

# Annual Governance Report

Merseyside Pension Fund

Audit 2008/09

September 2009

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## 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 and 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.
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Ladies and Gentlemen

## **2008/09 Annual Governance Report**

I am pleased to present the final version of my report on the results of my audit work for 2008/09.

A draft of the report was discussed and agreed with the Director of Finance on 15 September 2009 and has been updated since as issues have been resolved.

The 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 10);
- 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 pension fund's accounts 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 (Appendix 4); and
- agree your response to the proposed action plan (Appendix 5).

Yours faithfully

Michael Thomas  
District Auditor

22 September 2009

# Key messages

This report summarises the findings from the 2008/09 audit which is substantially complete. It includes the messages arising from my audit of your financial statements.

Financial Statements	Results	Page
Unqualified audit opinion	Yes	7
Pre-audit financial statements free from material error	No	7
Post-audit financial statements free from material error	Yes	7 & 14
Material weakness in internal control	No	8

## Audit opinion

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

## Financial statements

- The financial statements were submitted for audit in June and were supported by adequate working papers prepared by pension fund finance staff.
- However, there are five material adjustments which I draw to your attention in respect of:
  - £40.7m cash balances incorrectly classified as current assets should have been shown within investment assets;
  - £19.8m balances due from stockbrokers incorrectly classified as current assets should be shown within investment assets;
  - £22.8m balances due to stockbrokers incorrectly classified as current liabilities should be shown within investment liabilities; and
  - £2.9m Exchange income has been reclassified during the audit to 'change in value of market value of investments'.
  - £6.8m investment income debtor was reanalysed from current assets to investment assets within the net assets statement.
- The Director of Finance has agreed to adjust the financial statements for these material errors and a number of other non-material errors which are identified at Appendix 2. There is one error and a number of uncertainties which are drawn to your

## Key messages

attention at Appendix 3. We seek specific assurances from management in the Letter of representation for two of the uncertainties and the reason for not adjusting the error.

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### Audit fees

- 5 My fee proposals were communicated to you in my Audit Plan for 2008/09. I am satisfied that the audit fee was appropriate and no adjustment is required.

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# 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.**

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**6** 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 10);
- take note of the adjustments to the pension fund's accounts which are set out in this report (Appendix 2);
- agree to adjust the error in the pension fund's accounts 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 (Appendix 4); and
- agree your response to the proposed action plan (Appendix 5).

# Financial statements

The Pension Fund's accounts are important means by which the Fund accounts for its stewardship of pension funds. As Merseyside Pension Fund members you have a responsibility to review and recommend the statements to Wirral Council members who have the final responsibility for these statements. It is important that you consider my findings before you make this recommendation and the financial statements are authorised for issue.

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## Opinion on the financial statements

- 7 Subject to satisfactory clearance of outstanding matters, I plan to issue an audit report on the Council's financial statements that includes an unqualified opinion on the Pension Fund's accounts. Appendix 1 contains a copy of my draft audit report for the Annual Report on the Pension Fund Accounts. The outstanding matters are:
- review of the Annual Report
  - completion of disclosure note testing
  - review of amended statements
  - response by officers to the action plan.
- 

## Errors in the financial statements

- 8 The financial statements were submitted for audit in June and were supported by adequate working papers prepared by Pension Fund finance staff.
- 9 I have identified a number of material errors which I draw to your attention below. As previously reported to the Committee, we are required to report on all errors that are over the 'trivial' level which is £24k for the Fund Account and £352K for investments in 2008/09 representing 1% of the respective materiality levels (10% in previous years). The Director of Finance has agreed to adjust the financial statements for the errors identified at Appendix 2. The unadjusted error and a number of uncertainties are identified at Appendix 3.
- 10 The five material errors are summarised below.
- The Pensions SoRP provides for asset and liability balances relating specifically to investments to be disclosed within the Investments Assets section of the Statement of Accounts. These will include cash held for investment by investment managers and sums due to and from stockbrokers. In the Merseyside Pension Fund Statement of Accounts these have been shown under current assets and liabilities. The impact of this is that current assets is overstated and investment assets understated for cash and balances due from stockbrokers by £40,727k and £19,818 respectively; and current liabilities overstated and investment liabilities understated by balances due to stockbrokers by £22,844k.
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- The £40.7m cash balance is incorrectly classified as current assets should have been shown within investment assets. A prior period adjustment (PPA) is required for the re-analysis of the 2007/08 balance.
  - £19.8m balances due from stockbrokers incorrectly classified as current assets should be shown within investment assets. A prior period adjustment is required for the re-analysis of the 2007/08 balance.
  - £22.8m balances due to stockbrokers incorrectly classified as current liabilities should be shown within investment liabilities. A prior period adjustment is required for the re-analysis of the 2007/08 balance.
  - Exchange income on investments of £2.9m has been reclassified during the audit to income from ‘change in value of market value of investments’.
  - An investment income debtor of £6.8m was reanalysed during the audit from current assets to investment assets within the net assets statement
- 11 In addition, there are a number of non material errors and uncertainties identified in respect of investments, derivatives, debtors, creditors and the bad debt provision. These are included at Appendices 2 and 3.
- 12 We also identified a number of areas where disclosure notes needed to be improved and these have been amended and are noted at Appendix 2.
- 13 The overall effect of the adjusted errors is a reduction in the pension scheme net assets of £3,357k in both the Fund account and the Net assets statement.

