# AGENDA ITEM: 9 Page nos. 38 - 54

| | |
|---|---|
| Meeting | Pension Fund Committee |
| Date | 1 September 2011 |
| **Subject** | **External Auditor's Report under International Standard on Auditing (ISA) 260 for the year 2010/11** |
| Report of | Deputy Chief Executive & Chief Finance Officer |
| Summary | To consider the detailed reports from the external auditor on matters arising from the audit of the 2010/11 Pension Fund Accounts |

| | |
|---|---|
| Officer Contributors | John Hooton, Assistant Director, Strategic Finance |
| Status (public or exempt) | Public |
| Wards affected | Not applicable |
| Enclosures | Appendix A – ISA 260 report 2010/11 |
| For decision by | Pension Fund Committee |
| Function of | Council |
| Reason for urgency / exemption from call-in (if appropriate) | Not applicable |

Contact for further information: John Hooton, Assistant Director Strategic Finance 020 83592460

## 1. RECOMMENDATIONS

**1.1 That the Committee approve the audited Pension Fund Account 2010/11 and they be signed by the Chairman as having been approved.**

**1.2 That the matters raised by the external auditor relating to detailed aspects of the 2010/11 accounts audit, including the pension fund accounts, be noted.**

**1.3 That the officer response to matters raised by the external auditor be noted.**

**1.4 That the Committee consider whether there are any areas on which they require additional information or action.**

## 2. RELEVANT PREVIOUS DECISIONS

2.1 The un-audited Statement of Accounts for 2010/11 were approved, subject to audit, by the Pensions Committee on 21 June 2011.

## 3. CORPORATE PRIORITIES AND POLICY CONSIDERATIONS

3.1 Review of reports made under the International Standard on Auditing (ISA) 260 are an integral part of corporate governance, this is inline with Barnet's Corporate Plan within 'Better services with less money'.

## 4. RISK MANAGEMENT ISSUES

4.1 A positive external audit opinion on the Pension Fund Account plays an essential and key role in providing assurance that Barnet's financial risks are managed in an environment of sound stewardship and control.

## 5. EQUALITIES AND DIVERSITY ISSUES

5.1 Accurate financial reporting is important to ensure the management of resources to enable the equitable delivery of services to all members of the community and to reduce the differential impact of the services received by all of Barnet's diverse communities.

## 6. USE OF RESOURCES IMPLICATIONS (FINANCE, PROCUREMENT, PERFORMANCE & VALUE FOR MONEY, STAFFING, ICT, PROPERTY, SUSTAINABILITY)

6.1 The Pension Fund Account shows the financial position as at 31 March 2011.

## 7. LEGAL ISSUES

7.1 None in the context of this report.

## 8. CONSTITUTIONAL POWERS

8.1 Within the Council's Constitution, the functions of the Pensions Committee include acting as "those charged with governance" in respect of the Pension Fund Accounts.

## 9. BACKGROUND INFORMATION

9.1 In accordance with International Standard on Auditing (ISA) 260, the External Auditor is required to issue detailed reports on matters arising from the audit of the Council's accounts and Pension Fund accounts.

9.2 The ISA 260 report has to be considered by 'those charged with governance' before the External Auditor can sign the accounts, which legally has to be done by 30 September 2011.

9.3 Grant Thornton (GT) were presented with the draft financial statementsin June 2011. GT identified a number of adjustments which are set out in their report.

9.4 The key message arising from the audit of the Pension Fund accounts are:

- The audit has been concluded earlier than in previous years;
- The auditor will issue an unqualified opinion;
- There were a number of accounting adjustments that needed to be made;
- There were some problems experienced in auditing the cash and current asset figures in the accounts.

9.5 The problems arising from the audit of cash and current asset figures arose primarily as a result of the Treasury Manager leaving the Council during the audit. There are a number of controls and processes that need to be documented for 2011/12 to enable a smoother audit.

