

Annual governance report

Merseyside Pension Fund

Audit 2011/12



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Key messages

This report summarises the findings from my 2011/12 audit of the Pension Fund financial statements which is substantially complete.

Subject to satisfactory completion of a small number of outstanding issues, I intend to issue an unqualified opinion on the Pension Fund's Annual accounts for 2011/12 and the Pension Funds Annual Report.

The Pension Fund presented me with a set of statements in accordance with the statutory deadline. The statements were produced to a good standard and were supported by a comprehensive set of working papers. The standard of the working papers and timeliness of their receipt represents a significant improvement to the previous year.

I identified a number of non-material errors, all of which have been amended by the Pension Fund. None of these errors had a significant impact to the reported performance of the fund.

I also identified a number of disclosure errors and non trivial errors, all of which the pension fund have amended. These are detailed for your information at appendix 3.

There are no other significant matters that I need to bring to your attention.

Before I give my opinion

My report includes only matters of governance interest that have come to my attention in performing my audit. I have not designed my audit 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 am not aware of any relationships that may affect the independence and objectivity of the Audit Commission, the audit team or me, that I am required by auditing and ethical standards to report to you.

Next Steps

I ask the Pension Fund Committee to:

- Consider the matters raised in this report before recommending the approval of the financial statements to the Audit and Risk Management Committee (ARMC) of Wirral Council.
- take note of the adjustments to the Pension Fund's accounts which are set out in this report (Appendix 3);
- recommend to the Audit and Risk Management Committee the letter of representation on behalf of the Pension Fund before I issue my opinion and conclusion (Appendix 4); and
- confirm your response to the proposed action plan (Appendix 6).

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

- considers the matters raised in this report before approving the 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 action plan.

Financial statements

The Pension Fund's financial statements are an important mechanism for the Pension Fund to account for its stewardship of public funds. As Members you have final responsibility for these statements. It is important that you consider my findings before you adopt the financial statements.

Opinion on the financial statements

Subject to satisfactory clearance of a small number of outstanding matters, I plan to issue an audit report including an unqualified opinion on the financial statements. My opinion will be included within Wirral Council's Statement of Accounts and the financial statements included within the Pension Fund Annual Report. Appendix 1 and 1a contain copies of my draft audit reports.

As at 30 August 2012, my work is ongoing in a number of areas. These outstanding matters are:

- Completion of testing of investment valuations;
- Completion of review of related party transactions;
- Check of the final post audited financial statements; and
- Review of the final Annual Report.

I expect to complete all my work, including my final review procedures, before the Pensions Committee on 18 September. I will update the Committee as necessary as part of my oral report.

Corrected errors

My work identified a number of non-material errors in the statements presented for audit. None of these have a significant impact on the financial position of the Pension Fund at 31 March 2012. These have now been amended. A schedule of the changes is attached, appendix 3. I also agreed a number of changes to disclosures and supporting narrative.

The most significant amendments are:

- Overstatement of Pooled Investment Vehicles of £3.279 m due to incorrect currency rates being used.
- Mis-classification of investment management fee credit as investment income - amendment of £3.687m.
- Re-classification of UK quoted equities to overseas quoted equities - amendment of £12.183 m.

Specific risks and my findings

I reported to you in my December 2011 Audit Plan the specific risks that I identified relevant to my audit of your financial statements. In Table 1 I report to you my findings against each of these risks.

