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WIRRAL

Pensions Committee

Date:	**Monday, 27 September 2010**
Time:	**6.00 pm**
Venue:	Committee Room 1 - Wallasey Town Hall

Contact Officer:	Pat Phillips
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SUPPLEMENTARY AGENDA

3. ACCOUNTS 2009-2010 (Pages 1 - 16)

4. DRAFT ANNUAL REPORT (Pages 17 - 18)

5. AC ANNUAL GOVERNANCE REPORT (Pages 19 - 46)

15. BANKING CONTRACT

Item deferred.

16. FRC STEWARDSHIP CODE (Pages 47 - 54)

18. EXEMPT INFORMATION - EXCLUSION OF MEMBERS OF THE PUBLIC

The following items contain exempt information.

RECOMMENDATION: That, under section 100 (A) (4) of the Local Government Act 1972, the public be excluded from the meeting during consideration of the following items of business on the grounds that they involve the likely disclosure of exempt information as defined by the relevant paragraphs of Part I of Schedule 12A (as amended) to that Act. The Public Interest test has been applied and favours exclusion.

27. INVESTMENT MONITORING WORKING PARTY MINUTES (Pages 55 - 62)

WIRRAL COUNCIL

PENSIONS COMMITTEE

27 SEPTEMBER 2010

AUDIT AND RISK MANAGEMENT COMMITTEE

28 SEPTEMBER 2010

REPORT OF THE DIRECTOR OF FINANCE

MERSEYSIDE PENSION FUND: STATEMENT OF AUDITED ACCOUNTS FOR THE YEAR ENDED 31 MARCH 2010

1. EXECUTIVE SUMMARY

1.1 On 28 June 2010, Pensions Committee formally approved the accounts (Minute 122 refers) prior to their submission to the Audit Commission, who undertook an audit of the accounts and will now report back to this meeting of the Pensions Committee with the Annual Governance Report (AGR). Members are requested to consider this report with the Annual Governance Report and the Letter of Representation.

1.2 In accordance with the Accounts and Audit Regulations 2003, Members are requested to consider both the adjusted amendments to the annual accounts, and an unadjusted misstatement.

1.3 As the Pension Fund receives a separate AGR, this report will first be considered by the Pensions Committee, and then by the Audit and Risk Management Committee.

2 AMENDMENTS TO THE ACCOUNTS

2.1 The purpose of the Statement of Audited Accounts is to present the overall financial position of the Pension Fund as at 31 March 2010, in accordance with prescribed guidance.

2.2 Under the Audit Commission Act 1998 and the Audit Commission Code of Audit Practice for Local Government, the District Auditor reports on the Pension Fund Financial Statement, as part of those of the Council.

2.3 There are a number of amendments to the Statement of Accounts requested by the District Auditor, which are detailed in Appendix 2 of the AGR, and have been incorporated into the final accounts.

2.4 The amended accounts are attached as an appendix. The net assets of the Fund have increased from £ 4.686 billion to £4.706 billion, a net increase of £20 million.

2.5 FUND ACCOUNT AND NET ASSET STATEMENT

2.5.1 The following is an analysis of those changes which have affected the value of the Fund:

(a) a net increase in the valuation of a number of alternative investments, totalling £1.604m
(b) an overstatement of £0.344m of the value of an investment due to the use of a superseded pricing feed
(c) an overstatement of £1.053m in the value of an investment in the thematics portfolio
(d) an understatement of £3.089m in the valuation of the Capital Dynamics Portfolio of private equity
(e) an overstatement of £1.078m in the valuation of an investment in European Strategic Partners
(f) a decision to accrue for augmentation contributions worth £13.214m, due from employers which they will pay in future years
(g) a further accrual of augmentation payments of £2.792m in respect of payments relating to 2009/10
(h) an accrual £0.344m in creditors in regards to deficit funding contributions, which was subsequently re-imbursed
(i) an accrual of £0.275m for contribution income from a new employer which was received in the following financial year.
(j) a planned adjustment to correct an overstatement of £1.728m in the payments of pension lump sums which had been processed on 31 March 2010 to help manage the year end workflow volume, and which would subsequently need to be transferred to the following financial year.

2.5.2 The following amendments have affected the analysis but have no impact on the overall value of the Fund:

(a) The Canadian element, representing 8% of the UBS North American portfolio consists of segregated equities, and had previously been shown together with the majority 92% USA pooled assets as Managed and Unitised Funds. The value of the Canadian holdings as 31 March 2010, £30.356m, is now included under “Equities”. The equivalent figure as at 31 March 2009 has been adjusted as a prior period adjustment within Note 7

(b) The Committee previously agreed to change the two bond mandates, managed by Legal and General, and Schroders, to “unconstrained”. The previous “constrained” mandates were consequently closed, by treating the final assets as “sales” and the opening of the new, unconstrained mandates, as “purchases”. Although this facilitated internal accounting, for the final accounts such asset switches are now regarded as “Transfers” , and no longer shown as “Sales and Purchases” in Note 7. The sum of the bond holdings was £316m.

(c) Receipts of Employers' Contribution of £2.698m had initially been allocated as "Employees' Contributions" and has been adjusted to be shown as "Employers' Contributions".

(d) As greater analysis is now shown for "Contributions Receivable" £8.14m is now categorised as "Augmentation" rather than "Deficit Funding".

(e) A planned adjustment has been made to reflect the capitalisation of building improvement costs of £2.619m at one of the investment properties. As a result, within Note 7, the figure for "Investment purchases" is increased and "change in market value" decreased equivalently. "Net rent income" increases.

2.5.3 In addition to any amendments to the Notes to the Accounts required to reflect the changes indicated in paragraphs 2.5.1 and 2.5.2 above, other Notes to the Accounts have been amended or added, and additional levels of analysis provided, as follows:

(a) "Accounting Policies" are expanded

(b) the addition of "administration income" in the Fund Account

(c) greater analysis of "Investment Income" in Note 6.

(d) Note 9, "Current Assets and Liabilities" now separately discloses unpaid benefits.

(e) Note 11, Related Party Transactions, has been amended, both to widen its scope and to allow more up to date information to be included.

2.5.4 One unadjusted misstatement in the accounts has been identified following the audit, for reasons explained below. It is shown in Appendix 3 of the AGR, and totals £12.183m. The issue is also included in my Letter of Representation. Members are asked to consider whether or not they would like to adjust the Statement of the Pension Fund Accounts to exclude these transactions from the Statement of Accounts, and disclose separately as a Note to the Accounts:

- Hitherto Compensatory Added Years (CAY) have been included in the Annual Accounts for MPF, both as expenditure via pensions paid, and as income via re-imbursement from employers. As indicated in Appendix 3 of the Annual Governance Report (AGR), prior to The Local Government Pension Scheme (LGPS) Regulations 2009, CAYs fell outside of the LGPS Regulations. The AGR indicates that the inclusion of these receipts and payments is an error, implying that these items should lie outside the accounts, perhaps as a memorandum note similar to the treatment of Additional Voluntary Contributions.

I have included these receipts and payments within the accounts, continuing the previous practice. Under recent legislation, all employers have, until March 2012 on an individual employer basis, different options to change the current funding arrangements. Should any so opt, and had these cash flows been excluded from the accounts for year ended 31 March 2010, there would be a resultant inconsistency in accounting treatment both between employers, and between years. Paragraph 2.188 of the Pensions SORP refers to the fundamental accounting concept that there is consistency of accounting treatment within each accounting period, and from one period to the next. I therefore propose to retain the existing accounting treatment, but as soon as that option for employers has expired in March 2012, I shall then adopt the appropriate accounting treatment to reflect the employers' final decisions.

2.6 The Appendix contains other background information regarding the Pension Fund which will be shown in the Annual Report, but is required to be incorporated into the Statement of Accounts of Wirral Council.

3 CONCLUSIONS

3.1 The Audit Opinion will be issued following consideration of the Annual Governance Report and approval of the amended Statement of Accounts at both the Pensions Committee and the Audit and Risk Management Committee.

3.2 Once approved, the District Auditor has indicated that he will again issue an unqualified opinion, and state that the accounts present fairly the financial position of Merseyside Pension Fund as at 31 March 2010.

3.3 Subject to the decision regarding Compensatory Added Years' transactions, the accounts as now shown will form the basis of the Annual Report for the year ended 31 March 2010.

3.4 I have prepared a Letter of Representation on behalf of the Committee which gives assurances to the District Auditor on various aspects relating to the Pension Fund.

4 COMMENTS

4.1 As indicated in the AGR, during the year, there was a change to the accounting system. This was highlighted in the Audit Plan as a high risk area. The District Auditor has adequate assurance that the balances have been accurately transferred and that the controls are operating effectively.

4.2 An Action Plan has been agreed with the District Auditor, and is shown as Appendix 4 of the AGR.

4.3 A high proportion of the information and data forming the basis of the figures in the Annual Statement of Accounts is received from external sources. MPF cannot control the timing of receipt and accuracy of such information, and so a considerable effort has to be made to confirm and verify such figures within a very short time scale. Inevitably, there is some late information or clarifications that are received after the draft accounts have been approved by Committee. Changes to the draft accounts relating to such late information are termed “misstatements” within the AGR.

4.4 The value of the Fund Account and Net Asset Statement as at 31 March 2009 has not been changed by any Prior Period Adjustments.

4.5 The District Auditor has provisionally indicated that the audit was completed within the financial estimate.

4.6 All local authorities and their pensions funds will be required to comply with the International Financial Reporting Standards from 2010/2011 onwards.

5. FINANCIAL AND STAFFING IMPLICATIONS

5.1 There are no implications as a result of this report.

6. EQUAL OPPORTUNITY IMPLICATIONS

6.1 There are none arising directly from this report.

7. HUMAN RIGHTS IMPLICATIONS

7.1 There are none arising directly from this report.

8. COMMUNITY SAFETY IMPLICATIONS

8.1 There are no specific implications arising from this report.

9. LOCAL MEMBER SUPPORT IMPLICATIONS

9.1 There are no specific implications for any Member or Ward.

10. LOCAL AGENDA 21 IMPLICATIONS

10.1 There are no specific implications arising from this report.

11. PLANNING IMPLICATIONS

11.1 There are no specific implications arising from this report.

12. **BACKGROUND PAPERS**

12.1. None.

13. **RECOMMENDATIONS**

13.1 That the Pensions Committee considers the amendments to the Statement of Accounts for 2009/2010 the Annual Governance Report and the Letter of Representation.