## 10. LIST OF BACKGROUND PAPERS

10.1 None.

Legal: TE
CFO: JH

Grant Thornton

# London Borough of Barnet Pension Fund

Audit of Financial Statements 2010/11
Report to those Charged with Governance

**Contents** **Page**



**Appendices**

# 1 Executive Summary

ISAUK 260 requires communication of:

- relationships that have a bearing on the independence of the audit firm and the objectivity of the engagement team
- nature and scope of the audit work
- the form of reports expected.

## 1.1 Purpose of Report

Following a change to the regulations governing local government pension schemes, commencing with the 2008/09 year, auditors are required to carry out a separate audit of the Pension Fund, and engage with those charged with governance for the Fund. This is generally considered to be the Pensions Committee, but may be another committee as directed by the Administering Authority. As a result of this, auditors of the Pension Fund are required to issue a separate Audit Report and ISA260 report which records the findings of the auditors' work.

The London Borough of Barnet ('the Authority') is responsible for the preparation of accounts which record its financial position as at 31 March 2011 and its income and expenditure for the year then ended. We are responsible for undertaking an audit and reporting whether, in our opinion, the Authority's accounts present fairly the financial position of the Authority. Those accounts are required to include, as a separate appendix, the accounts of the Authority's Pension Fund.

This report has been prepared for the benefit of discussion between Grant ThorntonUK LLP and the Pension Fund Committee of the London Borough of Barnet Pension Fund ('the Fund'), to specifically consider the key issues affecting the Fund arising from our audit, and the preparation of the Fund's accounts for the year ended 31 March 2011. We would point out that the matters dealt with in this report came to our attention during the conduct of our normal audit procedures which are designed primarily for the purpose of expressing our opinion on the accounts of the Authority.

In consequence, our work did not encompass a detailed review of all aspects of the system and controls and cannot be relied upon necessarily to disclose defalcations or other irregularities, or to include all possible improvements in internal control that a more extensive special examination might develop.

The document is also used to report to management to meet the mandatory requirements of International Standard on Auditing (UK & Ireland) 260, and to report audit findings to "those charged with governance", designated as the Pension Fund Committee.

It is also our intention to provide this report for information to the Borough's Audit Committee as those charged with Governance for the Borough's overall affairs and accounts, and to summarise the findings in the Authority's overall ISA 260 report.

## 1.2 Audit Conclusions

Matters arising during the course of our work, that we would like to bring to the attention of the Committee, are set out in Section 2. An update on the action taken on matters raised during the audit for the year ended 31 March 2010 is set out in Section 3.

In Appendix B, we set out the proposed adjustments which the Authority has agreed to process in the accounts.

## 1.3 Acknowledgements

We would like to record our appreciation for the co-operation and assistance provided to us by the finance department and other staff at the Authority during the course of our audit.

**Grant Thornton UK LLP**

**Date………..**

# 2 Our findings

This section provides a summary of our observations arising from the audit of the Pension Fund.

This was a year of significant transition for the Fund, as it took over responsibility for accounting for cash held with Investment Managers. There was also a change in investment strategy, a change of accounting staff and the adoption of International Financial Reporting Standards. This has put a strain on the pensions team and findings 2.1 to 2.3 and 2.5 are likely to have been exacerbated by this transition.

## 2.1 Investment income

**Accrued investment income**

The draft accounts incorrectly included accrued investment income totalling £1.6m from the December Investment Manager reports. This income had already been accounted for when received by the Fund and therefore had therefore been double counted.

An adjustment has been processed by the Pensions team within the financial statements having the effect of reducing the net asset value of the scheme by £1.6m.

Management response: the adjustment has been processed.

**Other income**

During our audit work and confirmed through subsequent discussions with the Pensions team, we identified £1.55m of income included within the draft accounts relating to gains on foreign exchange which had been processed in error.

A reclassification adjustment has been proposed, accepted by the Pensions team and has been processed with the financial statements. The adjustment is a reclassification adjustment only and does not therefore impact the value of net assets.