### Recommendation

- R1 Strengthen internal quality assurance to ensure errors in the accounts are minimised.

### Material weaknesses in internal control

- 14 I have not identified any areas of material weakness in the Pension Fund systems of internal control.
- 15 My audit work included testing of controls in the main financial systems. Where appropriate I placed reliance on these controls in order to reduce substantive testing of the statement of accounts.

### Letter of representation

- 16 Before I issue my opinion, auditing standards require me to obtain appropriate written representations from you and management about your financial statements and governance arrangements. Appendix 4 contains the draft letter of representation I seek to obtain from the Council.



## Financial statements

### Key areas of judgement and audit risk

17 In planning the audit specific risks were identified and areas of judgement were considered as part of the audit. The findings are set out in Table 1.

**Table 1** Key areas of judgement and audit risk

Issue or risk	Finding
The introduction of new reporting requirements under the revised Statement of Recommended Practice (SoRP). Risk of not implementing leading to material misstatement.	We have raised some significant issues and these are reflected in the adjusted errors. We have also raised some issues regarding the qualitative aspects of your financial reporting and disclosure notes below.
The introduction of a new investment accounting system via the Custodian, State Street, in 2008/09.	The arrangements put in place and working papers produced provided good assurance that there were appropriate arrangements to ensure that the transfer of the Investment Ledger from Shareholder to SSB was effective and did not give rise to risk of material misstatement.
Merseyside Pension Fund invested £7.5m in Icelandic banks. Risk of not recognising and accounting properly for the impairment.	The year end substantive testing found the impairment was satisfactory following the guidance available during the audit. We identified an error regarding the debtor for interest at Appendix 3

### Accounting practice and financial reporting

18 I consider the qualitative aspects of Merseyside Pension Fund's (MPF) financial reporting. Table 2 contains the issues I want to raise with you.

**Table 2**

Issue or risk	Finding
Senior officers and members are required to complete declarations of interest for related parties transactions information.	One former Pensions Committee member has failed to provide the declaration requested by officers
Year end debtors need to be supported by a detailed audit trail. Risk of uncertainty.	MPF was unable to provide a detailed analysis of debtor invoices that Wirral Council is administering on its behalf as it is a live system and no record was retained as at 31 March 2009.

Issue or risk	Finding
The Pension Fund is required to compile the financial statements and disclose information in line with the SoRP. Risk of omission of or incorrect information required by SoRP	The material adjustments to the financial statements occurred because of non compliance with the Pension SoRP.

Recommendations
<b>R2</b> Members should ensure they comply with the process for making related party declarations
<b>R3</b> Ensure audit trails are available to support year end balances
<b>R4</b> Improve procedures within the pension fund to ensure compliance with the SoRP aided by improved communication with other pension funds and government to ensure interpretation is clear and consistent.

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

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## Independent auditor’s report on Merseyside Pension Fund to Members of Wirral Council

I have audited the pension fund accounts for the year ended 31 March 2009 under the Audit Commission Act 1998. The pension fund accounts comprise the Fund Account, the Net Assets Statement and the related notes. The pension fund accounts have been prepared under the accounting policies set out in the Statement of Accounting Policies.

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 prepared by the Audit Commission.

### Respective responsibilities of the Director of Finance and auditor

The Director of Finance is responsible for preparing the pension fund accounts, in accordance with relevant legal and regulatory requirements and the Code of Practice on Local Authority Accounting in the United Kingdom 2008. In preparing this pension fund accounts, the Director of Finance is responsible for:

- selecting suitable accounting policies and then applying them consistently;
- making judgements and estimating 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.

My responsibility is to audit the pension fund accounts and related notes in accordance with relevant legal and regulatory requirements and International Standards on Auditing (UK and Ireland).

I report to you my opinion as to whether the pension fund accounts present fairly, in accordance with relevant legal and regulatory requirements and the Code of Practice on Local Authority Accounting in the United Kingdom 2008, 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

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

comprises the commentary on the financial performance included within the Pension Fund Annual Report, is consistent with the pension fund accounts. That information comprises the Financial Statements, Statement of Responsibilities and the Audit Report.