13.2 That the Pensions Committee refers the recommendations to the Audit and Risk Management Committee.

13.3 That the Action Plan within the Annual Governance Report be agreed, and that the Pensions Committee be informed of progress with its implementation.

IAN COLEMAN
DIRECTOR OF FINANCE

FNCE/189/10

APPENDIX

Fund Account - for year ended 31 March 2010

	Note	2010 £'000	2009 £'000
Contributions and Benefits			
Contributions receivable	3	**262,656**	245,976
Transfers in		**21,932**	18,436
Administration Income	6	**125**	83
		284,713	264,495
Benefits payable	4	**231,318**	212,476
Leavers	5	**19,658**	15,121
Administration expenses		**3,965**	3,860
		254,941	231,457
Net additions from dealings with members		**29,772**	33,038
Return on Investments			
Investment Income	6	**84,024**	71,129
Change in market value of investments	7	**1,080,102**	-833,021
Investment Management Expenses	8	**-9,745**	-4,982
Net return on Investments		**1,154,381**	-766,874
Net increase (-decrease) in the Fund during the year		**1,184,153**	-733,836
Net Assets of the Fund at the start of the year		**3,521,496**	4,255,332
Net Assets of the Fund at the end of year		**4,705,649**	3,521,496

Net Assets Statement as at 31 March 2010

		2010 £'000	2009 £'000
Investments			
Other Investments	7	**318,224**	264,580
Equities		**1,903,013**	1,277,175
Managed and Unitised Funds		**2,126,946**	1,644,108
Derivative Contracts		**33**	130
Properties		**210,225**	199,535
Short Term Deposits		**56,207**	74,089
Other Investment Balances		**57,286**	41,453
		4,671,934	3,501,070
Current Assets	9	**46,631**	30,412
Current Liabilities	9	**12,916**	9,986
Net Assets of the Fund as at 31 March 2010		**4,705,649**	3,521,496

NOTES TO THE ACCOUNTS

1. General

Although the Scheme is exempt from the requirements of the Occupational Pension Schemes (Requirement to obtain Audited Accounts and a Statement from the Auditor) Regulations 1996, the financial statements have been prepared in accordance with these regulations and with the guidelines set out in the Statement of Recommended Practice, Financial Reports of Pension Schemes (the SORP) May 2007

The financial statements record the transactions of the Scheme during the year and summarise the net assets at the disposal of the Managers at the end of the financial year. They do not take account of obligations to pay pensions and benefits which fall due after the end of Scheme year. The actuarial position of the Scheme, which does take account of such obligations, is dealt with in the statement by the Actuary on pages 00 to 00 and these financial statements should be read in conjunction with it.

2. Accounting Policies

Basis of Preparation

The financial statements are prepared in accordance with applicable UK accounting standards and with the guidelines set out in the Statement of Recommended Practice, Financial Reports of Pension Schemes.

Valuation of Investments

Investments are stated at market value. For listed securities the stock exchange values are used. Such values are shown at bid price, i.e. the price which the Fund would have obtained should the securities have been sold at the year end.For this purpose unlisted investments, other than direct property are included at manager's valuation. Valuations of UK private equity are consistent with the guidelines and conventions of the British Venture Capital Association. Properties have been valued independently by Colliers Erdman Lewis, Chartered Surveyors as at 31 March 2010. Some investments, such as limited partnerships, are not readily realiseable.

Translation of foreign currencies

Assets and liabilities in foreign currencies are translated into sterling at rates ruling at the year end. Foreign income received during the year is translated at the rate ruling at the date of receipt. All resulting exchange adjustments are included in the revenue account.

Investment income

Interest on fixed interest stocks and on short term deposits has been accounted for on an accruals basis. Income from equities is accounted for when the related investment is quoted "ex-dividend".

Rental income

Rental income from properties is taken into account by reference to the periods to which the rents relate and is shown net of related expenses. The Fund accrues rent up to 24 March each year. Rent received on the Quarter Day, 25 March, is accounted for in full in the following year.

Contributions and benefits

Contributions are accounted for on an accruals basis. Benefits payable represent the benefits paid during the financial year and include an estimated accrual for lump-sum benefits outstanding as at the year end. Augmentation payments due from employers in future years are now accrued for, which represents a change in acccounting policy.

Transfers to and from other schemes

Transfer payments relate to those early leavers whose transfers have been paid during the year plus an accrual for future payments in respect of members moving their service to other schemes under bulk transfer arrangements. One bulk transfer into MPF is included in 2009/10, for which a cash payment will be received.

Investment Management Expenses

In accordance with the SORP, costs in respect of the internal investment team are classified as investment management expenses rather than as administrative expenses.

Prior Period Adjustments

There has been no changes to the March 2009 totals of the Fund Account or its Net Asset Statement. However four Prior Period Adjustments have been made, which net out to nil. Note 3 to the Accounts shows a more detailed analysis of Contributions Receivable. Administration Income is now shown separately within the Fund account, with a subsequent reduction in the figure of Investment Income (note 6). Also in note 6, greater analysis is provided of the sources of investment income. Finally, in Note 7 (Investments) the £24m of the market value as at 31 March 2009 of the North American portfolio has been re-attributed to "Equities" from "Managed and Unitised Funds".

3. Contributions Receivable

		2010	2009
		£'000	£'000
Employers			
Normal		**164,996**	158,778
Augmentation		**522**	134
Pension Strain		**23,811**	11,859
Deficit Funding		**316**	7,568
Compensatory Added Years		**12,183**	8,000
Employees			
Normal		**60,828**	59,637
		262,656	245,976
relating to :	Administering Authority	**40,981**	36,524
	Statutory Bodies	**185,133**	167,958
	Admission Bodies	**36,542**	41,494
		262,656	245,976

"Augmentation" represents payments by employers to the Fund for the costs of additional membership benefits awarded under LGPS regulations. An accrual has been made for agreed future payments to the Fund.

"Pension Strain" represents the cost to employers when their employees retire early to compensate the Fund for the reduction in contribution income and the early payment of benefits. Payments to the Fund for such costs are made over agreed periods. An accrual has been made for agreed future payments to the Fund.

"Deficit Funding" represents additional payments by employers to reduce a past service deficit, thereby potentially reducing their future contribution rates. Such payments may be made either as lump sum payments (nil 2009/2010, £8m in 2008/2009) or as regular additional contributions.

"Compensatory Added Years" represents re-imbursements by employers to the Fund for additional pension payments awarded under the Local Government (Early Termination of Employment)(Discretionary Compensation) Regulations 2000. Such pensions payments lie outside the LGPS regulations, with the Fund acting as agent for such payments. The equivalent additional pension payments are included in "Pensions" in Note 4.

4. Benefits Payable

		2010	2009
		£'000	£'000
Pensions		**185,968**	173,545
Lump Sum Retiring Allowances		**41,260**	35,387
Lump Sum Death Benefits		**4,090**	3,544
		231,318	212,476
relating to :	Administering Authority	**34,053**	29,784
	Statutory Bodies	**166,898**	156,773
	Admission Bodies	**30,367**	25,919
		231,318	212,476

5. Payments to and on Account of Leavers

Refunds to members leaving service	**41**	21
Payment for members joining state scheme	**2**	25
Income for members from state scheme	**-7**	-29
Individual transfers to other schemes	**19,622**	15,104
	19,658	15,121

6. Investment Income

Dividends from Equities	**53,650**	40,740
Income from Associate and Joint Ventures	**1,732**	7,410
Income from Managed and Unitised Funds	**7,730**	2,147
Net Rents from Properties	**18,734**	16,419
Interest on Deposits	**1,279**	3,927
Other	**899**	486
	84,024	71,129

6. Investment Income (continued)

A net nil Prior Period Adjustment has been made to reflect the separate disclosure in the main Fund Account of income attributed to "Administration", reducing the "Other" amount for 2008-2009 by £83m.

Figures of 'Dividends from Equities" and "Income from Managed and Unitised Funds' are now shown separately. Within these headings is included recoverable taxation of £1.27m, (2008/09 £0.65m). Income from profits from associate and joint ventures of £1.7m (2008/09 £7.41m) is now shown separately. Irrecoverable taxation amounted to £2.35m (2008/09 £2.64m).

The Fund is seeking to recover tax witheld by UK and overseas tax regimes under the EU principle of free movement of capital within its borders, but is not accruing for future receipt of such income within these accounts. In 2009-2010 £225,000 was recovered, gross of fees.

As at 31 March 2010, £88.4m of stock was on loan to market makers, which was covered by non-cash collateral totalling £93.6m, giving a margin of 5.7%. Income from stock lending is included within 'Other' Investment Income".

7. Investments

	Market Value @ 31.3.09	Purchases at cost and derivative payments	Sale Proceeds and derivative receipts	Change in Market Value*	**Market Value @ 31.3.10**
	£'000	£'000	£'000	£'000	**£'000**
Equities	1,277,175	782,528	743,826	587,136	**1,903,013**
Managed and Unitised Funds	1,644,108	69,749	41,770	454,859	**2,126,946**
Other	264,580	89,988	67,082	30,738	**318,224**
Derivative Contracts	130	1,386	1,690	207	**33**
Properties	199,535	2,619	2	8,073	**210,225**
	3,385,528	**946,270**	**854,370**	**1,081,013**	**4,558,441**
Short Term Deposits	74,089			233	56,207
Other Investment Balances	41,453			-1,144	57,286
	3,501,070			**1,080,102**	**4,671,934**

*Note: The change in market value of investments during the year comprises all realised and unrealised appreciation and depreciation.

The North American mandate is now separated out into "Equities" for the segregated Canadian holdings (some 8%) and "Managed and Unitised Funds" (some 92%) as at both March 2009 and March 2010.

Equities (segregated holdings)	**2010 £'000**	2009 £'000
UK Quoted	802,580	550,034
Overseas Quoted	1,100,433	727,141
	1,903,013	1,277,175

Managed* and Unitised Funds	**2010 £'000**	2009 £'000
UK Fixed Interest	**0**	172,351
UK Corporate Bonds	**0**	156,438
Overseas Fixed Interest	**0**	0
Unconstrained Bonds	**359,907**	0
Index-Linked Securities	**477,650**	442,823
UK Equities	**644,224**	417,468
Overseas Equities	**365,421**	250,760
Unlisted Securities (Private Equity)	**191,905**	145,314
Property Unit Trusts	**87,839**	58,954
	2,126,946	1,644,108

*All fixed interest/band holdings are in managed and unitised funds. Other than Corporate Bonds, other fixed interest holdings are public sector securities.