Management response: the adjustment has been processed.

**Processing of investment data**

The above errors have been exacerbated by investment transaction data which has not been processed within the SAP accounting software since mid-November 2010.

The absence of recording investment transactions represents a control risk relating to an over-reliance on the fund manager reports and the lack of a proper and up-to-date reconciliation procedure between the accounting system and the investment manager reports. There is also potentially a risk of misappropriation of assets in the absence of such controls.

**Recommendation: We recommend that the Pensions team implement formal processes and controls to ensure that investment transactions are appropriately reflected in SAP and reconciled to investment manager reports and reviewed on a timely basis.**

**Management response: Accepted. The Treasury Manager left the team during the 2010/11 audit and this highlighted a lack of documentation of processes which will be rectified for 2011/12.**

### 2.2 Unrecorded benefits

As part of our audit procedures review, we found that approximately £1.6m of retirement benefits had not been provided for within the financial statements.

The error arose as a result of commutations on the final day of the year not having been identified for accrual amounting to £1.6m. This item is a one off error where member movements to 30 March 2011 were included and provided for but where member movements on 31 March 2011 were omitted.

In addition we identified one member's death benefit that required accrual within the financial statements amounting to £0.1m.

An adjustment has therefore been proposed, accepted by the Pensions Team and has been processed with the financial statements having the effect of increasing benefits payable and reducing the net asset value of the Fund by £1.7m.

**Recommendation: We recommend that a further review of benefits is carried out on or around 31 March each year to ensure all amounts are properly recorded.**

**Management response: Accepted.**

### 2.3 Financial statements preparation

As part of our audit work we noted that that certain trial balance codes which would have been expected to have been mapped to the net assets statement had not mapped to the net assets statement as presented for audit.

In addition, there was not a clear mapping of all the trial balance nominal ledger codes to the financial statements presented for audit.

Of the ten nominal ledger codes not clearly mapped, the following nominal ledger balances (all credit balances totalling £3.4m) were identified as balances that should have been included within the net asset statement:

- cash transfer account £1.3m
- investment management and professional fees creditors balance £1.8m
- Pay as you earn "PAYE" on pensions payments relating to the month of March 2011 £0.3m

On highlighting these issues, the pensions team have accepted that adjustments are required having the effect of reducing the fund account balance by £3.4m.

**Recommendation: We recommend that a full review of the mapping process is performed.**

**Management response: Accepted. The Treasury Manager left the team during the 2010/11 audit and this highlighted a lack of documentation of processes which will be rectified for 2011/12.**

### 2.4 Cash balances

During the year, cash balances held on behalf of Pension Fund were transferred to a separate bank account held by the Fund.

During our audit work we obtained a listing of cash balances at year end which included a series of reconciling items amounting to £4.6m and of this balance it was identified that £1.3m had not cleared after the year end.

An adjustment has therefore been proposed, accepted by the Pensions Team and has been processed with the financial statements having the effect of reducing the net asset value of the scheme by £1.3m as noted in section 2.3 above.

**Recommendation: We recommend that formal bank reconciliations are prepared on a monthly basis and reviewed and evidenced as reviewed by an appropriate member of the Pension team. We also recommend that bank account reconciling items are agreed as having cleared after the month end to ensure they are valid entries.**

**Management response: the responsibility for bank reconciliations across all Council accounts rests outside of the Pensions Accounting team. This will be reviewed in 2011/12 to ensure that the most effective process is put in place but it is accepted that there needs to be oversight in the Pension Accounting team.**

### 2.5 Timeliness of contributions receipts

Regulations require that contributions deducted from members' salaries are paid over to the Fund by no later than the nineteenth day following the calendar month, from which the contributions have been deducted.

During our review of contributions, it was noted that for nine bodies, contributions were late for between 1 and 35 days. This included:

- one instance of contributions being late for 35 days, relating to total contributions of £9.4k
- six instances where contributions were late for more than 10 days, relating to total contributions of £159k
- twelve instances of contributions being late up to 10 days, relating to total contributions of £1.4m.

