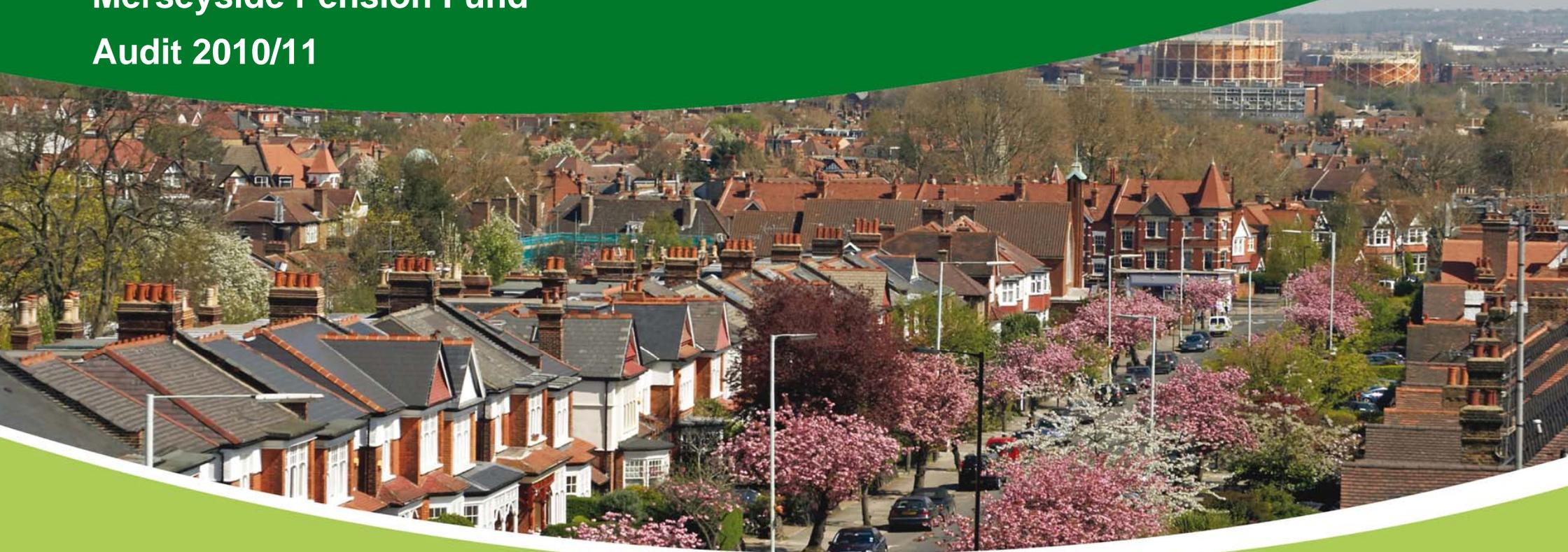


# Annual governance report

Merseyside Pension Fund

Audit 2010/11



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**Traffic lights**

Red  Amber  Green 

# Key messages

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**This report summarises the findings from my 2010/11 audit of the accounts of Merseyside Pension Fund (the Pension Fund) which is substantially complete.**

	<b>Our findings</b>
Audit opinion	

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## **Audit opinion and financial statements**

- Subject to satisfactory completion of outstanding matters I plan to issue an unqualified audit opinion on the accounts of Merseyside Pension Fund.
- I identified two material errors in the accounts, the omission of a Net Assets Statement as at 1 April 2009, and a mis-classification of £273m pooled investments as equity. The Pension Fund has agreed to amend the accounts for both of these items.
- I identified a small number of other disclosure errors and one non-trivial accounting error, all of which the Pension Fund has agreed to amend.

# Before I complete my audit

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## I confirm to you

My report 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.

### Independence

I can confirm that I have complied with the Auditing Practices Board's ethical standards for auditors, including ES 1 (revised) - Integrity, Objectivity and Independence. I can also confirm there were no relationships resulting in a threat to independence, objectivity and integrity.

The Audit Commission's Audit Practice has not undertaken any non-audit work for the Pension Fund during 2010/11.

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## I ask you to confirm to me

### I ask the Pension Fund Committee to:

- consider the matters raised in this report before recommending approval of the Pension Fund accounts to Wirral Borough Council's (the Council's) Audit and Risk Management Committee (the ARMC).
- take note of the adjustments to the Pension Fund's accounts which are set out in this report (Appendix 2);
- recommend the approval of the letter of representation (Appendix 3) to the ARMC on behalf of the Pension Fund before I issue my opinion and conclusion; and
- recommend the ARMC approve management's response to the proposed action plan (Appendix 4).