	2010 £'000	2009 £'000
Derivative Contracts	**33**	130

Type of Derivative

Futures	Expiration	Economic Exposure	Market Value
DJ Euro STOXX 50 Index Futures	June 2010	**330**	33

A Futures contract is the obligation under a legal arrangement to make or take delivery of a specified instrument at a fixed future date, at a price determined at the time of dealing. Merseyside Pension Fund's index futures contracts are externally managed and thier objective is to hedge overseas investment postions against adverse index movements. Futures dealing requires the posting of margin. Initial margin which must be posted before you can trade and variation margin, the mark-to-market value of the futures contracts you have. Variation margin is exchanged daily and exists to reduce counterparty credit exposure. Collateral is held in Euro currency and the Sterling equivalent amount is £33,092.

	2010 £'000	2009 £'000
Other Investments	**318,224**	264,580
UK Properties		
Freehold	**190,574**	182,038
Leasehold	**19,651**	17,497
	210,225	199,535
Short Term Deposits	**56,207**	74,089

Short-term deposits only cover cash balances held by the Fund. Cash held by investment managers awaiting

	2010 £'000	2009 £000
Other Investment Balances		
Amounts due from brokers	**33**	858
Amounts due to stockbrokers	**-5,607**	-22,413
Amounts due from stockbrokers	**6,636**	19,171
Outstanding dividend entitlements and recoverable withholding tax	**12,796**	6,110
Cash deposits	**43,428**	37,727
	57,286	41,453

'Other Investment Balances' include amounts due to and from stockbrokers and also cash with managers awaiting investment.

Disclosure Note Re: Transaction Costs

Transaction costs include fees and commisions paid to agents, advisers, brokers and dealers, levies by regulatory agencies and securities exchanges, transfer taxes and duties. They have been added to purchases and netted against sales proceeds as appropriate. Transaction costs during the year amounted to £1.966m. In addition to these costs, indirect costs are incurred through the bid-offer spread on investments in pooled vehicles. The amount of indirect costs is not provided directly to the Fund.

Disclosure Note Re: Icelandic Deposits

Early in October 2008, the Icelandic banks collapsed and their UK subsidiaries went into administration. The Fund had £5m deposited with Glitnir Bank at an interest rate of 6.30% which was due to mature 15 October 2008 and £2.5m deposited with Heritable Bank at an interest rate of 5.94% which was due to mature 10 December 2008.

All monies within these institutions are currently subject to the respective administration and receivership processes. The amounts and timing of payments to depositors such as the Fund will be determined by the administrators/receivers.

The current situation with regards to recovery of the sums deposited varies between each institution. Based on the latest information available the Fund has given consideration to an impairment adjustment for the deposits, and has taken the action outlined below. As the available information is not definitive as to the amounts and timings of payments to be made by the administrators/receivers, it is likely that further adjustments will be made to the accounts in future years.

Glitnir Bank hf

Glitnir Bank hf is an Icelandic entity. Following steps taken by the Icelandic Government in early October 2008 its domestic assets and liabilities were transferred to a new bank (New Glitnir) with the management of the affairs of Old Glitnir being placed in the hands of a resolution committee. Old Glitnir's affairs are being administered under Icelandic law. The Glitnir Winding-Up Board has expressed the view that local authority deposits do not have priority status. However, legal advice to local authorities' remains that deposits do have priority status under Icelandic law and decisions on priority status of local authority deposits will be made by the Icelandic courts.

The expected recovery rate for claims that have priority status is 100%. Full recovery is subject to the following uncertainties and risks:

• Confirmation that local authority deposits enjoy preferential creditor status, which is to be tested through the Icelandic Courts.

• The impact of exchange rate fluctuations on the value of assets recovered by the resolution committee and on the settlement of the Fund's claim, which may be denominated wholly or partly in currencies other than sterling.

Therefore the Fund has followed the latest Local Authority Accounting Panel recommendation that the estimated recoverable amount is based on the assumption that local authority deposits will enjoy priority status. The Fund therefore continues to assume the future recovery on the full amount of principal and interest up to 22 April 2009. However, an impairment is now made to reflect the loss of interest to the Fund until the funds are repaid.

Failure to secure preferential creditor status would have a significant impact upon the amount of the deposit that is recoverable. Therefore, if preferential creditor status is not achieved the recoverable amount is approximately 29%. No payment is expected to be received prior to the court cases and any appeals in respect of priority status being heard. In calculating the impairment the Fund has assumed that the repayment of priority deposits will be made by June 2011. Recoveries are expressed as a percentage of the Fund's claim in the administration, which it is expected may validly include interest accrued up to 22 April 2009.

Heritable

Heritable Bank is a UK registered bank under English law. The company was placed in administration on 7 October 2008. The creditor progress report issued by the administrators Ernst and Young, dated 17 April 2009 outlined that the return to creditors was projected to be 80p in the £. To date the Fund has received three dividend payments totalling 34.98 pence in the £ which have exceeded the levels originally projected. The latest creditor progress report, dated January 2010 outlined that the return to creditors was projected to be 85p in the £. The Fund has therefore decided to decrease the impairment loss based on it recovering 85p in the £. In calculating the impairment the Fund has made the following assumptions re timing and recoveries:

June 2010	5%	September 2011	5%
September 2010	5%	December 2011	5%
December 2010	5%	March 2011	5%
March 2011	5%	June 2011	5%
June 2011	5%	September 2011	5%

Recoveries are expressed as a percentage of the Fund's claim in the administration, which includes interest accrued up to 6 October 2008.

The impairment loss recognised in the Fund Account in 2009/10, £475,532 has been calculated by discounting the assumed cash flows at the effective interest rate of the original deposit in order to recognise the anticipated loss of interest to the Fund until monies are recovered.

Adjustments to the assumptions will be made in future accounts as more information becomes available.

8. Investment Management Expenses

Fees paid to the eleven major investment managers amount to £8.2m, and constitute the bulk of the figure of £9.7m investment management expenses. Charges vary between fund managers and between markets and types of security. Charges are calculated as a percentage of the value of the investments. Internal investment management expenses are also included here.

9. Current Assets and Liabilities

	2010	2009
	£'000	£'000
Assets		
Contributions due	**33,357**	20,885
Accrued and outstanding investment income	**234**	847
Transfer values receivable	**1,700**	2,357
Cash at bank	**724**	725
Retirement Grants paid in advance	**1,726**	0
Sundries	**9,039**	6,071
Provision for bad debts	**-149**	-473
	46,631	30,412
Liabilities		
Transfer values payable	**0**	0
Retirement Grants due	**1,647**	4,080
Provisions	**596**	541
Miscellaneous	**10,673**	5,365
	12,916	9,986
Total Other Assets and Liabilities	**33,715**	20,426

"Sundries" mainly covers general debtors, property arrears due, agent's balances and recoverable taxation.

"Provision for Bad Debt" relates to property rental income.

The main components of "Miscellaneous Liabilities" are the outstanding charges for investment management fees, payable quarterly in arrears, custodial and actuarial fees, plus income tax due, pre-paid rent and administering authority re-imbursement.

10. Commitments

Commitments for investments amounted to £194.017m as at 31 March 2010.

11. Related Party Transactions

Administration and investment management costs include charges by Wirral Council in providing services in its role as administering authority to the Fund, which amount to £3.838m (2009 £3.511m). Such charges principally relate to staffing required to maintain the pension service.

A specific declaration has been received from Pension Committee Members and principal officers regarding membership of, and transactions with, such persons or their related parties. A number of Members act as Councillors or Board members of particular scheme employers, listed below, who maintain a conventional employer relationship with the Fund:

Liverpool City Council, Knowsley Council, Sefton Council and St Helens Borough Council, all of whose Councillors may become scheme members, Wirral Council, Liverpool John Moores University, CDS Housing, and Wirral Partnership Homes. The value of the transactions with each of these related parties, namely the routine monthly payments to the Fund of employers' and employees' contributions, is determined by the Local Government Pension Scheme Regulations, and as such no related party transactions have been declared.

The Fund invested £20.1m in Bramdean Alternatives in periods between its initial placing in July 2007 and November 2008. Following a change of management, the company is now known as Aberdeen Private Equity Fund (APEF). As at 31 March 2010, the Fund's holdIng in APEF, which represented 15.1% of the issued share capital of the company, was valued at £10.9m. Philip Hebson, Senior UK Investment Manager at the Fund, was appointed a non-executive Director of Aberdeen Private Equity Fund on 23 December 2009, for which he received a fee.

Patrick Dowdall, Investment Manager - Alternatives, acts in an un-remunerated advisory capacity on 5 investment bodies in which the Fund has an interest, Standard Life (£6.3m), F&C (£3.6m) and Zeus (£3.1m), by whom travel expenses and accommodation were paid, plus Key Capital (£1.5m) and Enterprise (£0.3m). As such no related party transactions have been declared.

12. Summary of Managers Portfolio Values as at 31 March 2010

	2010 £'m	%
Externally Managed		
JP Morgan	**177**	3.8
UBS	**381**	8.2
Nomura	**647**	13.9
Schroders	**177**	3.8
Legal & General (Pooled Assets)	**941**	20.2
Legal & General (Bonds)	**183**	3.9
Unigestion	**138**	3.0
M&G	**146**	3.1
TT International	**139**	3.0
Blackrock	**143**	3.1
Newton	**122**	2.6
	3,194	68.6
Internally Managed	1,477	31.4
	4,671	100.0

13. Additional Voluntary Contribution Investments

The Committee holds assets invested separately from the main fund. In accordance with regulation 5 (2) (c) of the Pensions Schemes (Management and Investment of Funds) Regulations 1998, these assets are excluded from the Pension Fund accounts.

The Scheme providers are Equitable Life, Standard Life and Prudential. Individual members participating in this arrangement each receive an annual statement confirming the amounts held on their account and the movements in the year. As requested by the Local Authority Statement of Recommended Practice an aggregate breakdown between contributions, repayments and change in market value is also shown.