The Fund's officers actively chased late payments and wrote to all bodies during the year reminding them of their duties to pay contributions to the Fund in a timely manner.

**Recommendation: We recommend that the Pension Fund officers continue to remind Scheduled and Admitted Bodies of the requirement to ensure that contributions are received on time, and late contributions are chased regularly.**

**Management response: the Pensions Administration team follow up payment of contributions on an annual basis and will ensure additional focus on this activity in 2011/12.**

### 2.6 Sundry Debtors

The sundry debtors balance included old debtors amounting to £0.3m not considered recoverable by the Pensions team.

An adjustment has therefore been proposed, accepted by the Pensions Team and has been processed within the financial statements having the effect of reducing the net asset value of the Fund by £0.3m.

**Recommendation: We recommend that the review of aged debtors is carried out more frequently.**

**Management response: Accepted. This will form part of the 2011/12 year end process.**

### 2.7 First time adoption of IFRS

In order for the Fundto comply with the code of practice "the code" on local authority accounting the Fundis required to adopt International Financial ReportingStandards ("IFRS") for the first time for the year ended 31 March 2011.

The Pension Fund has adopted 'Option C' under International Accounting Standard 26 Accounting and Reporting by Retirement Benefit Plans ("IAS 26"). On this basis the Pension Fund has not included the pension liability within the net assets statement but included the value as an appendix "IAS 26 disclosures as at 31 March 2011" as provided by the actuary Barnett Waddingham Public Sector Consulting.

# 3 Resolution of prior year findings

This section provides an update on observations made during the audit for the year ended 31 March 2010 which had implications for the 2010/11 audit.

## 3.1 Use of shared bank accounts

We reported last year that the Authority did not operate separate bank accounts in the name of the Pension Fund. The result of this was that separate reconciliations were required to ensure that monies in connection with the Pension Fund are "ring fenced" from that of the Authority. Cash allocated for investment with fund managers was also physically held by the Authority. In the prior year, we noted that management intended to improve the SAP accounting system to alleviate the time spent on reconciling the monies and strengthen controls.

**Update for 2010/11:**

The Fund started operating its own bank account from March 2011. Approximately £22m was transferred to Santander. Initially the Pensions team were unable to provide supporting documentation, however, subsequently, supporting documentation was received from the management team. The fund managers now also hold cash allocated for investments.

We refer you to section 2.3 for recommendations in respect of bank reconciliations.

## 3.2 Timeliness of contributions receipts

See section 2.4 above.

## 3.3 Accuracy of contribution deductions

In 2009/10, we identified one instance where the employer contribution rate had not been updated to the rate of 24% and therefore contributions were being deducted at the prior year rate of 23.3%. This occurred as a member joined the scheme in April 2009 and the employer rate was incorrectly entered.We recommended that the Treasury Manager, in conjunction with the Benefits Team, carried out an annual review of contribution rates to avoid any future errors.

**Update for 2010/11:**

We have not identified any similar instances in the sample selected for testing in the current year.

## 3.4 New pensioners

In 2009/10, we identified that in one death in service case the monthly pension for a widower had been incorrectly calculated. This error was not identified by a subsequent review.We recommend that the review controls in this area are strengthened.

**Update for 2010/11:**

We have not identified any similar instances during our audit work for the current year.

### 3.5 Discharge of future fund liabilities

Members are not required to confirm within their standard transfer out request form that they understand by transferring out of the Fund this discharges any further liabilities by the fund to those members. We recommend that the standard transfer out request forms is amended to include this statement.

**Update for 2010/11:**
Arrangements have been made for the transfer forms to be updated.

### 3.6 Connaught Partnerships

The scheduled body, Connaught Partnerships formally entered administration on 8 September 2010. The consequences of the administration will not be known until the process has been completed. The notes to the pension fund accounts include a statement to this effect.We recommend that the situation is closely monitored

**Update for 2010/11:**
We understand that Barnet's legal department are liaising with KPMG, the administrator, to recover the outstanding payment. The Fund actuary has reported that the impact on the deficit will be less that 0.1% of the payroll.