Table 1: Risks and findings

Risk	Finding
<p><u>Scheme contributions</u></p> <p>The Pension Fund receives contributions in respect of equal pay settlements made by admitted bodies. Some but not all admitted bodies have made contributions in respect of equal pay. There is a risk this may lead to a material misstatement of contributions income in the financial statements.</p>	<p>I have reviewed management's arrangements for ensuring that reasonable contributions have been made in respect of equal pay.</p> <p>I have considered settlements made within major scheduled bodies to the fund and assessed if they may give rise to potential material assets to the fund, if contributions were not made. I am satisfied that the risk of material misstatement has been reduced to an appropriately low level.</p>
<p><u>Investment valuations</u></p> <p>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'.</p> <p>The Pension Fund's accounting policies describe the valuation methodology used for unquoted investments, including hedge funds and private equity. These are in line with the valuations provided by the independent administrators, or where these are not available, at the investment managers' valuation.</p> <p>As reported in my 2010/11 Annual Governance report and supplement, unquoted investments, primarily private equity, were undervalued by £13m because out of date valuations were used.</p>	<p>I have reviewed the Pension Fund's due diligence procedures for the valuation of investments, including its review and consideration of AAF 01/06, ISAE 3402 controls reports from investment managers, and found these procedures to be adequate.</p> <p>My team is in the process of substantively testing investments. Their work has so far identified two investments where incorrect currency rates were applied. This has led to an overstatement of £3.279m in the net assets statement.</p> <p>I plan to have completed my testing by the 18 September. If there are any further significant errors I will update the Pensions Committee and Audit and Risk Management Committee.</p>

Risk	Finding
<p><u>Impact of redundancies on capacity within the Pension Fund</u></p> <p>I am aware that Wirral Council and the Pension Fund have undergone a redundancy process in 2010/11 and 2011/12. This may affect the capacity of the finance team to deliver materially correct statements within agreed timescales.</p>	<p>The statements were provided within deadline, and supported by comprehensive working papers.</p> <p>We have maintained regular dialogue with the Pension Fund officers and have been kept informed of significant changes in resources. Where potential weaknesses around separation of duties have arisen from the new structure, we are satisfied that the Pension Fund has applied adequate safeguards to mitigate risks.</p>

Weaknesses in internal control

It is the responsibility of the Pension Fund to develop and implement systems of internal financial control and to put in place proper arrangements to monitor their adequacy and effectiveness in practice. My responsibility as your auditor is to consider whether the Pension Fund has put adequate arrangements in place to satisfy itself that the systems of internal financial control are both adequate and effective in practice.

I have tested the controls of the Pension Fund only to the extent necessary for me to complete my audit. I am not expressing an opinion on the overall effectiveness of internal control.

The following weakness in internal control is only that I have identified during the audit that is relevant to preparing the financial statements.

Table 2: **Weakness in internal control**

Issue	Finding
<p>Out of date list of authorised employees within the Pension Fund to receive correspondence from external bodies, for example Fund Managers.</p>	<p>An ex employee of the Fund is still listed as authorised to receive correspondence from external bodies, for example, Fund Managers. This employee has not been working at MPF for a period of 3 years. Whilst this employee is still employed by Wirral MBC, it is essential that only authorised employees of the fund are authorised to receive such information. I have been told that the Fund has postponed updating this information as it has been awaiting the conclusion of the internal restructure and the revised banking arrangements. However, this should be addressed without further delay.</p>

Recommendation

R1 Ensure that the Pension Fund's authorised contacts list is updated. .

Other matters

I am required to communicate to you significant findings from the audit and other matters that are significant to your oversight of the Pension Fund's financial reporting process including the following.

- Qualitative aspects of your accounting practice
- Matters specifically required by other auditing standards to be communicated to those charged with governance. For example, issues about fraud, compliance with laws and regulations, external confirmations and related party transactions.
- Other audit matters of governance interest.

My findings are reported in the table below:

Table 3: **Other matters**

Issue	Finding
Breach of the Local Government Pension Scheme (Management and Investment of Funds) Regulations 2009 in regards to investment limits.	The Local Government Pension Scheme (Management and Investment of Funds) Regulations 2009 (which came into force on 1 January 2010) set out a required process for Pension Funds to follow when planning to increase investment limits. In 2011/12 the Pension Fund exceeded the limits as set out in their current Statement of Investment Principals (SIP), without following the proper procedure as set out in the regulations
Financial instruments disclosures	The Pension fund has enhanced the financial instruments disclosures in 2011/12, in line with requirements. To be fully compliant with the requirements of the Code of Practice on Local Authority Accounting in the United Kingdom, further enhancements are needed, particularly in regards to the quantitative reporting of credit, currency and liquidity risk.

Recommendation

R2 Implement robust controls for monitoring and reporting against the investment limits set in the Statement of Investment Principals to ensure that future breaches of the Local Government Pension Scheme (Management and Investment of Funds) Regulations 2009 do not occur.