	2010 £000	2009 £000
The aggregate amount of AVC investments is as follows :		
Equitable Life	**3,010**	3,076
Standard Life	**6,834**	5,833
Prudential	**4,400**	3,864
	14,244	12,773

Changes during the year were as follows:

Contributions	**1,575**
Repayments	**1,879**
Change in market values	**1,775**

14. Financial Performance

The Pension Fund is administered under a budget that is approved by Pensions Committee each January. That budget is reviewed and, if appropriate, revised the following January, based on the known and anticipated pattern of expenditure and market movements. In January 2009 a budget of £11.7m was approved for the financial year 2009/10. This was revised in January 2010 to £12.4m.

The two main elements of the budget were salaries and related costs of £2.8m and investment management fees of £6.9m. The final accounts for the year ended 31 March 2010 indicate expenditure levels of £3.96m on administrative costs overall and £10.25m on all investment management expenses. Investment management expenses include, as its main element, external managers' fees, but also cover custodian fees, advisors fes and performance measurement fees. Fees of external managers and the Fund's custodian are on ar ad valorem basis, and will therefore vary as the size of each portfolio changes. The overspend on external mananger fees reflects the significant increase in the value of the Fund during the year. In addition, in the final accounts, the salaries and related expenses of the internal investment team are, in accordance with the Pensions Statement of Recommended Practice (the SORP), shown within investment management expenses.

There is no budget as such for The Fund itself. The payment of pensions is in accordance with the Regulations. Receipts of employers' contributions are in accordance with the Triennial Valuation. Consequently, basic pensions transactions, eg. income from employers and employees contributions, benefits payable, transfers in and out are only contained in the fund account, and do not form part of the budget. However, the scale and timing of such transactions are taken into account for cash flow management purposes.

The Fund does reserve the right to levy interest charges on late receipt of contributions from employers. In 2009/10 no such charges were levied.

Background Information

Merseyside Pension Fund operates the Local Government Pensions Scheme (LGPS) which provides for the occupational pensions of employees (other than teachers, police officers and fire fighters) of the local authorities within the Merseyside Area. The current contributing employers are shown below. As at 31 March 2010, there were 50,776 active members, 40,935 pensioners and 28,848 deferred beneficiaries.

The overall responsibility for the management of the Fund rests with the Pensions Committee, which for 2009/10 included 10 councillors from Wirral Council, the Administering authority, plus one councillor from each of the 4 other Borough Councils, and one member representing the other employers in the scheme. Representatives of trade unions also attend. The more detailed consideration of investment strategy and asset allocation of the Fund’s portfolios is considered by the Investment Monitoring Working Party, which includes an external adviser and a consultant.

The Pensions Committee annually reviews its Statement of Investment Principles. The principles ensure that the Fund's investments would continue to be determined by all relevant considerations including the Council's fiduciary duty to employing bodies and the Council taxpayer, rate of return, risk, environmental, social and governance considerations rather than a blanket policy of disinvestment from any specific industry or sector. The latest review was in March 2010, and is available on the Fund’s website merseysidepensionfund.org.uk.

Under the LGPS Regulations, employer contributions are calculated by the Fund’s actuary, having regards to the assumptions and methodology set out in the Fund’s Funding Strategy Statement (FSS). The most recent Triennial Valuation by the actuary was as at 31 March 2007, when the funding level was 80% of projected actuarial liabilities. The funding objective is to achieve and then maintain assets equal to the funding target. The funding target is the present value of 100% of projected accrued liabilities, including allowance for projected final pay. The FSS specifies a maximum period for achieving full funding of 25 years.

The funding method adopted is the projected unit method, which implicitly allows for new entrants replacing leavers.

The table below sets out the summary of the market (gilts) yields at the valuation date, together with the yields at the date of the previous valuation:

	31-Mar-07	31-Mar-04
Long-dated gilt yield	4.40%	4.60%
Long-dated index-linked gilt yield	1.30%	1.80%
Market expectation for inflation (long term)	3.10%	2.80%

The assumptions to which the valuation results are particularly sensitive are shown below:

	2007 Funding Target
Investment Return pre-retirement	6.40%
Investment Return post-retirement	5.40%
Salary increases	4.35%
Pension increases in payment	3.10%
Non-retired members mortality	*PA92 MC YoB tables + 2 years*
Retired members mortality	*PA92 MC YoB tables + 2 years*

The outcomes of the next Triennial Valuation, as at March 2010 are expected in the Autumn of 2010.

SCHEME EMPLOYERS WITH ACTIVE MEMBERS AS AT 31 MARCH 2010

SCHEDULED BODIES

Academy of St Francis
Arena & Convention Centre Liverpool
Belvedere Academy
Birkenhead Sixth Form College
Carmel College
Halewood Parish Council
Hugh Baird College
King George V College
Knowsley Community College
Knowsley M.B.C.
Knowsley Parish Council
Liverpool City Council
Liverpool Community College
Liverpool John Moores University
Merseyside Fire & Rescue Authority
Merseyside Integrated Transport Authority (MITA)
Merseyside Passenger Transport Executive (MPTE)
Merseyside Police Authority
Merseyside Waste Disposal Authority
National Probation Service
North Liverpool Academy Ltd
Prescot Town Council
Rainford Parish Council
Rainhill Parish Council
Sefton M.B.C.
Southport College
St. Helens Community College
St. Helens M.B.C.
Valuation Tribunal Service
Whiston Parish Council
Wirral Council
Wirral Metropolitan College

ADMISSION BODIES

Age UK - Liverpool
Arriva North West
Arvato Government Services
Association of Police Authorities
Balfour Beatty Workplace Ltd
Beechwood and Ballantyne Housing Association
Beechwood Educare Centre
Berrybridge Housing Ltd
Birkenhead Citizens Advice Bureau
Birkenhead Market Services Ltd
Birkenhead School (2002)
Blue Coat School
Burton Manor Residential College
Capita Symonds (Sefton)
Catholic Children's Society
CDS Housing
Cobalt Housing Ltd
COLAS
Care Quality Commission
Compass (Scolarest) Liverpool Schools
Compass (Scolarest) Wirral Schools
Comtechsa Limited
Enterprise Liverpool Cleansing
Enterprise (Liverpool Highways) Ltd
Enterprise-Liverpool Limited
Enterprise Liverpool Neighbourhood Grounds
Geraud Markets Liverpool Ltd
Glendale (Liverpool Parks Services) Ltd
Glenvale Transport Ltd/Stagecoach.
Greater Hornby Homes
Greater Merseyside Connexions
Helena Partnerships Ltd.
Higher Education European Funding Services Ltd.
Hochtief Liverpool Schools
Hochtief Wirral Schools
Kingswood Colomendy Ltd.
Knowsley Housing Trust
LACORS
Lairdside Communities Trust
Lee Valley Housing Association Ltd
Liberata (UK) Ltd.
Liverpool Association for the Disabled
Liverpool Church of England Council for Social Aid
Liverpool Citizens Advice Bureau
Liverpool Hope University
Liverpool Housing Trust
Liverpool Mutual Homes Ltd.
Liverpool Vision Limited
Local Government Association
Merseyside Lieutenancy
Merseyside Society for the Deaf
Merseyside Welfare Rights
Merseyside Youth Association
Mott Macdonald (M.I.S.)
Mouchel (2020 Liverpool/Parkman)
Mouchel (2020 Knowsley Ltd)
Netherley Citizens Advice Bureau
North Huyton New Deal New Future
North Liverpool Citizens Advice Bureau
Novas Group
Nugent Care
One Vision Housing Ltd.
Partners Credit Union
Sefton Education Business Partnership
Sefton New Directions Ltd.
South Liverpool Housing Ltd
Southern Neighbourhood Council
Taylor Shaw Catering (St Wilfred's RC School)
Taylor Shaw New Heys School
The Port Sunlight Village Trust
University of Liverpool
Upton Hall Convent
Vauxhall Neighbourhood Council
Village Housing Association Ltd
Wavertree Citizens Advice Bureau
Welsh Local Government Association
Wirral Autistic Society
Wirral Council Voluntary Service
Wirral Partnership Homes Ltd

WIRRAL COUNCIL

PENSIONS COMMITTEE

27 SEPTEMBER 2010

REPORT OF THE DIRECTOR OF FINANCE

MERSEYSIDE PENSION FUND: DRAFT ANNUAL REPORT

1. EXECUTIVE SUMMARY

1.1 This report advises Members of the proposed content of the Annual Report for 2009-10, a copy of which will be available at Committee. It needs to be read in conjunction with the separate report on the Statement of Accounts included elsewhere on this agenda.

2 BACKGROUND

2.1 Regulation 34 of the Local Government Pension Scheme (LGPS) (Administration) Regulations 2008 requires MPF to produce an Annual Report for the year to 31 March by 1 December of that year. Traditionally MPF has produced an Annual Report in time for the Annual Employers Conference each November.

2.2 The LGPS Administration Regulations also require the Pension Fund Annual Report to contain the Fund Account and Net Asset Statement with supporting notes and disclosures, prepared in accordance with proper practices.

2.3 The Audit Commission wishes to review the Annual Report along with the Accounts prior to presenting the Annual Governance Report (AGR) to the Pensions Committee and then to the Audit and Risk Management Committee.

2.4 International Standard on Auditing (UK and I) 700 requires that the auditors read any information published with the accounts. It also states that the auditor should not issue an opinion until that other information is published.

2.5 Although the content of non-financial information in the draft Annual Report is considered final, subject to receipt of the Auditor opinion, the audited accounts and the inclusion of details of holdings representing 5% or more of Fund assets, the Annual Report layout and presentation is yet to be finalised.

2.6 Although draft guidance on the production and content of the Annual Report was released in July 2009, final guidance has not yet been received, and the draft guidance is accepted as non-mandatory.

3 FINANCIAL AND STAFFING IMPLICATIONS

3.1 There are no implications as a result of this report.

4. **EQUAL OPPORTUNITY/EQUALITY IMPACT ASSESSMENT**

4.1 There are no implications arising directly from this report.

5. **HUMAN RIGHTS IMPLICATIONS**

5.1 There are none arising directly from this report.

6. **COMMUNITY SAFETY IMPLICATIONS**

6.1 There are no specific implications arising from this report.

7. **LOCAL MEMBER SUPPORT IMPLICATIONS**

7.1 There are no specific implications for any Member or Ward.

8. **LOCAL AGENDA 21 IMPLICATIONS**

8.1 There are no specific implications arising from this report.

9. **PLANNING IMPLICATIONS**

9.1 There are no specific implications arising from this report.

10. **BACKGROUND PAPERS**

10.1 LGPS (Administration) Regulations 2008.

11. **RECOMMENDATION**

11.1 That the Committee notes the content of the Annual Report.

IAN COLEMAN
DIRECTOR OF FINANCE

FNCE/188/10

Annual Governance Report

Merseyside Pension Fund

Audit 2009/10

September 2010

Contents

Status of our reports

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. Reports prepared by appointed auditors are addressed to non-executive directors/ members or officers. They are prepared for the sole use of the audited body. Auditors accept no responsibility to:

- any director/member or officer in their individual capacity; or
- any third party.