We recommend that the matter is continued to be disclosed in the financial statements.

# A Reporting requirements of ISA 260

The principal purpose of the ISA 260 report is:

To reach a mutual understanding of the scope of the audit and the respective responsibilities of the auditor and those charged with governance.
To share information to assist both the auditor and those charged with governance fulfil their respective responsibilities.
To provide to those charged with governance constructive observations arising from the audit process.

Matters Reported under ISA 260

| Area | Key Messages |
|---|---|
| **Independence** | We are able to confirm our independence and objectivity as auditors and draw attention to the following points:<br><br>We are independently appointed by the Audit Commission.<br>The firm has been assessed by the Audit Commission as complying with its required quality standards.<br>The appointed auditor and client service manager are subject to rotation every 5 years<br>We comply with the Auditing Practices Board's Ethical Standards. |
| **Audit Approach** | Our approach to the audit was set out in our 2010/11 audit plan. We have planned our audit in accordance with auditing standards and the Audit Commission's Code of Audit Practice. Other key factors to highlight include:<br><br>We consider the materiality of items in the financial statements in determining the audit approach and in determining the impact of any errors. |

| Area | Key Messages |
|---|---|
| **Accounting Policies** | We consider that the Fund has adopted appropriate accounting policies in the areas covered by our testing. Accounting policies were in accordance with the Local Government Pension Scheme Regulation 2007 (As Amended) and with guidelines set out in the Code of Practice of Local Authority Accounting in the United Kingdom 20010/11. The financial statements also comply with Statement of Recommended Practice, Financial Reporting of Pension Schemes (Revised May 2007), as applicable to Local Government Pension Schemes.<br><br>The Pensions Committee should confirm that it is satisfied that the accounting policies adopted are the most appropriate, as required by FRS 18. |
| **Audit Adjustments** | We have discussed with management a number of adjustments to the accounts having the effect of reducing the value of net assets by £3.6m and also to improve the fair presentation of the financial statements as well as the clarity and presentation of disclosure notes.<br><br>These adjustments are summarised in Appendix B. |
| **Unadjusted Errors** | There were no unadjusted errors. |
| **Other Matters** | The following material weaknesses in internal control was identified during our audit:<br><br>Reconciliation of nominal ledger balances, accrued income, unrecorded benefits, creditors and sundry debtors as documented in our findings. |

# B Adjustments misstatements

The following table presents all significant adjustments made to the accounts arising from the audit process which have been agreed with the Treasury Manager to amend the draft accounts.

Adjustment Type

- **Misstatement** - A change to the value of a balance presented in the financial statements.
- **Classification** - The movement of a balance from one location in the accounts to another.
- **Disclosure** - A change to the way in which a balance is disclosed or presented in an explanatory note.

The overall effect of the adjustments listed below is to decrease Fund assets by £7.0m

| Adjustment type | Accounts balance | Impact on financial statements |
|---|---|---|
| **Misstatement** | Accrued income | Reversal on investment accrued income of £1.6m which had been received by investment managers before the year end and therefore accrued in error. |
| **Misstatement** | Other income | Reversal of double counted exchange differences £1.55m (reclassification only, no affect to fund account) |
| **Misstatement** | Benefit accruals | Increase of benefit accruals amounting to £1.7mto account for members who had selected their options before the year end, but were awaiting payment |
| **Misstatement** | Cash netting off adjustment | Adjustment to cash balance arising from mapping errors £1.3m |
| **Misstatement** | Creditors | Increase to creditors arising from mapping errors £1.8m |
| **Misstatement** | Creditors | Increase to creditors arising from mapping errors £0.3m |
| **Misstatement** | Other debtors | Provision for aged debtors £0.3m. |