### I ask the ARMC to:

- consider the matters raised in this report and the recommendations of the Pension Committee before it:
    - approves the Council's financial statements;
    - approves the letter of representation (Appendix 3) before I issue my opinion and conclusion; and
    - agrees a response to the proposed action plan (Appendix 4)..
-

# Financial statements

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The Pension Fund's financial statements are an important means by which the Council accounts for its stewardship of the funds. The members of the ARMC have final responsibility for these statements. It is important that the members of the ARMC consider my findings before adopting the Council's financial statements.

## Opinion on the financial statements

Subject to satisfactory clearance of outstanding matters, I plan to issue an audit report including an unqualified opinion on the financial statements.

Matters outstanding are:

- I have not received a final set of accounts including all the amendments agreed on audit
- I have yet to complete elements of my testing, in particular on:
  - Contributions, and
  - Investments

Appendix 1 contains a copy of my draft report for inclusion in the Council's Statement of Accounts.

I received the Annual Report for the Pension Fund on 1 September. If there are no material inconsistencies with the financial statements governance statement and the Governance Statement reflects compliance with the Local Government Pension Scheme (Administration) Regulations 2008 and related guidance, I will issue an unqualified opinion. Appendix 1a contains a copy of my draft report for inclusion in the Pension Fund's Annual Report.

## Errors in the financial statements

I identified two material errors in the Pension Fund's accounts. The first is that, in common with most local government pension funds, the accounts did not include a Net Assets Statement as at 1 April 2009. It is a requirement of IFRS 1 First time adoption of IFRS that bodies include a comparative Net Assets Statement at the date of transition to IFRS. The second is a misclassification of two investments totalling £273m as equity rather than pooled investments.

I also identified one non-material error in the value of investments and a small number of other disclosure errors.

The Pension Fund management has agreed to amend the accounts for all of the errors I identified.

For details of all of the amended errors, see Appendix 2.

The Pension Fund management are also amending the draft accounts to increase the value of investments by £6.7m. In accordance with its accounting policy, the Pension Fund had used the latest audited accounts (as at 30 September 2010) to value an unquoted investment. However, by the time of our audit, accounts as at 31 December 2010 were available for the investment and we identified the movement in valuation.

## Recommendation

### Recommendation

- R1** Ensure that any changes to the investment ledger after it has been reconciled with the general ledger are also reflected in the accounts.
- R2** Review the latest available information on unquoted investments as part of a formal process considering potential adjusting post balance sheet events between the preparation and members' approval of the accounts.

## Specific risks and areas of judgement

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

### Key audit risk and our findings

Key audit risk	Finding
<p><b>1. Triennial Actuarial Valuation Review</b></p> <p>The Fund has completed a Triennial Actuarial Valuation Review reflecting its position at 31 March 2010. Whilst this is not a direct audit opinion risk, it is a key issue as regards the ongoing governance of the Fund. There are risks of increased deficits leading to additional costs from increased employer contributions.</p>	<p>An actuarial valuation is attached to the Pension Fund's accounts.</p> <p>No employer has defaulted on their contributions in the year.</p>
<p><b>2. Move to 'OpenAir' system</b></p> <p>The Fund replaced the system used to monitor and control internally managed investments, 'Shareholder', with the 'OpenAir' system in 2010/11. There is a risk that the balances will not be accurately transferred between systems and a risk that effective controls are not in place in the new system.</p>	<p>Internal Audit reconciled the closing book cost figures from 'Shareholder' to the opening book cost figures within 'OpenAir'. They did not identify any discrepancies.</p>

## Key audit risk

## Finding

### 3. Impact of voluntary redundancy

I am aware that Wirral Council is undergoing a voluntary redundancy process whereby a significant number of employees will leave in 2010/11. This may affect the capacity of the finance team to deliver materially correct statements within agreed timescales.

The Pension Fund provided its accounts for audit within the statutory deadline on 28 June.

### 4 First time application of International Financial Reporting Standards

From 2010/11 the Pension Fund is required to adopt the International Financial Reporting Standards (IFRS) Code. The Code sets out the proper accounting practices that bodies must follow and requires some additional disclosures for 2010/11.

We found one material error in the Pension Funds application of IFRS – in common with most local government pension funds the Fund omitted a transitional Net Asset Statement.

### 5 Financial pressures – contributing employers

We are aware that contributing bodies to the pension fund are under financial pressure and in many cases are offering voluntary early retirement, voluntary redundancy and possibly may need to make compulsory redundancies in the near future. This may place additional workload on the Pensions team in dealing with the large volume of severance arrangements

We did not find evidence of any backlog in pensions administration as a result of an increase in workload from increased numbers of severance cases in contributing bodies.