Ladies and Gentlemen

2009/10 Annual Governance Report

I am pleased to present the final version of my report on the results of my audit work for 2009/10.

I discussed and agreed a draft of the report with the Director of Finance on 7 September 2010 and updated it as issues have been resolved.

My report sets out the key issues that you should consider before I complete the audit.

It asks you to:

- consider the matters raised in the report before recommending the approval of the financial statements to the Audit and Risk Management Committee (ARMC) (pages 4 to 11);
- take note of the adjustments to the Pension Funds accounts set out in this report (Appendix 2);
- agree to adjust the errors in the financial statements I have identified, which management has declined to amend or set out the reasons for not amending the errors; (Appendix 3);
- approve and recommend to the ARMC the letter of representation on behalf of the Council before I issue my opinion and conclusion (Appendix 4); and
- agree your response to the proposed action plan (Appendix 5).

Yours faithfully

Michael Thomas
District Auditor

27 September 2010

Key messages

This report summarises the findings from the 2009/10 audit which is substantially complete. It includes the messages arising from my audit of your financial statements.

Financial statements	Results	Page(s)
Unqualified audit opinion	Yes	7
Pre-audit financial statements free from material error	No	7-8
Post-audit financial statements free from material error	Yes	7-8
Weakness in internal control	Yes	8-9

Audit opinion

1 I have now substantially completed my audit work and subject to the clearance of outstanding matters I propose to give an unqualified opinion on your financial statements. My draft report for the Annual Report is attached in Appendix 1.

Financial statements

2 The financial statements were submitted on 22 June and were supported by adequate working papers prepared by Pension Fund finance staff. These were received week commencing 29 June.

3 The audit has identified two material adjustments, which have been amended in the accounts, and which I draw your attention in respect of your governance responsibilities:

- in Note 7 to the statements £168 million and £148 million of transfers were incorrectly classified as purchases and sales; and
- in Note 7 to the statements £30 million of segregated Canadian holdings were incorrectly classified Managed and Unitised Investments rather than Equities.

4 The Director of Finance has agreed to adjust the financial statements for these material errors and a number of non-material errors which are identified at Appendix 2.

5 There is one unadjusted error which I draw to your attention at Appendix 3. We seek specific assurances from management in the Letter of representation for the reason for not adjusting the error.

Audit fees

6 My initial fee proposals were communicated to you in my Audit Plan for 2009/10. These were updated in my Progress Report of 28 June 2010.

7 Following completion of the audit I am satisfied that the revised audit fee of £54,065 remains appropriate and no adjustment is required.

Independence

8 I can confirm that the audit has been carried out in accordance with the Audit Commission's policies on integrity, objectivity and independence.

Next steps

This report identifies the key messages that you should consider before I issue my opinion on the Pension Fund's accounts, which forms part of my report on the Council's financial statements. It includes only matters of governance interest that have come to my attention in performing my audit. My audit is not designed to identify all matters that might be relevant to you.

9 I ask the Pension Committee to:

- Consider the matters raised in the report before recommending the approval of the financial statements to the Audit and Risk Management Committee (ARMC) (pages 4 to 11)
- take note of the adjustments to the Pension Fund 's accounts which are set out in this report (Appendix 2);
- agree to adjust the errors in the financial statements I have identified that management has declined to amend or set out the reasons for not amending the errors (Appendix 3);
- consider and recommend the letter of representation to the Council before I issue my opinion and conclusion (Appendix 4); and
- agree your response to the proposed action plan (Appendix 5).

10 I will ask the ARMC to consider the recommendation of the Pension Committee in relation to this report before it:

- considers the matters raised in this report before approving the Council's financial statements;
- takes note of the adjustments to the financial statements which are set out in this report;
- approves the letter of representation before I issue my opinion; and
- agrees a response to the proposed audit plan.

Financial statements

The Pension Fund's accounts are important means by which the Fund accounts for its stewardship of public funds. The Council has a final responsibility for these statements. It is important that you consider my findings before you adopt the financial statements and the annual governance statement.

Opinion on the financial statements

11 Subject to satisfactory clearance of outstanding matters, I plan to issue an audit report including an unqualified opinion on the financial statements. Appendix 1 contains a copy of my draft audit report. The outstanding matters are:

- Review of the Annual Report.
- Completion of the following items of testing:
  - Pension Contributions (Augmentation and Lump sums); and
  - Administration expenses.
- Review of the amended statements.

Errors in the financial statements

12 The financial statements were submitted to audit supported by adequate working papers on 22 June. Officers were available throughout the audit to respond to queries.

13 I have identified a number of material errors which I draw to your attention below. We are required to report to Committee on all errors that are over the trivial level which is £234, 000 representing 1 per cent of the materiality level.

14 The Director of Finance has agreed to adjust the errors identified at Appendix 2.

15 The two material errors are summarised below:

- Within the two Bond Mandates amounts of £168 million and £148 million were recorded as purchases and sales in the ledger, with these sums being carried forward into the Statement of Accounts. These amounts were internal transfers and not actual transactions and as such their inclusion in Note 7 to the accounts is inappropriate. Purchases and sales of investments are being amended to exclude these amounts.
- The UBS North American portfolio (£381 million) consists of £351 million in a managed fund of US investments plus £30m of segregated Canadian equity holdings. The analysis to Note 7 within the accounts shows the full value of these investments has been included within Managed and Unitised Funds in error. The £30 million of holdings is being reclassified in note 7 to Equities.

16 In addition there are a number of non material errors and uncertainties in respect of investment valuation and contributions from employers and employees. These are shown at Appendix 2.

17 There are also a number of areas where disclosure notes and narrative have been amended. These are also noted at Appendix 2.

Recommendation	
R1	Strengthen internal quality control to ensure errors in the financial statements are minimised.

Important weaknesses in internal control

18 The Pension Fund has not carried out reconciliations between the values in the AXISe Pension Payroll and membership administration systems, to those in the General Ledger. These are essential procedures which are intended to give the Fund assurance that transactions recorded in the Fund Account are correctly stated as well as providing controls assurance over receipts and payments in a number of key areas. MPF is currently unable to reconcile between these systems due to timing issues. I have gained my assurance through substantive testing. Management should ensure that procedures are put in place to enable future reconciliation between the systems.

19 Regulation 42(2) of the Local Government Pension Scheme Regulations 2008 requires employer authorities to pay employee contributions to the administering authority within 19 days of the end of the month to which they relate. My review of contributions receipts from employers found that whilst most bodies pay on time, some smaller bodies missed these deadlines regularly, therefore breaching the regulations. We note that the habitual late payers are employers with few employees and therefore do not represent a material risk to the Fund. However this represents a control weakness which we are obliged to report to you.

20 The SORP requires the valuation of investments to be at market value or where the value is not readily ascertainable, at the Fund's estimate of ‘fair value’. The Pension Funds accounting policies describe the methodology used for these investments as ‘at manager's valuation’ and the process followed for both alternatives and private equity relies on valuations reports provided by the investment managers and/or administrators. Guidance issued by Pensions Research Advisory Group (PRAG) stresses the need for Fund managers to undertake due diligence in determining the fair value of investments and highlights the inverse relationship between the ease with which investments can be valued and the amount of due diligence required.

21 The Pension Funds private equity valuation process relies on monitoring undertaken by Capital Dynamics Ltd under an arrangement dating back to 1991. Our review of the contract has identified that:

- the contract is with Crossroads Management UK Ltd - this is a predecessor organisation pre dating Capital Dynamics Ltd (and Westport);
- it specifies an annual charge of £52,500 for the service provided - no such payment has been made for many years (probably ten years+); and
- the service to be provided relates to advising on strategy and investments, and monitoring progress. This monitoring was to be based on managers' reports and the Crossroads database - there is no specific valuation service specified.

The Pension Fund has confirmed that the current arrangements are unchanged from those specified in the 1991 document. The service provided by Capital Dynamics Ltd is limited in terms of assurance for valuation of the portfolio and is inadequate, both because of the uncertain legal status of the contractual arrangements and the scope of the service provided.

The Pension Fund should review the contractual arrangements with Capital Dynamics Ltd if it continues to place reliance upon the valuation of the private equity portfolio.

Recommendation	
R2	Carry out regular reconciliations between the Pensions Payroll (AXISs) and the general ledger.
R3	Strengthen procedures to monitor timely receipt of employers' contributions and take action where appropriate.
R4	Review and improve arrangements for due diligence over annual investments valuation.
R5	The Pension Fund should review the contractual arrangements with Capital Dynamics Ltd if they continue to place reliance upon the valuation of the private equity portfolio.

Letter of representation

22 Before I issue my opinion, auditing standards require me to ask you and management for written representations about your financial statements and governance arrangements. Appendix 4 contains the draft letter of representation.

23 I am seeking specific representation from you concerning an unadjusted error of £12 million for receipts and payments relating to Compensatory Added Years (detailed in Appendix 3)

Key areas of judgement and audit risk

24 In planning my audit I identified specific risks and areas of judgement that I have considered as part of my audit.

Table 1 Key areas of judgement and audit risk

Issue or risk	Finding
A new investments ledger maintained by the State Street Bank, the Fund's global custodian, was introduced in 2008/09. However, the Fund's officers still rely upon a combination of the SSB Investment Ledger and data from the former Shareholder Investment Ledger system. Shareholder continues to be relied on for alternatives, ventures and property. There is a risk that sourcing the accounts from two investment ledger systems operating in parallel will lead to inaccuracy, duplication or omission from the financial statements.	We have gained adequate assurance from our substantive testing that the investments in the financial statements are materially correct. However, the Fund continues to rely on reports from both of these systems both to monitor and record investment transactions and to produce the annual accounts
A new general ledger accounting system was implemented at Merseyside Pension Fund with effect from 1st October 2009. There is a risk that the balances are not accurately transferred between systems and that effective controls will not be in place in the new system.	We have tested the transfer of balances between the two systems and have adequate assurance that the balances have been accurately transferred and that controls are operating effectively.
A total of 16 (non trivial) errors and adjustments were identified and corrected during the 2008/09 audit, including five material errors. We also identified four errors in the disclosure notes, one of which was a material adjustment.	There continue to be a high number of errors and misstatements identified in the Pension Fund account. I have recommended that the Pension Fund strengthens its internal control arrangements to ensure that the number of errors and misstatements are minimised.
The 2008/09 audit identified a failure by a member to provide the necessary related party disclosure declaration. There is a risk of non disclosure of related party relationships or transactions.	All members have provided related party disclosures for 2009/10. Related party transaction note in the draft set of accounts did not fully comply with the requirements of the Pensions SORP, but has since been amended. The detail of this is provided in Appendix 2.