I review whether the governance compliance statement published in the Pension Fund Annual Report reflects compliance with the requirements of Regulation 34(1)(e) 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 financial 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.

I read other information published with the pension fund accounts and related notes and consider whether it is consistent with the audited pension fund accounts. This other information comprises the Explanatory Foreword 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 accounts and related notes. My responsibilities do not extend to any other information.

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### Basis of audit opinion

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 accounts and related notes. It also includes an assessment of the significant estimates and judgements made by the Authority in the preparation of the pension fund accounts and related notes, and of whether the accounting policies are appropriate to the Authority’s circumstances, consistently applied and adequately disclosed.

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 accounts 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 accounts and related notes.

**Opinion**

In my opinion the pension fund accounts and related notes present fairly, in accordance with the Code of Practice on Local Authority Accounting in the United Kingdom 2008, the financial transactions of the Pension Fund during the year ended 31 March 2009, and the amount and disposition of the fund’s assets and liabilities as at 31 March 2009, other than liabilities to pay pensions and other benefits after the end of the scheme year.

Michael Thomas

District Auditor, Audit Commission

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

September 2009

(An original signed copy of the Auditor’s Report can be viewed by request to the Financial Controller, Merseyside Pension Fund, PO Box 120, Castle Chambers, 43 Castle Street, Liverpool L69 2NW)

# Appendix 2 – Adjusted amendments to the draft Pension Fund’s accounts

The following misstatements were identified during the course of my audit and the financial statements have been adjusted by management. I bring them to your attention to assist you in fulfilling your governance responsibilities.

**Table 3**

Adjusted misstatements	Nature of Adjustment	Fund Account		Net assets statement	
		Dr £000s	Cr £000s	Dr £000s	Cr £000s
Current assets and investment assets in the Net assets statement	£40.7m cash balances incorrectly classified as current assets and should have been shown within investment assets. No overall impact on net assets of the Fund.			40,700	40,700
Current assets and investment assets in the Net assets statement	£19.8m balances due from stockbrokers incorrectly classified as current assets and should have been shown within investment assets. No overall impact on net assets of the Fund			19,800	19,800
Current assets and investment assets in the net assets statement	£6.8 m investment income debtors were incorrectly classified as current assets. No overall impact on net assets of the Fund.			6,800	6,800

## Appendix 2 – Adjusted amendments to the draft Pension Fund’s accounts

Current liabilities and investment liabilities in the Net assets statement	£22.8m balances due to stockbrokers incorrectly classified as current liabilities and should have been shown within investment liabilities. No overall impact on net assets of the Fund.			22,800	22,800
Return on investments on the Fund Account	Exchange income on investments has been reclassified by officers during the audit to income from ‘change in value of market value of investments’ by £2,922k. No overall impact on net assets of the Fund.			2,922	2,922
Derivatives in the Net assets statement	There was a misclassification between investment categories as a result of the incorrect accounting treatment of the derivative valuations. Investment manager cash should be reduced and investment assets increased by £3,001k. No overall impact on net assets of the Fund.			3,001	3,001
Creditors in the Net assets statement	During the review of the year end lump sum creditors and the cut-off of year end lump sum payments, we note that the cut-off has not been applied correctly, resulting in an understatement of year end creditors of £1,129k	1,129			1,129
Investments in the Net assets statement	Investments were initially overstated by £934k in respect of venture valuations	934			934

## Appendix 2 – Adjusted amendments to the draft Pension Fund’s accounts

Investments in the Net assets statement	Alternative investments were initially overstated by £900k	900			900
Creditors in the Net assets statement	Prior to the start of the audit, MPF identified a fund management expenditure invoice £650k relating to 2008-09 where it had failed to accrue for.	650			650
Bad debt provision within Debtors in the Net assets statement	Bad debt provisions £473K were initially incorrectly analysed as year end creditors			473	473
Debtors in the Net assets statement	Year end debtors and contributions income needed to be reduced by £43k	43			43
Debtors in the Net assets statement	Balances due from stockbrokers overstated by £647k			647	647
Creditors in the Net assets statement	Balances due to stockbrokers overstated £431k			431	431
Creditors in the Net assets statement	Year end creditors were overstated by £309k in respect of an invoice which had been incorrectly accrued for twice at the year end.		309	309	
Derivatives in the Net assets statement	Derivatives were incorrectly valued in the year end balance sheet. There was a net reduction of scheme assets of £10k	10			10



## Appendix 2 – Adjusted amendments to the draft Pension Fund’s accounts

We identified a number of areas where disclosure notes were improved and management amended.