R3 Review the current reporting arrangements for credit and liquidity risk, to enable fully compliant reporting in line with the Code of Practice on Local Authority Accounting in the United Kingdom.

Pension Fund Annual Report

The Pension Fund prepared its draft Annual Report on 1 August 2012. Upon satisfactory completion of my audit of the financial statements, the Pension Fund will prepare its final Annual Report, which I will review. As a result I have not yet completed my review and report on the financial statements included in the Annual Report. I expect to report on the financial statements included in the Annual Report by 18 September 2012.

Fees

I reported my planned audit fee in the December 2011 Audit Plan.

I will complete the audit within the planned fee.

Table 4: Fees

	Planned fee 2011/12 (£)	Expected fee 2011/12 (£)
Audit	59,181	59,181
Non-audit work	0	0
Total	59,181	59,181

Appendix 1 – Draft independent auditor’s report for the Councils financial statements

DRAFT INDEPENDENT AUDITOR’S REPORT TO THE MEMBERS OF WIRRAL BOROUGH COUNCIL - EXCERPT REGARDING MERSEYSIDE PENSION FUND.

Opinion on the pension fund financial statements

I have audited the pension fund financial statements for the year ended 31 March 2012 under the Audit Commission Act 1998. The pension fund financial statements comprise the Fund Account, the Net Assets Statement and the related notes. The financial reporting framework that has been applied in their preparation is applicable law and the CIPFA/LASAAC Code of Practice on Local Authority Accounting in the United Kingdom 2011/12.

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 Chief Financial Officer and auditor

As explained more fully in the Statement of the Chief Financial Officer’s Responsibilities, the Chief Financial Officer is responsible for the preparation of the Authority’s Statement of Accounts, which includes the pension fund financial statements, in accordance with proper practices as set out in the CIPFA/LASAAC Code of Practice on Local Authority Accounting in the United Kingdom, and for being satisfied that they give a true and fair view. My responsibility is to audit and express an opinion on the financial 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 financial statements sufficient to give reasonable assurance that the financial 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 Chief Financial Officer; and the overall presentation of the financial statements. In addition, I read all the financial and non-financial information in the explanatory foreword and the annual report to identify material inconsistencies with the audited financial statements. If I become aware of any apparent material misstatements or inconsistencies I consider the implications for my report.

Opinion on financial statements

In my opinion the pension fund's financial statements:
give a true and fair view of the financial transactions of the pension fund during the year ended 31 March 2012 and the amount and disposition of the fund's assets and liabilities as at 31 March 2012, 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 for the financial year for which the financial statements are prepared is consistent with the financial statements.

Appendix 2 – Draft independent auditor’s report for the Pension Fund Annual Report

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 financial statements for the year ended 31 March 2012 under the Audit Commission Act 1998. The pension fund financial statements comprise the Fund Account, the Net Assets Statement and the related notes. The financial reporting framework that has been applied in their preparation is applicable law and the CIPFA/LASAAC Code of Practice on Local Authority Accounting in the United Kingdom 2011/12.

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 of Audited Bodies published by the Audit Commission in March 2010.

Respective responsibilities of the Chief Financial Officer and auditor

As explained more fully in the Statement of the Chief Financial Officer’s Responsibilities, the Chief Financial Officer is responsible for the preparation of the pension fund’s financial statements and for being satisfied that they give a true and fair view. My responsibility is to audit and express an opinion on the financial 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 financial statements sufficient to give reasonable assurance that the financial 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 Chief Financial Officer; and the overall presentation of the financial statements. In addition, I read all the financial and non-financial information in the annual report to identify material inconsistencies with the audited financial statements. If I become aware of any apparent material misstatements or inconsistencies I consider the implications for my report.

Opinion on financial statements

In my opinion the pension fund's financial statements:

- give a true and fair view of the financial transactions of the pension fund during the year ended 31 March 2012 and the amount and disposition of the fund's assets and liabilities as at 31 March 2012; and
- have been prepared properly in accordance with the CIPFA/LASAAC Code of Practice on Local Authority Accounting in the United Kingdom 2011/12.