Issue or risk	Finding
Increased risk of fraudulent financial reporting due to the current economic climate and increased financial pressures	We have not identified any incidences of fraud in our testing.
The Pension Fund and Council must produce its accounts by the end of June and we have planned for most of our work to be completed during July 2010. Consequently, a delay in producing either the accounts or necessary supporting working papers will impact on our ability to complete the audit by the deadline and report to members.	We were provided with the draft statements on 22 June 2010. The working papers were received week commencing 28 June. The audit is substantially complete and the Annual Governance Report was agreed with officers on 7 September 2010.
A significant proportion of the Pension Fund's investments (in excess of £2 billion) are held in unlisted investments such as pooled investment vehicles and limited partnerships. The valuation of such investments is complex as they not quoted or exchange traded. There is a risk in the current financial environment that the valuation of such investments could be misstated.	Our substantive testing did not identify any material errors in the valuation of unquoted investments. However we have made a recommendation (R4 provides detail) regarding the due diligence carried out on Investment valuations.
The LGPS Management and Investment of Funds Regulations 2009 came into force on 1 January 2010. Key changes include the banking arrangements between Administering Authorities and Pension Funds, and limits on investments.	Our review of laws and regulations has confirmed compliance against the LGPS Management and Investment of Funds Regulations 2009.

Accounting practice and financial reporting

25 I consider the non-numeric content of your financial reporting. Within this I am required to consider the overall balance and clarity of the information contained in information published with the financial statements.

26 The LGPS (Administration) Regulations 2008 specify that copies of the current Governance Compliance statement, Statement of Investment Principles, Funding Strategy Statement and Communications policy be included in the Annual Report. The draft version produced (August 2010) referred to these documents on p 6, but copies are not included, neither is there any reference to where a copy may be found (for example, website). I am advised that reference to where these documents can be found will be made in to the final version.

27 As set out in paragraph 11 I am yet to receive and review the final Annual Report so am unable to report fully on the balance and clarity of the information contained within it.

Glossary

Audit closure certificate

28 A certificate that I have completed the audit following statutory requirements. This marks the point when I have completed my responsibilities for the audit of the period covered by the certificate.

Audit opinion

29 On completion of the audit of the accounts, auditors must give their opinion on the financial statements, including:

- whether they give a true and fair view of the financial position of the audited body and its spending and income for the year in question;
- whether they have been prepared properly, following the relevant accounting rules; and
- for local probation boards and trusts, on the regularity of their spending and income.

Qualified

30 The auditor has some reservations or concerns.

Unqualified

31 The auditor does not have any reservations.

Appendix 1 – DRAFT Independent auditor's report on Merseyside Pension Fund to Members of Wirral Borough Council

Independent auditor's report to the Members of Wirral Borough Council

1 I have audited the Pension Fund accounting statements for the year ended 31 March 2010. The Pension Fund accounting statements comprise the Fund Account, the Net Assets Statement and the related notes. The Pension Fund accounting statements have been prepared under the accounting policies set out in the Statement of Accounting Policies.

2 This report is made solely to the members of Wirral Borough Council in accordance with Part II of the Audit Commission Act 1998 and for no other purpose, as set out in paragraph 49 of the Statement of Responsibilities of Auditors and of Audited Bodies published by the Audit Commission in April 2008.

Respective responsibilities of the Director of Finance and auditor

3 The Director of Finance is responsible for preparing the Pension Fund's accounting statements, in accordance with relevant legal and regulatory requirements and the Code of Practice on Local Authority Accounting in the United Kingdom 2009: A Statement of Recommended Practice. In preparing the Pension Fund accounting statements, the Director of Finance is responsible for:

- selecting suitable accounting policies and then applying them consistently;
- making judgments and estimates that were reasonable and prudent;
- keeping proper accounting records which were up to date;
- taking reasonable steps for the prevention and detection of fraud and other irregularities.

4 My responsibility is to audit the Pension Fund accounting statements and related notes in accordance with relevant legal and regulatory requirements and International Standards on Auditing (UK and Ireland).

5 I report to you my opinion as to whether the Pension Fund accounting statements give a true and fair view, in accordance with relevant legal and regulatory requirements and the Code of Practice on Local Authority Accounting in the United Kingdom 2009: A Statement of Recommended Practice, the financial transactions of the Pension Fund during the year and the amount and disposition of the fund’s assets and liabilities, other than liabilities to pay pensions and other benefits after the end of the scheme year. I also report to you whether, in my opinion, the information which comprises the commentary on the financial performance included within the Pension Fund Annual Report, is consistent with the Pension Fund accounting statements. That information comprises the Financial Statements, Statement of Responsibilities and the Audit Report.

6 I review whether the governance compliance statement referred to in the Pension Fund Annual Report reflects compliance with the requirements of the Local Government Pension Scheme (Administration) Regulations 2008 and related guidance. I report if it does not meet the requirements specified by the Department of Communities and Local Government or if the statement is misleading or inconsistent with other information I am aware of from my audit of the accounting statements. I am not required to consider, nor have I considered, whether the governance statement covers all risks and controls. Neither am I required to form an opinion on the effectiveness of the Authority’s corporate governance procedures or its risk and control procedures.

7 I read other information published with the Pension Fund accounting statements and related notes and consider whether it is consistent with the audited Pension Fund's accounting statements. This other information comprises the Background Information published in the financial statements and the following elements of the Pension Fund Annual Report: Management Structure, Chair's Introduction, Management Report, Investment Report, Scheme Administration Report and the Consulting Actuary's Statement. I consider the implications for my report if I become aware of any apparent misstatements or material inconsistencies with the Pension Fund accounting statements and related notes. My responsibilities do not extend to any other information.

Basis of audit opinion

8 I conducted my audit in accordance with the Audit Commission Act 1998, the Code of Audit Practice issued by the Audit Commission and International Standards on Auditing (UK and Ireland) issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the Pension Fund accounting statements and related notes. It also includes an assessment of the significant estimates and judgments made by the Authority in the preparation of the Pension Fund's accounting statements and related notes, and of whether the accounting policies are appropriate to the Authority’s circumstances, consistently applied and adequately disclosed.

9 I planned and performed my audit so as to obtain all the information and explanations which I considered necessary in order to provide me with sufficient evidence to give reasonable assurance that the Pension Fund's accounting statements and related notes are free from material misstatement, whether caused by fraud or other irregularity or error. In forming my opinion I also evaluated the overall adequacy of the presentation of information in the Pension Fund's accounting statements and related notes.

Opinion

10 In my opinion:

- the Pension Fund accounting statements and related notes give a true and fair view, in accordance with the Code of Practice on Local Authority Accounting in the United Kingdom 2009: A Statement of Recommended Practice, of the financial transactions of the Pension Fund during the year ended 31 March 2010, and the amount and disposition of the fund's assets and liabilities as at 31 March 2010, other than liabilities to pay pensions and other benefits after the end of the scheme year; and
- the information given in the commentary on financial performance included within the Pension Fund Annual Report is consistent with the Pension Fund accounting statements.

Michael Thomas

District Auditor, Audit Commission

The Heath Technical & Business Park, the Heath, Runcorn, Cheshire, WA7 4QF

September 2010

Appendix 2 – Amendments to the draft Pension Fund's accounts

1 I identified the following misstatements during my audit and managers have made the necessary adjustments. I bring them to your attention to aid you in fulfilling your governance responsibilities.

Table 2

		Fund Account		Net Assets Statement	
Adjusted misstatements	**Nature of adjustment**	**Dr £000s**	**Cr £000s**	**Dr £000s**	**Cr £000s**
Purchases Sales	In Note 7 to the statements £168m and £148 million of transfers were incorrectly classified as purchases and sales.			 316,167	316,167
Managed Equities	In Note 7 to the statements £30 million of segregated Canadian holdings were incorrectly classified Managed and Unitised Investments rather than Equities.			 30,356	30,356
Augmentation Debtors ER Strain Debtors ER Strain Deficit Funding	Note 3 to the Fund account for Augmentation has been understated by £24,146k: • £13,214k due to under accrual for payments due in future years. • £2,792k due to under accrual of payments relating to 2009/10. • £8,140k due to misclassification as deficit funding.	 8,140	13,214 2,792 8,140	 13,214 2,792	

		Fund Account		Net Assets Statement	
Adjusted misstatements	**Nature of adjustment**	**Dr £000s**	**Cr £000s**	**Dr £000s**	**Cr £000s**
Deficit Funding Creditors	£394k of Deficit Funding was incorrectly classified within Augmentation Contributions in Note 3. Much of this balance was later reimbursed. Therefore the correct treatment should be: £4k Deficit funding £390k accrued for the amount reimbursed (creditors)	390			390
Net Assets Statement - Investments Change in market value	Audit testing identified a number of Alternatives valuation misstatements leading to understatement in the Net assets statement and Fund account. The total understatement is £1,604k.		1,604	1,604	
Investments CIMV	Audit testing identified a pricing error for an investment in an internally managed mandate. The price used was sourced from a Bloomberg report dated 26 Feb rather than 31 March. This has lead to an overstatement of the investment of £344k.	344			344
Employers Employees Debtors	An error in the classification of contributions was identified during testing (£2,047k). Subsequent enquiry by officers identified similar classification errors in respect of contributions made by eight other employers and an omission (understatement of £275k) in respect of a new employer. Employers contributions Employees contributions	2698	2973	275	
Investments CIMV	An overstatement of £1,053k in the valuation of an investment in the Thematics portfolio.	1,053			1,053