### 6 Reconciliations between AXISe and the General Ledger

The Pension Fund did not carry out reconciliations between the values in AXISe Pensions Payroll and membership administration systems to those in the General Ledger in 2009/10. These are essential procedures which are intended to give the Pension Fund assurance that transactions in the fund account are correctly stated as well as providing controls assurance over receipts and payments in key areas.

The Pension Fund has reconciled lump sums in AXISe and the ledger.

We have asked for evidence of a reconciliation of other transactions.

### 7 Timeliness of contributions

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. Our review of contributions in 2009/10 found that whilst most bodies pay on time, some smaller bodies missed these deadlines regularly, breaching the regulations.

We have asked for evidence of the timeliness of contributions from employer authorities.

## Key audit risk

### 8 Valuation of unquoted investments

The Pensions Statement of Recommended Practice (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 Fund's 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. It is essential that the preparers of the pension fund financial statements are satisfied that the valuations provided by these specialists comply with the requirements of the SORP. Guidance issued by Pensions Research Advisory Group (PRAG) provides a framework of due diligence for preparers of Pension Fund statements

### 9 Contract with Capital Dynamics

The Pension Fund's private equity valuation process relies on monitoring undertaken by Capital Dynamics Ltd under an arrangement dating back to 1991. Our review in 2009/10 of the contract identified that the contract is out of date and does not specify the valuation work.

### 10 Compensatory added years

The Pension Fund's receipts and payments were overstated by £12m in 2009/10 due to the incorrect inclusion of compensatory added years (CAYs). CAYs are awarded under the Local Government Regulations 2000 and therefore fall outside of the LGPS. The LGPS (Misc) Regulations 2009 now permit employers to convert CAYs into pension service, however there has to be a resolution by the employing authority to do this conversion by 31 March 2012.

## Finding

The Pension Fund developed a due diligence questionnaire based on the PRAG framework. It has used this when considering the valuation of investments.

A new contract with Capital Dynamics Ltd was signed in June 2011.

The Pension Fund managers have confirmed that no employing authority has made a resolution to convert CAYs into pension service. (I have asked that members also confirm this in the letter of representation). The Pension Fund has therefore excluded CAYS from its income and expenditure in 2010/11. It has also amended the comparative figures for 2009/10.

## Significant weaknesses in internal control

### I have not identified any significant weaknesses in internal control

I only report those weaknesses I identify during the course of the audit that are relevant to preparing the financial statements. I am not expressing an opinion on the overall effectiveness of internal control.

## Quality of your financial statements

I consider aspects of your accounting practices, accounting policies, accounting estimates and financial statements disclosures.

I have only one matter to report to you:

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### Accounting practices, policies, estimates and financial closures

Issue	Findings and recommendations
<p><b>1. Disclosure of pooled and internally managed investments</b></p> <p>The accounts initially disclosed internally managed investment balances in aggregate only. Pooled investment vehicles were also disclosed in aggregate only. Whilst this disclosure does comply with the SORP, in my opinion this does not give the reader of the accounts adequate information on the nature of these investments.</p>	<p>The Pension Fund management agreed that the information could be enhanced and agreed to change the disclosure to be more useful to the user of the accounts.</p>

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## Letter of representation

Before I issue my opinion, auditing standards require me to ask you and management for written representations about your financial statements and governance arrangements. I have included a draft at Appendix 4

# Appendix 1 – Draft independent auditor’s report to the members of Wirral Borough Council

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## Opinion on the pension fund accounting statements

I have audited the pension fund accounting statements for the year ended 31 March 2011 under the Audit Commission Act 1998. The pension fund accounting statements comprise the Fund Account, the Net Assets Statement and the related notes. These accounting statements 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 48 of the Statement of Responsibilities of Auditors and Audited Bodies published by the Audit Commission in March 2010.

## Respective responsibilities of the Director of Finance and auditor

As explained more fully in the Statement of Responsibilities for the Statement of Accounts, the Director of Finance is responsible for the preparation of the pension fund’s Statement of Accounts in accordance with proper practices as set out in the CIPFA/LASAAC Code of Practice on Local Authority Accounting in the United Kingdom. My responsibility is to audit the accounting statements in accordance with applicable law and International Standards on Auditing (UK and Ireland). Those standards require me to comply with the Auditing Practices Board’s Ethical Standards for Auditors.

i For inclusion in the Council’s Statement of Accounts

## Scope of the audit of the financial statements

An audit involves obtaining evidence about the amounts and disclosures in the accounting statements sufficient to give reasonable assurance that the accounting statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of: whether the accounting policies are appropriate to the fund's circumstances and have been consistently applied and adequately disclosed; the reasonableness of significant accounting estimates made by the fund; and the overall presentation of the accounting statements. I read all the information in the explanatory foreword [*and the annual report*]<sup>i</sup> to identify material inconsistencies with the audited accounting statements. If I become aware of any apparent material misstatements or inconsistencies I consider the implications for my report.