Opinion on other matters

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

Michael Thomas
District Auditor

Aspinall House
Aspinall Close
Horwich
Bolton
BL6 6QQ

September 2012

Appendix 3 – Corrected errors

I identified the following errors during the audit which management have addressed in the revised financial statements.

		Fund Account		Net Assets Statement	
Item of account	Nature of error	Dr £'000s	Cr £'000s	Dr £'000s	Cr £'000s
Net assets statement - Unquoted investments	Overstatement of unquoted investments through use of incorrect currency conversion rates.	3,279			3,279
Fund manager expenses	Understatement of Fund manager expenses.	188			188
Fund account (& note 6) - Contributions receivable	Overstatement of employee's contributions, understatement of employer's contributions.	743	743		
Note 11 - Investment income	Dividend income incorrectly classified as interest on short term cash deposits.	553	553		
Note 11 - Investment income	Investment management fee credit incorrectly classified as investment income.	3,687	3,687		
Note 13 (a)	Reclassification of UK quoted equities to overseas quoted equities.			12,183	12,183
Accounting policies	Revision and enhancement of accounting policies in a number of				

		Fund Account		Net Assets Statement	
	<p>areas. Specifically:</p> <ul style="list-style-type: none"> ■ Inclusion of an accounting policy for treatment of income for pooled investments; ■ Inclusion of policy on movement in the net market value of investments; ■ Inclusion of policy relating to tax on fund expense items; ■ Inclusion of policy on financial liabilities; ■ Enhanced narrative of policy for transfers to and from other schemes; ■ Enhancement of the basis for estimates to disclosure inherent uncertainties and judgement used in the basis of the valuation estimates for unquoted investments; ■ Enhanced policy for costs related to pooled investment vehicles; and ■ Enhanced policy for property valuation. 				
Accounting policies	Removal of a note on prior period adjustments from within accounting policies. No prior period adjustments have been applied in 2011/12.				

		Fund Account		Net Assets Statement	
Fund account - Contributions receivable	Overstatement of £922K of contributions income has been recorded in respect of 2011-12 which relates to 2010-11.				
Note 13 - Investments	Removal of purchases and sales of short term cash deposits.				
Note 10 – Administration expenses	Addition of an explanatory note.				
Note 6 contribution income	Deficit funding relating to magistrates courts disclosed as £6.4 million. Should be £1.4 million.				
Statement of the consulting actuary	Fund deficit was incorrectly recorded as £1400 million. Actuary to provide a note stating £1310 million.				
Note 14a – classification of financial instruments	£12,251K financial liabilities at amortised cost incorrectly recorded as loans and receivables.				
Note 21 - Related Party Transactions	Revision to the key management personnel table following updated guidance. Enhancement and revision of some existing text within the note.				

Appendix 4 – Draft letter of management representation

Merseyside Pension Fund - Audit for the year ended 31/03/2012

I confirm to the best of my knowledge and belief, having made appropriate enquiries of other directors and officers of Merseyside Pension Fund and Wirral Borough Council, the following representations given to you in connection with your audit of the Pension Fund's financial statements for the year ended 31/03/2012.

Compliance with the statutory authorities

I have fulfilled my responsibility under the relevant statutory authorities for preparing the financial statements in accordance with the Accounts and Audit (England) Regulations 2011 and the Code of Practice on Local Authority Accounting in the United Kingdom which give a true and fair view of the financial position and financial performance of the Pension Fund, for the completeness of the information provided to you, and for making accurate representations to you.

Supporting records

I have made available all relevant information and access to persons within the Pension Fund and Wirral Borough Council for the purpose of your audit. I have properly reflected and recorded in the financial statements all the transactions undertaken by the Pension Fund.

Internal control

I have communicated to you all deficiencies in internal control of which I am aware.

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 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.

Other than the breach of regulations identified and reported in Table 3, transactions and events have been carried out in accordance with law, regulation or other authority. 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.

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.

