The disclosure made complies with the requirements for Option B as detailed in the Code of Practice on Local Authority Accounting 2010/11.

Other risk area – Management override of controls

Audit risk

From 15 December 2010 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.

Deloitte response

Our audit approach was as follows:

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

All testing was completed with satisfactory results.

2. Other areas of audit focus

Valuation of investments

Audit risk

The valuation of investments is a key area for audit focus, given the size of the balance. Should the investments be valued incorrectly there would be significant issues with the funding position of the Plan.

Areas covered during our testing were the ownership, existence and valuation of investments.

Our key audit procedure for testing investments was to request direct confirmations from all investment managers. In order to gain comfort over these confirmations we reviewed available internal controls SAS 70 or AAF01/06 reports for the investment managers.

We also performed the following detailed procedures:

- analytical review of performance of the portfolios;
- detailed testing of a sample of purchases and sales transactions across the year;
- independent valuation testing for a sample of investments;
- discussed with investment manager the size of any holdings in the Eurozone crisis regions; and
- reviewed compliance with SIP.

The audit work completed has not uncovered any material issues with the valuation of investments and we found no material exposure to the Eurozone crisis regions. Except for investment allocations not being in line with the SIP (see section 3 for more details) all testing was found to be satisfactory.

3. Accounting and internal control systems

Control observation

During the course of our audit we identified two areas for improvement in the internal control system which is detailed below:

Observation

The Pension Fund currently operates its cash flows through the main London Borough of Harrow bank account. Therefore when contributions are 'made' there is no physical movement of cash, i.e. a journal entry is booked between the expense to the Authority and the contributions to the Pension Fund. At year end, the total cash balance is reconciled and allocated between the Pension Fund and the Authority.

The Local Government Pension Scheme (Management and Investment of Funds) Regulations 2009, regulation 6 introduces a new requirement for each pension fund to have, by 1 April 2011, a bank account which is separate from any which the administering authority has in its capacity as a local authority. This change is 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.

Recommendation

Although as at 1 April 2011, the Fund is complying with the requirement to have its own bank account, the Pension Fund still operates its cash flows through the main London Borough of Harrow bank account. Whilst complying with the specific requirement to have its own bank account this does not follow the intent of the requirement which is to ensure that monies are clearly ring fenced from other monies of the local authority.

This process should be amended so that all cash flows operate directly from the Pension Fund bank account.

Management response

Agreed. From 1 April 2011, a separate pension fund bank account has been established which holds the fund's cash balances. The value of fund transactions processed by the Council is transferred at least monthly to the pension fund bank account. Fund cash balances are invested separate from those of the council. An IT project is planned to commence Q4, 2011 to implement a system whereby the fund's cash transactions can be operated directly through its own bank account.

3. Accounting and internal control systems (continued)

Observation	The Statement of Investment Principles reflected the Authority's latest investment strategy did not include control ranges around the strategic asset allocations or the policy on rebalancing these. As a consequence, the investment holdings at year end are not in line with the Statement of Investment Principles.
Recommendation	This issue was highlighted last year but has yet to be implemented. Therefore we recommend that the Statement of Investment Principles is updated to include control ranges around the strategic asset allocations. We are satisfied that non-compliance with the Statement of Investment Principles has been adequately disclosed within the Pension Fund's Annual Report.
Management response	During the year the Pension Fund Investment Panel ("PFIP") agreed ranges around the strategic allocation, which have been complied with. A rebalancing policy was also agreed. At each PFIP meeting, actual versus strategic asset allocations and ranges are considered and quarterly, officers have delegated authority to rebalance the equity and bond allocations should they be out of range. The SIP will be updated following the completion of the strategic review later in 2011 to include asset allocation ranges and the rebalancing policy.

4. 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 Local Government Pension Scheme are 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.

The Local Government Pension Scheme (Benefit, Membership and Contributions) (Amendment) Regulations 2011

There are no key changes to regulation contained in this statutory instrument. The purpose of the statutory instruments is to clarify the regulation contained in the Local Government Pension Scheme (Benefit, membership and Contributions) Regulations 2007 where the member retires on the grounds of ill health.

The Pension Regulator – final employer support guidance

In November 2010, the Pensions Regulator published guidance, following consultation with the industry on employer support, focusing on encouraging trustees to take proactive steps to ensure there is adequate security for their pension scheme.

The guidance sets out that the employer covenant – the employer's legal obligations to a defined benefit scheme, and its ability to meet them – is a crucial element in protecting members' benefits. The guidance provides information on what trustees should do to measure and monitor employer covenant and any subsequent action that might be required to strengthen scheme security.

The guidance also provides information on how arrangements such as contingent assets can work alongside employer covenants to provide further safeguards. The recently published Purple Book showed a 16% increase in the use of contingent assets recognised by the Pension Protection Fund.

Given the partnership working that is being undertaken by Local Authorities with private sector Local Government Pension Scheme are in general seeing an increased number of applications for employers to be admitted to the Scheme. Given the last man standing nature of the Local Government Pension Scheme we consider that this guidance may be relevant to you when determining whether to admit new employers to the fund and if they are to be admitted what security should be requested of employers.

The Pensions Regulator – campaign on record keeping

The Pensions Regulator issued a statement on 9 February 2011 on "The importance of good scheme administration" which was aimed at scheme trustees and administrators.