## Opinion on accounting statements

In my opinion the pension fund's accounting statements:

- give a true and fair view of the financial transactions of the pension fund during the year ended 31 March 2011 and the amount and disposition of the fund's assets and liabilities as at 31 March 2011 other than liabilities to pay pensions and other benefits after the end of the scheme year and
- have been properly prepared in accordance with the CIPFA/LASAAC Code of Practice on Local Authority Accounting in the United Kingdom.

## Opinion on other matters

In my opinion, the information given in the explanatory foreword [*and the content of the Annual Report*]<sup>ii</sup> for the financial year for which the accounting statements are prepared is consistent with the accounting statements.

<sup>i</sup> I will insert these words if there are no matters arising from my review of the Council's annual report.

<sup>ii</sup> I will insert these words if I have no matters arising from my review of the Council's annual report.

# Appendix 1a – Draft independent auditor’s report for inclusion in Pension Fund Annual Report

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## **Draft independent auditor’s report to the members of Wirral Borough Council**

### **Opinion on the pension fund accounting statements**

I have audited the pension fund accounting statements for the year ended 31 March 2011 under the Audit Commission Act 1998. The pension fund accounting statements comprise the Fund Account, the Net Assets Statement and the related notes. These accounting statements have been prepared under the accounting policies set out in the Statement of Accounting Policies.

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

As explained more fully in the Statement of Responsibilities for the Statement of Accounts, the Director of Finance is responsible for the preparation of the pension fund’s Statement of Accounts in accordance with proper practices as set out in the CIPFA/LASAAC Code of Practice on Local Authority Accounting in the United Kingdom. My responsibility is to audit the accounting statements in accordance with applicable law and International Standards on Auditing (UK and Ireland). Those standards require me to comply with the Auditing Practices Board’s Ethical Standards for Auditors.

## **Scope of the audit of the financial statements**

An audit involves obtaining evidence about the amounts and disclosures in the accounting statements sufficient to give reasonable assurance that the accounting statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of: whether the accounting policies are appropriate to the fund's circumstances and have been consistently applied and adequately disclosed; the reasonableness of significant accounting estimates made by the fund; and the overall presentation of the accounting statements. I read all the information in the annual report to identify material inconsistencies with the audited accounting statements. If I become aware of any apparent material misstatements or inconsistencies I consider the implications for my report.

## **Opinion on accounting statements**

In my opinion the pension fund's accounting statements:

- give a true and fair view of the financial transactions of the pension fund during the year ended 31 March 2011 and the amount and disposition of the fund's assets and liabilities as at 31 March 2011 other than liabilities to pay pensions and other benefits after the end of the scheme year; and
- have been properly prepared in accordance with the CIPFA/LASAAC Code of Practice on Local Authority Accounting in the United Kingdom.

## **Opinion on other matters**

In my opinion, the information given in the annual report for the financial year for which the accounting statements are prepared is consistent with the accounting statements.

## **Matters on which I report by exception**

I have nothing to report in respect of the governance statement on which I report to you if, in my opinion the governance statement does not reflect compliance with the Local Government Pension Scheme (Administration) Regulations 2008 and related guidance.

# Appendix 2 – Amendments to financial statements

I identified the following misstatements during my audit and management have adjusted the financial statements. I bring them to your attention to aid you in fulfilling your governance responsibilities.

Adjusted misstatement	Nature of adjustment	Fund account		Net assets statement	
		Dr £000s	Cr £000s	Dr £000s	Cr £000s
Transitional IFRS net asset statement omitted	Include net assets statement as at 1 April 2009				
Misanalysis of investments	£139m investment in Amundi Global Emerging Markets and £134m investment in M&G Global Emerging Markets categorised as equity investments rather than pooled investments				
10,000 units in L’Oreal Prime de Fidelité omitted from net assets statement	Increase value of investments in net assets statement and increase change in market value of investments in funds account		728	728	

	Fund account	Net assets statement
Other disclosure errors	<ul style="list-style-type: none"> <li>■ a small number of typographic errors and mis-castings</li> <li>■ gross up £4m Forward Euro contracts and £4m associated liabilities in investments disclosure note</li> <li>■ £0.5m transitional fund manager balance categorised as equity rather than cash</li> <li>■ The contributions note does not disclose that an element of regular employer contributions represents deficit funding</li> </ul>	

# Appendix 3 – Letter of representation

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## Merseyside Pension Fund - Audit for the year ended 31 March 2011

I confirm to the best of my knowledge and belief, having made appropriate enquiries of other directors and officers of the Merseyside Pension Fund (the Fund), the following representations given to you in connection with your audit of the Fund's financial statements for the year ended 31 March 2011.