For accounting estimates relating to Private Equity, Hedge Funds and Investment Property valuations, I confirm:

- the appropriateness of the measurement method, including related assumptions and models, and the consistency in application of the method;
- the assumptions appropriately reflect management's intent and ability to carry out specific courses of action on behalf of the Pension Fund, where relevant to the accounting estimates and disclosures;
- the disclosures relating to the accounting estimate are complete and appropriate under the Code; and
- that no subsequent event requires the Pension Fund to adjust the accounting estimate and related disclosures included in the financial statements.

Related party transactions

I confirm that I have disclosed the identity of the Pension 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 requirements of the Code.

Subsequent events

I have adjusted for or disclosed in the financial statements all relevant events subsequent to the date of the financial statements.

Signed on behalf of Merseyside Pension Fund

I confirm that this letter has been discussed and agreed by the Audit and Risk Management Committee on 19 September 2012.

Signed

Name

Position

Date

Appendix 5 – Glossary

Annual Audit Letter

Letter issued by the auditor to the Pension Fund after the completion of the audit that summarises the audit work carried out in the period and significant issues arising from auditors' work.

Annual Governance Report

The auditor's report on matters arising from the audit of the financial statements presented to those charged with governance before the auditor issues their opinion.

Audit of the accounts

The audit of the accounts of an audited body comprises all work carried out by an auditor under the Code to meet their statutory responsibilities under the Audit Commission Act 1998.

Audited body

A body to which the Audit Commission is responsible for appointing the external auditor.

Auditing Practices Board (APB)

The body responsible in the UK for issuing auditing standards, ethical standards and associated guidance to auditors. Its objectives are to establish high standards of auditing that meet the developing needs of users of financial information and to ensure public confidence in the auditing process.

Auditing standards

Pronouncements of the APB that contain basic principles and essential procedures with which auditors must comply, except where otherwise stated in the auditing standard concerned.

Auditor(s)

Auditors appointed by the Audit Commission.

Code (the)

The Code of Audit Practice for local government bodies issued by the Audit Commission and approved by Parliament.

Commission (the)

The Audit Commission for Local Authorities and the National Health Service in England.

Ethical Standards

Pronouncements of the APB that contain basic principles relating to independence, integrity and objectivity that apply to the conduct of audits and with which auditors must comply, except where otherwise stated in the standard concerned.

Financial statements

The annual statement of accounts that the Pension Fund is required to prepare, which report the financial performance and financial position of the Pension Fund in accordance with the Accounts and Audit (England) Regulations 2011 and the Code of Practice on Local Authority Accounting in the United Kingdom.

Internal control

The whole system of controls, financial and otherwise, that the Pension Fund establishes to provide reasonable assurance of effective and efficient operations, internal financial control and compliance with laws and regulations.

Materiality

The APB defines this concept as ‘an expression of the relative significance or importance of a particular matter in the context of the financial statements as a whole. A matter is material if its omission would reasonably influence the decisions of an addressee of the auditor’s report; likewise a misstatement is material if it would have a similar influence. Materiality may also be considered in the context of any individual primary statement within the financial statements or of individual items included in them. Materiality is not capable of general mathematical definition, as it has both qualitative and quantitative 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.

Pension Fund Annual Report

The annual report, including financial statements, that the Pension Fund must publish under Regulation 34 of the Local Government Pension Scheme (Administration) Regulations 2008.

Significance

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

Those charged with governance

Those entrusted with the supervision, control and direction of the Pension Fund. This term includes the members of the Authority, the Pension's Committee and the Audit and Risk Management Committee.

Appendix 6 – Action plan

Recommendations

Recommendation 1

Ensure that the Pension Fund's authorised contacts list is updated.

Responsibility

Priority

Date

Comments

Recommendation 2

Implement robust controls for monitoring and reporting against the investment limits set in the Statement of Investment Principals, to ensure that future breaches of the Local Government Pension Scheme (Management and Investment of Funds) Regulations 2009 do not occur.

Responsibility

Priority

Date

Comments

Recommendation 3

Review the current reporting arrangements for credit and liquidity risk, to enable fully compliant reporting in line with the Code of Practice on Local Authority Accounting in the United Kingdom.

Responsibility

Priority

Date

Comments

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