We understand from meetings with the Regulator, both as a firm and throughout representing the ICAEW that this is the first part of a campaign over the coming months by the Regulator to make clear its expectations on record keeping and the maintenance of member data in particular the role trustees need to play in ensuring improvements are made as necessary.

It advises that the GARM should be ready for a challenge as to why they are satisfied with the current record keeping of member records.

5. 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.

Independence

We consider that we comply with APB Revised Ethical Standards for Auditors and that, in our professional judgement, we are independent and the objectivity of the audit engagement partner and audit staff is not compromised.

If the GARM wishes to discuss matters relating to our independence, we would be happy to arrange this.

Non-audit services

We are not aware of any inconsistencies between APB Revised Ethical Standards for Auditors and the Administering Authority's policy for the supply of non audit services or of any apparent breach of that policy.

An analysis of professional fees earned by Deloitte LLP in the period from 1 April 2010 to 31 March 2011 will be provided to the GARM by the London Borough of Harrow Pension Fund audit team in their report.

Fees payable to the auditors for the audit of the annual accounts of the London Borough of Harrow Pension Fund (excluding VAT) were £35,000 (2009/10 £38,500).

Our fee is consistent with the scale fee determined by the Audit Commission.

International Standards on Auditing (UK and Ireland)

We consider that there are no additional matters in respect of those items highlighted in our publication "Briefing on audit matters" to bring to your attention that have not been raised elsewhere in this report or our audit plan.

Liaison with internal audit

The Audit team, following an assessment of the independence and competence of the internal auditor, reviewed the findings of internal audits to inform the risk assessment and considered the impact on our audit approach.

No adjustments were made to the audit approach as a result of our review of the work of internal audit.

Written representations

A copy of the representation letter to be signed on behalf of the Authority is attached at Appendix 1.

Relationships

There are no relationships (including the provision of non-audit services) we have with the London Borough of Harrow Pension Fund, its members and senior management and its affiliates, and other services provided to other known connected parties that we consider may reasonably be thought to bear on our objectivity and independence, together with the related safeguards that are in place.

6. Responsibility statement

The Audit Commission published a 'Statement of responsibilities of auditors and of audited bodies' alongside the Code of Audit Practice. The purpose of this statement is to assist auditors and audited bodies by summarising where, in the context of the usual conduct of the audit, the different responsibilities of auditors and of the audited body begin and end, and what is expected of the audited body in certain areas. The statement also highlights the limits on what the auditor can reasonably be expected to do.

Our audit plan has been prepared on the basis of, and our audit work carried out in accordance with the Code and the Statement of Responsibilities, copies of which have been provided to London Borough of Harrow by the Audit Commission.

The audit may include the performance of national studies developed by the Audit Commission, where the auditors are required to follow the methodologies and use the comparative data provided by the Commission. Responsibilities for the adequacy and appropriateness of these methodologies and the data rests with the Audit Commission. The audit may be extended to include reviews such as this report which address locally determined risks and issues the scope of which is agreed with management in advance of the work. In this case it is for management to determine whether the scope is adequate and appropriate to their needs.

While our reports may include suggestions for improving accounting procedures, internal controls and other aspects of your business arising out of our audit, we emphasise that our consideration of the Pension Fund's system of internal control was conducted solely for the purpose of our audit having regard to our responsibilities under Auditing Standards and the Code of Audit Practice. We make these suggestions in the context of our audit but they do not in any way modify our audit opinion which relates to the financial statements as a whole. Equally, we would need to perform a more extensive study if you wanted us to make a comprehensive review for weaknesses in existing systems and present detailed recommendations to improve them.

Any conclusion, opinion or comments expressed herein are provided within the context of our opinion on the financial statements and our conclusion on value for money as a whole, which was expressed in our auditors' report.

We view this report as part of our service to you for corporate governance purposes and it is to you alone that we owe a responsibility for its contents. We accept no duty, responsibility or liability to any other person as the report has not been prepared, and is not intended, for any other purpose. It should not be made available to any other parties without our prior written consent.

Deloitte LLP

Chartered Accountants
St Albans
9 September 2011

Appendix 1: Draft representation letter

Deloitte LLP
3 Victoria Square
Victoria Street
St Albans
AL1 3TF

Our Ref: PS/DPH

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 2011 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 2010, the financial transactions of the Pension Fund during the year ended 31 March 2011, and the amount and disposition of the Fund’s asset and liabilities as at 31 March 2011, 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 our responsibilities for ensuring that the financial statements are prepared which give a true and fair view, in accordance with the Code of Practice on Local Authority Accounting in the United Kingdom 2010, 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.
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") or other requirements.
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 2011 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.
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:
- all retirement benefits and schemes, including UK, foreign, funded or unfunded, approved or unapproved, contractual or implicit have been identified and properly accounted for;
 - all settlements and curtailments have been identified and properly accounted for;
 - all events which relate to the determination of pension liabilities have been brought to the actuary's attention;
 - 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;
 - the actuary's calculations have been based on complete and up to date member data as far as appropriate regarding the adopted methodology; and
 - 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.
24. We confirm that the information that is contained within the Pension Fund Annual Report and Accounts for the year to 31 March 2011 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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