### Compliance with the statutory authorities

I have fulfilled 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 which give a true and fair view of the financial position and financial performance of the Fund for the completeness of the information provided to you, and for making accurate representations to you.

### Supporting records

All relevant information and access to persons within the entity has been made available to you for the purpose of your audit, and all the transactions undertaken by the Fund have been properly reflected and recorded in the financial statements.

### Irregularities

I acknowledge my responsibility for the design, implementation and maintenance of internal control to prevent and detect fraud or error.

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;
- 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; and
- the results of our assessment of the risk that the financial statements may be materially misstated as a result of fraud.

## **Law, regulations, contractual arrangements and codes of practice**

I have disclosed to you all known instances of non-compliance, or suspected non-compliance with laws, regulations and codes of practice, whose effects should be considered when preparing financial statements.

Transactions and events have been carried out in accordance with law, regulation or other authority. The 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.

All known actual or possible litigation and claims, whose effects should be considered when preparing the financial statements, have been disclosed to the auditor and accounted for and disclosed in accordance with the applicable financial reporting framework.

## **Accounting estimates including fair values**

I confirm the reasonableness of the significant assumptions used in making the accounting estimates, including those measured at fair value.

## **Related party transactions**

I confirm that I have disclosed the identity of the Fund's related parties and all the related party relationships and transactions of which I am aware. I have appropriately accounted for and disclosed such relationships and transactions in accordance with the requirement of the framework.

## **Compensatory added years (CAYs)**

No employing authority has made a resolution to convert CAYs into pension service.

## **Subsequent events**

All events subsequent to the date of the financial statements, which would require additional adjustment or disclosure in the financial statements, have been adjusted or disclosed.

# Appendix 4 – Action Plan

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Page no.	Recommendation	Priority 1 = Low 2 = Med 3 = High	Responsibility	Agreed	Comments	Date
6	Ensure that any changes to the investment ledger after it has been reconciled with the general ledger are also reflected in the accounts.	3	Group Accountant	Yes	A review of information flows has already begun.	June 2012
6	Review the latest available information on unquoted investments as part of a formal process considering potential adjusting post balance sheet events between the preparation and members' approval of the accounts.	3	Group Accountant	Yes		Sept 2012

# Appendix 5 – Glossary

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## Annual governance statement

A statement of internal control prepared by an audited body and published with the financial statements.

## Audit opinion

On completion of the audit of the financial statements, I must give my 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; and
- whether they have been prepared properly, following the relevant accounting rules.

## Opinion

If I agree that the financial statements give a true and fair view, I issue an unqualified opinion. I issue a qualified opinion if:

- I find the statements do not give a true and fair view; or
- I cannot confirm that the statements give a true and fair view.

## Materiality and significance

The Auditing Practices Board (APB) defines this concept as ‘an expression of the relative significance or importance of a particular matter for the financial statements as a whole. A matter is material if its omission would reasonably influence users of the financial statements, such as the addressees of the auditor’s report; also a misstatement is material if it would have a similar influence. Materiality may also be considered for any individual primary statement within the financial statements or of individual items included in them. We cannot define materiality mathematically, as it has both numerical and non-numerical aspects’.

The term ‘materiality’ applies only to the financial statements. Auditors appointed by the Commission have responsibilities and duties under statute, as well as their responsibility to give an opinion on the financial statements, which do not necessarily affect their opinion on the financial statements.

‘Significance’ applies to these wider responsibilities and auditors adopt a level of significance that may differ from the materiality level applied to their audit in relation to the financial statements. Significance has both qualitative and quantitative aspects.

## Weaknesses in internal control

A weakness in internal control exists when:

- a control is designed, set up or used in such a way that it is unable to prevent, or detect and correct, misstatements in the financial statements quickly; or
- a control necessary to prevent, or detect and correct, misstatements in the financial statements quickly is missing.

An important weakness in internal control is a weakness, or a combination of weaknesses that, in my professional judgement, are important enough that I should report them to you.

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- any third party.

