

# Annual Governance Report

Merseyside Pension Fund

Audit 2009/10

September 2010

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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. 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.
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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.

## Key messages

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### 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.

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### 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.

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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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**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.**

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## 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.

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## 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.



## Financial statements

**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   |
|--|---|
| <p>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.</p> <p>Shareholder continues to be relied on for alternatives, ventures and property.</p> <p>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.</p> | <p>We have gained adequate assurance from our substantive testing that the investments in the financial statements are materially correct.</p> <p>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</p> |
| <p>A new general ledger accounting system was implemented at Merseyside Pension Fund with effect from 1st October 2009.</p> <p>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.</p>  | <p>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.</p>  |
| <p>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.</p>  | <p>There continue to be a high number of errors and misstatements identified in the Pension Fund account.</p> <p>I have recommended that the Pension Fund strengthens its internal control arrangements to ensure that the number of errors and misstatements are minimised.</p>                                      |
| <p>The 2008/09 audit identified a failure by a member to provide the necessary related party disclosure declaration.</p> <p>There is a risk of non disclosure of related party relationships or transactions.</p>  | <p>All members have provided related party disclosures for 2009/10.</p> <p>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.</p> <p>The detail of this is provided in Appendix 2.</p>                          |

## Financial statements

| 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.  |
| <p>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.</p> <p>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.</p>                                      | 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.          |
| <p>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.</p> | <p>Our substantive testing did not identify any material errors in the valuation of unquoted investments.</p> <p>However we have made a recommendation (R4 provides detail) regarding the due diligence carried out on Investment valuations.</p> |
| <p>The LGPS Management and Investment of Funds Regulations 2009 came into force on 1 January 2010.</p> <p>Key changes include the banking arrangements between Administering Authorities and Pension Funds, and limits on investments.</p>  | 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

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## 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.

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## 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.
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## Qualified

**30** The auditor has some reservations or concerns.

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## Unqualified

**31** The auditor does not have any reservations.

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

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## 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.

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## 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).

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

- 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.

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### 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.

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

- 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.

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### 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**

| Adjusted misstatements   | Nature of adjustment   | Fund Account |                          | Net Assets Statement |          |
|--|--|--------------|--------------------------|----------------------|----------|
|  |  | Dr £000s     | Cr £000s                 | Dr £000s             | Cr £000s |
| Purchases<br>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<br>ER Strain Debtors<br>ER Strain Deficit Funding | Note 3 to the Fund account for Augmentation has been understated by £24,146k: <ul style="list-style-type: none"> <li>£13,214k due to under accrual for payments due in future years.</li> <li>£2,792k due to under accrual of payments relating to 2009/10.</li> <li>£8,140k due to misclassification as deficit funding.</li> </ul> | 8,140        | 13,214<br>2,792<br>8,140 | 13,214<br>2,792      |          |

## 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 |
| 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:<br><br>£4k Deficit funding<br>£390k accrued for the amount reimbursed (creditors)  | 390          |          |                      | 390      |
| Net Assets Statement - Investments | 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                |          |
| Change in market value             |   |              | 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.<br><br>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).<br>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.<br>Employers contributions<br>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.<br>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                 |          |

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

- 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<br>£000 |
|---|--|------------------------|
| <p>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.</p> | <p>Fund Account, and related notes</p> | <p>12,183</p>          |

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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 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;

## Appendix 4 – Draft letter of representation

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-imbusement 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<br>1 = Low<br>2 = Med<br>3 = High | Responsibility             | Agreed | Comments   | Date         |
|---|--|--|----------------------------|--------|--|--------------|
| <b>Annual Governance Report 2009/10 - Recommendations</b> |  |  |                            |        |  |              |
| 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 |

## Appendix 5 – Action plan

| Page no. | Recommendation  | Priority<br>1 = Low<br>2 = Med<br>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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