Appendix 2 – Amendments to the draft Pension Fund's accounts

		Fund Account		Net Assets Statement	
Adjusted misstatements	**Nature of adjustment**	**Dr £000s**	**Cr £000s**	**Dr £000s**	**Cr £000s**
Investments CIMV	During testing to verify the value of the Capital Dynamics Ltd portfolio an understatement of £3,089k in the total value of the investment was identified.		3089	3,089	
Contributions Debtors	Payments due for the quarter relating to early retirement strain income in January to March 2010 had not been accrued for. This has lead to an understatement of £2,792k.		2792	2792	
Investments CIMV	The valuation of investment in European Strategic Partners was included in the NAS as £4,578k. However, a direct confirmation from the manager indicated a value of £3,500k.	1,078			1,078
Investment Inc Inv Purchases	MPF decided to capitalise building improvements costs incurred during 2009/10 after the statement of accounts were adopted. The amount involved is £2,619k and the amendment will impact Net Rental income, Investment purchases and change in market value entries.			2619	2619
Benefits Debtors	After the statement of accounts were adopted MPF identified 44 instances of lump sums due to be paid on 1 April which had been processed during 09/10 (as part of workload management to avoid delays processing and paying 31 March retirements). The total sum involved was £1,728k. The accounts and annual report are to be amended to correct the consequent misstatements.		1728	1728	

2 We identified several areas where disclosure notes are being improved following management amendment.

- The accounting policies note regarding transfers to and from other schemes initially described the arrangements for transfers out but did not specifically deal with transfers in.
- Related party transaction note did not fully comply with the requirements of the SORP. The SORP requires the note to be sufficiently detailed to:
  - include names of transacting related parties,
  - description of the relationship of between parties,
  - a description of the transactions,
  - the amounts involved,
  - any other elements of the transactions necessary for an understanding of the accounts.
- Review of SORP disclosures identified the following omissions of information which is required to be disclosed separately in the Fund Account, Net Assets Statement or Notes:
  - Other Income. This has been included within Investment Income in the MPF accounts - a line will be added in annual report.
  - Dividends from Equities; Income from pooled investments. Currently shown together as single sum in accounts - to be separated in annual report.
  - Share of Profits/losses in associates and joint ventures. Currently included as a note - a separate line will be added in the annual report.
  - Unpaid benefits. Currently included within miscellaneous - a separate line will be added in the annual report.
  - Significant restrictions affecting the ability of the Fund to realise assets. Currently excluded from the Annual Report. A note will be added.
  - The value of any investments which exceed 5 per cent of Fund. Currently excluded from the Annual Report. A note will be added.

Appendix 3 – Unadjusted misstatements in the accounts

1 I identified the following misstatements during my audit, but management has not adjusted the financial statements. I bring them to your attention to help you in fulfilling your governance responsibilities. If you decide not to amend, please tell us why in the representation letter. If you believe the affect of the uncorrected errors, individually and collectively, is immaterial, please reflect this in the representation letter. Please attach a schedule of the uncorrected errors to the representation letter.

Table 3

Description of error	Accounts affected	Value of error £000
Compensatory added years (CAYs) are awarded under the Local Government Regulations 2000. Prior to The Local Government Pension Scheme (LGPS) Regulations 2009 CAYs fell outside of the LGPS. Therefore any payments or receipts in respect of CAYs by a Pension Fund would have been outside the debits and credits as the Pension Fund would have been purely acting as an agent for the employer. MPF have included these receipts and payments in the Pension Fund accounts in error.	Fund Account, and related notes	12,183

Appendix 4 – Draft letter of representation

To:
Michael Thomas
District Auditor
Audit Commission
The Heath Technical & Business Park
Runcorn
Cheshire
WA7 4QF

Merseyside Pension Fund - Audit for the year ended 31 March 2010

I confirm to the best of my knowledge and belief, having made appropriate enquiries of other directors, officers, officials of Merseyside Pension Fund, the following representations given to you in connection with your audit of the Merseyside Pension Fund's financial statements for the year ended 31 March 2010. All representations cover Merseyside Pension Fund's accounts.

Compliance with the statutory authorities

I acknowledge my responsibility under the relevant statutory authorities for preparing the financial statements in accordance with the Code of Practice for Local Authority Accounting in the United Kingdom: A Statement of Recommended Practice and the Pension Fund SORP 2007, which give a true and fair view of the financial position and financial performance of the Pension Fund and for making accurate representations to you.

Uncorrected misstatements

I confirm that I believe that the effects of the uncorrected financial statements misstatements listed in the attached schedule are not material to the financial statements. These misstatements have been discussed with those charged with governance within the Pension Fund and the reason for not correcting this item is as follows;

Hitherto Compensatory Added Years (CAY) have been included in the Annual Accounts for MPF, both as expenditure via pensions paid, and as income via re-imbursement from employers. As indicated in Appendix 3 of the Annual Governance Report (AGR), prior to The Local Government Pension Scheme (LGPS) Regulations 2009, CAYs fell outside of the LGPS Regulations. The AGR indicates that the inclusion of these receipts and payments is an error, implying that these items should lie outside the accounts, perhaps as a memorandum note similar to the treatment of AVC's.

I have included these receipts and payments within the accounts. All Fund employers have until March 2012, on an individual employer basis, different options to change the current funding arrangements. Should any so opt, and had these cash flows been excluded from the accounts for year ended 31 March 2010, there would be a resultant inconsistency in accounting treatment both between employers, and between years. Paragraph 2.188 of the Pensions SORP refers to the fundamental accounting concept that there is consistency of accounting treatment within each accounting period, and from one period to the next. I therefore propose to retain the existing accounting treatment, but as soon as that option for employers has expired in March 2012, I shall adopt the appropriate accounting treatment to reflect the employers' final decisions.

Supporting records

All the accounting records have been made available to you for the purpose of your audit and all the transactions undertaken by the Pension Fund have been properly reflected and recorded in the accounting records. All other records and related information, including minutes of all relevant meetings, have been made available to you.

Irregularities

I acknowledge my responsibility for the design and implementation of internal control systems to prevent and detect fraud or error.
There have been no:

- irregularities involving management or employees who have significant roles in the system of internal accounting control;
- irregularities involving other employees that could have a material effect on the financial statements; or
- communications from regulatory agencies concerning non-compliance with or deficiencies on, financial reporting practices which could have a material effect on the financial statements.

I also confirm that I have disclosed:

- my knowledge of fraud, or suspected fraud, involving either management, employees who have significant roles in internal control or others where fraud could have a material effect on the financial statements; and
- my knowledge of any allegations of fraud, or suspected fraud, affecting the entity's financial statements communicated by employees, former employees, analysts, regulators or others.

Law, regulations, contractual arrangements and codes of practice

There are no instances of non-compliance with laws, regulations and codes of practice, likely to have a significant effect on the finances or operations of the Pension Fund.

The Pension Fund has complied with all aspects of contractual arrangements 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.

Fair Values

I confirm the reasonableness of the significant assumptions within the financial statements.

I confirm:

- the appropriateness of the measurement method;
- the basis used by management to overcome the presumption under the financial reporting framework;
- the completeness and appropriateness under the financial reporting framework; and
- if subsequent events require adjustment to the fair value measurement.

Contingent liabilities

There are no contingent liabilities. In particular:

- there is no significant pending or threatened litigation;
- there are no material commitments or contractual issues, other than those already disclosed in the financial statements; and
- no financial guarantees have been given to third parties.

Appendix 4 – Draft letter of representation

Related party transactions

I confirm the completeness of the information disclosed regarding the identification of related parties.
The identity of, and balances and transactions with, related parties have been properly recorded and where appropriate, adequately disclosed in the financial statements

Post balance sheet events

Since the date of approval of the financial statements by the Pensions Committee, no additional significant post balance sheet events that have occurred which would require additional adjustment or disclosure in the financial statements.

The Pension Fund has no plans or intentions that may materially alter the carrying value or classification of assets and liabilities reflected in the financial statements.

Signed on behalf of Wirral Borough Council

I confirm that this letter has been discussed by the Pensions Committee on 27 September 2010 and agreed by the Audit and Risk Management Committee on 28 September 2010.

Signed

Ian Coleman
Director of Finance, Wirral Council

September 2010

Appendix 5 – Action plan

Page no.	Recommendation	Priority 1 = Low 2 = Med 3 = High	Responsibility	Agreed	Comments	Date
	Annual Governance Report 2009/10 - Recommendations					
8	R1 Strengthen internal quality control to ensure errors in the financial statements are minimised.	2	Gerard Moore	Yes	MPF is now benefiting from the flexibility of the Council's accounting system, which allows for a more detailed breakdown of income and expenditure than previously available. In addition, the data capture changes indicated in Recommendation 2 will lead to improvements.	Ongoing
9	R2 Carry out regular reconciliations between the Pensions Payroll (AXISe) and the general ledger.	3	Gerard Moore to coordinate	Yes	Additional details will be captured as part of an improvement in pensions payroll procedures, which will facilitate the reconciliation of pensions paid. However, there will remain timing differences between legal entitlement to benefits; and the receipt of the necessary detailed documentation from both employers and new pensioners, to allow release of those benefits. Hence the calculation of accrued benefit payments will remain a complex and detailed task.	January 2011

Page no.	Recommendation	Priority 1 = Low 2 = Med 3 = High	Responsibility	Agreed	Comments	Date
9	R3 Strengthen procedures to monitor timely receipt of employers' contributions and take action where appropriate.	1	Gerard Moore	Partially	Delayed receipt of contributions is not a major problem. Any action taken would need to be cost-effective.	Ongoing
9	R4 The Pension Fund should review and improve arrangements for due diligence over annual investments valuation.	2	Gerard Moore	Yes	The most problematic area is the valuation of fund of funds private equity, each reflecting a host of underlying investments. This is an industry-wide issue, with no simple solution. Supplementary valuation methods and opportunities will be researched, and if and where appropriate, adopted for the March 2011 closure of accounts process.	June 2011
9	R5 The Pension Fund should review the contractual arrangements with Capital Dynamics Ltd if they continue to place reliance upon the valuation of the private equity portfolio.	3	Peter Wallach	Yes	This will be reviewed before March 2011.	March 2011

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WIRRAL COUNCIL

PENSIONS COMMITTEE

27 SEPTEMBER 2010

REPORT OF THE DIRECTOR OF FINANCE

THE STEWARDSHIP CODE FOR INSTITUTIONAL INVESTORS

1. EXECUTIVE SUMMARY

1.1 This paper provides an outline of the contents of the U.K. Stewardship Code, the background to its formation and its relevance to the Statement of Investment Principles. A statement of compliance with the Stewardship Code is included as an appendix to this report, and Members are requested to approve its publication.