- Note 12 to the financial statements gives a summary of the sums managed by individual managers. However, the values shown initially excluded £43m in respect of cash and sums due to and from stockbrokers (see material errors noted above).
- Due to an initial miscoding of administration costs, the related party disclosure note 11 for this was initially misstated by £225k.
- Prior period adjustment disclosures are required for the re-analysis of fund manager cash, balances due to and from stockbrokers in the net assets statement and the reanalysis of the investment income debtor into investment assets(see material errors noted above).
- Fund account note 3 was amended to reflect augmentation income of £19,993k (2007/08 £11,931k) with a corresponding reduction in the ‘Normal’ and ‘Deficit funding’ income categories. Comparatives for 2007/08 were changed and a prior period adjustment disclosure needs to be made.

# Appendix 3 – Unadjusted uncertainties in the accounts

The following uncertainties were identified during the course of my audit and the financial statements which need to be considered by management. No amendments are required. I bring these to your attention to assist you in fulfilling your governance responsibilities. Uncertainties are summarised below.

**Table 4**

Description of uncertainty	Accounts effected	Value of uncertainty £000s
We were not able to obtain 3 <sup>rd</sup> party confirmation for a Structured investment of £2.4m. We accepted assurance from internal records but seek assurance from management in the Letter of representation.	Investment assets in the Net assets statement	2,408 (uncertainty)
There is uncertainty over the exact amount of monies recoverable from the year end tax debtor. We seek assurance from management in the Letter of representation.	Current assets in the Net assets statement	752 (uncertainty)
Different sources of valuation information provided different values on alternative investments. This arose from use of market data from different price sources, rather than Bloomberg and Reuters.	Investment assets in the net assets statement	500 (uncertainty)

### Appendix 3 – Unadjusted uncertainties in the accounts

Description of error	Accounts effected	Value of error/uncertainty £000s
The year end Icelandic impairment was correctly applied against the capital value of investments, but the interest element was included in investments rather than a debtor in current assets.	Net assets statement	67

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# Appendix 4 – Draft letter of representation

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**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 2009**

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 Merseyside Pension Fund's financial statements for the year 31/3/09. 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 Pensions SoRP 2007-08, which present fairly 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 misstatement listed below is not material to the financial statements. The Auditor's finding is that the year end Icelandic Bank impairment was correctly applied against the capital value of investments, but the interest element was included in investments rather than a debtor in current assets. This misstatement has been discussed with those charged with governance within the Council and the reason for not correcting this is set out below:

- The amount and treatment in the pre-audit statements is based on guidance that was issued prior to approval of the accounts in June. This guidance has recently been updated and the suggested amount of the amendment (£67k) will change. We are considering the impact of this but it would not be material.

## Appendix 4 – Draft letter of representation

### 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.

### 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.

### Specific representations (see Appendix 3 above):

We are satisfied the Harewood structured investment balance of £2,408k has been properly recorded and disclosed in the financial statements.

We are satisfied that the tax debtor of £752k recorded in the year end financial statements is collectable from Her Majesty's Revenue and Customs.

### Signed on behalf of Wirral Borough Council

I confirm that the this letter has been discussed by the Pensions Committee on 22 September 2009 and agreed by the Audit and Risk Management Committee of Wirral Council on 23 September 2009

Signed

Ian Coleman

Director of Finance, Wirral Council

Date [usually the date of the audit opinion]

## Appendix 4 – Draft letter of representation

### Guidance notes (will be deleted in final copy)

The ISA (UK&I) 580 requirement is only that management need sign. Those TCWG must acknowledge their collective responsibility for the compilation of the financial statements and arguably this would include considering the adequacy of the LoR.

The audited body should ensure that representations are only provided by those competent to give them, such that;

- acknowledgement of the responsibilities of “directors” for the financial statements is made by those in whom the responsibilities are vested; and,
- management representations on matters material to the financial statements are made by persons who have the knowledge of the facts or who are authorised to make the judgement to express an opinion (for instance a legal officer may be best placed to make representations about contingent liabilities).

Representations should usually be given by the Responsible Financial Officer.

## Appendix 5 – Action plan

Page no.	Recommendation	Priority 1 = Low 2 = Med 3 = High	Responsibility	Agreed	Comments	Date
<b>Annual Governance Report 2008/09 - Recommendations</b>						
8	R1: Strengthen internal quality assurance to ensure errors in the accounts are minimised.	3	Financial Controller	Yes		
11	R2: Members should ensure they comply with the process for making related party declarations	2	Financial Controller	Yes		
11	R3: Ensure audit trails are available to support year end balances	2	Financial Controller	Yes		
11	R4: Improve procedures within the pension fund to ensure compliance with the SoRP aided by improved communication with other pension funds and government to ensure interpretation is clear and consistent.	2	Financial Controller	Yes		