2. BACKGROUND

2.1 In the aftermath of the financial crisis, the previous Government set up the Walker Review to examine the role of U.K. banks and other financial institutions. One strand of reform recommended by Walker was to improve the extent and effectiveness of shareholder engagement with companies. The Walker Review recommended that the Financial Reporting Council (FRC) should have responsibility for a new Stewardship Code, setting out best practice in respect of shareholder engagement.

2.2 At the start of July 2010 the FRC published its version of the Stewardship Code, which adopted wholesale the principles laid down by the Institutional Shareholders Committee (ISC) in its 2009 document 'Code on the Responsibilities of Institutional Shareholders and Agents'. The Statement of Investment Principles (approved by Pensions Committee on 23 March 2010) endorses the ISC Code, *"The ISC Code sets out best practice for institutional investors that choose to engage with the companies in which they invest. The Fund considers that its responsible ownership policy already complies with, and may even exceed, the principles in the ISC Code. However, the Fund believes it has direct relevance for managing its relationships with external investment managers, and will require its managers to state their approach to the ISC Code on a 'comply or explain' basis…"*

2.3 The LGPS Regulations (Investment & Management of Funds) 2009 contain a requirement to abide by guidance from the Secretary of State when producing a Statement of Investment Principles (SIP). This guidance has taken the form of the CIPFA paper on adapting the revised Myners Principles to the LGPS, which was used in the preparation of the SIP and which makes explicit reference to adopting the ISC Code. Therefore, it can be inferred that adherence to the Stewardship Code is a requirement of the Scheme Regulations.

2.4 MPF has contributed to the development of the Stewardship Code through its participation in the Local Authority Pension Fund Forum (LAPFF). The Forum submitted detailed responses to both the FRC consultation exercise on the Stewardship Code, and to the earlier consultation preceding the Walker Review.

3. THE STEWARDSHIP CODE

3.1 The Stewardship Code is a set of best practice principles that are intended to frame both shareholder engagement with companies and the disclosure of such activity. It is intended that shareholders adhere to the principles with the same ‘comply or explain’ approach used by U.K. companies in respect of the FRC Corporate Governance Code.

3.2 The principles are as follows –

Institutional investors should:

1. Publicly disclose their policy on how they will discharge their stewardship responsibilities
2. Have a robust policy on managing conflicts of interest in relation to stewardship and this policy should be publicly disclosed
3. Monitor their investee companies
4. Establish clear guidelines on when and how they will escalate their activities as a method of protecting and enhancing shareholder value
5. Be willing to act collectively with other investors where appropriate
6. Have a clear policy on voting and disclosure of voting activity
7. Report periodically on their stewardship and voting activities.

3.3 The FRC has stated that, while the Stewardship Code is principally aimed at asset managers, other institutional investors (and especially pension funds as a significant client group for asset managers) are strongly encouraged to report under it. The FRC has asked that institutional investors publish by the end of September 2010 a statement on their website of the extent to which they have complied with the Code, and to inform the FRC when they have done so.

3.4 The FRC has asked that such a statement consists of a description of how the principles of the Code have been applied. In many respects, the SIP already fulfils this brief. The Local Authority Pension Fund Forum (LAPFF) has issued guidance to member pension funds on reporting under the Code. The guidance included a 'model' statement, which has been adapted to suit MPF arrangements and practices (as outlined in the SIP), and is included as an appendix to this report.

3.5 Those institutions who publish their statements on the Code by the end of September 2010 will be recognized by the FRC as early adopters and will be included in a 'roll of honour' on the FRC website. The FRC has stated that it will undertake annual monitoring of the take-up and application of the Code, as well as regular reviews of its content and impact. This is due to commence in the second half of 2011.

3.6 Issues likely to be considered for future inclusion in the Code will include policy recommendations on stock-lending, voting rights for beneficial owners in pooled funds and the form of voting disclosure. There also remain wider questions as to whether the scope of the Code should be widened to consider ownership responsibilities beyond listed equities; and whether there should be a review mechanism, independent of the FRC, to monitor investors' adherence to the Code.

4. FINANCIAL AND STAFFING IMPLICATIONS

4.1 There are none arising from this report.

5. EQUAL OPPORTUNITY IMPLICATIONS

5.1. There are none arising from this report.

6. COMMUNITY SAFETY IMPLICATIONS

6.1. There are none arising from this report.

7. LOCAL MEMBER SUPPORT IMPLICATIONS

7.1. This report has no particular implications for any Members or wards.

8. LOCAL AGENDA 21 IMPLICATIONS

8.1. There are none arising from this report.

9. PLANNING IMPLICATIONS

9.1. There are none arising from this report.

10. BACKGROUND PAPERS

10.1 LAPFF member briefing, 'Reporting under the Stewardship Code' September 2010.

11. RECOMMENDATION

11.1 That Members approve the submission to the FRC of the appended statement of compliance with the Stewardship Code, and its publication on the MPF website.

IAN COLEMAN
DIRECTOR OF FINANCE

FNCE/186/10

MERSEYSIDE PENSION FUND

Statement of compliance with the U.K. Stewardship Code for Institutional Investors

Merseyside Pension Fund has a long-standing commitment to the values of stewardship, in relation to its conduct as an asset owner. It considers the responsibilities of stewardship to be part of its fiduciary duty to its stakeholders. In 2007, the Fund became a signatory to the United Nations Principles for Responsible Investment: stewardship is one of the cornerstones of the Fund's responsible investment policy.

Principle 1 – Institutional investors should publicly disclose their policy on how they will discharge their stewardship responsibilities.

Merseyside Pension Fund takes its responsibilities as a shareholder seriously. It seeks to adhere to the Stewardship Code and encourages its appointed asset managers to do so too.

In practice the Fund's policy is to apply the Code both through its arrangements with its asset managers and other agents and through membership of the Local Authority Pension Fund Forum (LAPFF) and other collaborative groups. The Fund makes this explicit in its Statement of Investment Principles and will, in time, directly refer to the Stewardship Code in Section 5 of the SIP, 'Responsible Ownership'.[1]

The Fund has previously required its asset managers to state their approach to the ISC Code on the Responsibilities of Institutional Investors on a comply or explain basis. The Fund has also promoted adoption of the UNPRI as representing the highest standard of best practice of responsible ownership. The Fund's investment strategy seeks long-term returns from investing in equities and appoints asset managers who best reflect this long-termism in their investment philosophy and process.

The Fund does not delegate all responsibility for stewardship to its asset managers. It retains control of its voting policy, including where possible, over its underlying beneficial interests in pooled funds. The Fund retains a corporate governance and voting advisory and execution service (PIRC Ltd) to ensure that the maximum of its voting rights are exercised in support of high corporate governance standards.

[1] http://mpfmembers.org.uk/content/statement-investment-principles

Principle 2 – Institutional investors should have a robust policy on managing conflicts of interest in relation to stewardship and this policy should be publicly disclosed.

The Fund encourages the asset managers it employs to have effective policies addressing potential conflicts of interest, when it comes to matters of stewardship.

The Fund requires all those who are directly involved in its management and governance to disclose any interest in any company, or other entity, in which the Fund has an ownership interest.

Principle 3 – Institutional investors should monitor their investee companies.

Day-to-day responsibility for managing our equity holdings is delegated to our appointed asset managers. The Fund expects them to monitor companies, and intervene where necessary, and to report back regularly on activity undertaken. Quarterly review meetings with our asset managers are used to raise particular issues of note or concern.

In addition, the Fund receives an 'Alerts' service from LAPFF, which highlights corporate governance issues of concern at investee companies.

Principle 4 – Institutional investors should establish clear guidelines on when and how they will escalate their activities as a method of protecting and enhancing shareholder value.

As highlighted above, responsibility for day-to-day interaction with companies is delegated to the Fund's asset managers, including the escalation of engagement when necessary. Their guidelines for such activities are expected to be disclosed in their own statement of adherence to the Stewardship Code.

However, on occasion the Fund may itself choose to escalate activity, principally through engagement activity with LAPFF. When it believes it is warranted by the egregious conduct of a company board causing a loss of shareholder value, the Fund will seek redress by pursuing shareholder litigation, of whatever form and in whatever jurisdiction deemed suitable. The Fund considers this an appropriate tool for use by long-term shareholders to send a powerful message of reproach to a company's directors and to the wider industry.

Principle 5 – Institutional investors should be willing to act collectively with other investors where appropriate.

The Fund seeks to work collaboratively with other institutional shareholders in order to maximize the influence that it can have on individual companies. The Fund seeks to achieve this through membership of the LAPFF, which engages with companies over environmental, social and governance issues on behalf of its members.

On environmental issues in particular, the Fund also pursues engagement with companies through membership of the Institutional Investors Group on Climate Change (IIGCC). One of the core objectives of the IIGCC is to engage in dialogues with companies to standardize and improve disclosure on climate change and improve performance.

Principle 6 – Institutional investors should have a clear policy on voting and disclosure of voting activity.

The Fund has adopted as its voting policy the Global Shareholder Voting Guidelines of its voting agent, PIRC Ltd. The Fund commissions PIRC to provide detailed voting recommendations and to exercise all votes attaching to its UK equity holdings in accordance with these. PIRC's analysis includes consideration of company explanations of compliance with the Corporate Governance Code. Where practical, the Fund seeks to exercise its voting rights attaching to its non-UK equity holdings.

The Fund discloses summary level information on voting activity on its website, on a semi-annual basis. The Fund intends to disclose voting activity by company on its website in the near future.

Principle 7 – Institutional investors should report periodically on their stewardship and voting activities.

The Fund maintains a Responsible Investment section on its website. Annual reporting on stewardship activity, including voting and engagement work, has formed part of the report and accounts. In future, it is envisaged that the Fund will report through a Responsible Investment Review, which will also report on the stewardship activities of the Fund's asset managers.

About Merseyside Pension Fund:

Merseyside Pension Fund is the 5^{th} largest fund in the Local Government Pension Scheme. It has assets under management of £4.6 billion, managed by a combination of an in-house team and external investment managers.

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By virtue of paragraph(s) 3 of Part 1 of Schedule 12A
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