Annual governance report

Kent Pension Fund

Audit 2011/12

audit commission

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Key messages

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

I issued an unqualified audit opinion on the 2011/12 financial statements on 26 July 2012.

The financial statements submitted for audit on 11 June 2012 were of a good quality. The Council produced the accounts earlier than the statutory deadline of 30 June. A few amendments were required to the financial statements, all of which were agreed by management and adjusted in the approved financial statements.

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.

The Audit Commission's Audit Practice has not undertaken any non-audit work for the Pension Fund during 2010/12.

I ask the Superannuation Fund Committee to:

- take note of the matters raised in this report; and
- note officers' response to the action plan (Appendix 3).

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 Council Members you have final responsibility for these statements.

Opinion on the financial statements

I issued an audit report including an unqualified opinion on the financial statements included within the Authority's Statement of Accounts on 26 July 2012.

My audit seeks to ensure the accounts are materially correct and present a true and fair view of the financial transactions of the Council in 2011/12. The concept of materiality is defined at Appendix 2. For the 2011/12 accounts I have set materiality level at £16.5 million for the Superannuation Fund. Under International Standards on Auditing I also set a threshold below which I judge any errors to be 'trivial' and do not ask for the accounts to be amended. For 2011/12 the triviality threshold is set at £165,000.

Where I identify errors above this triviality threshold, under auditing standards I must request management to amend the accounts. Where management chooses not to do so, and the Governance and Audit Committee agrees, I request a written representation from the Committee as to whether it believe the effects of the uncorrected misstatements are not material individually and in aggregate.

Uncorrected errors

My audit work did not identify any errors that have not been corrected by management in the 2011/12 financial statements.

Corrected errors

I identified a few errors in the financial statements, some of which were material, and impact on the primary statements and disclosure notes. In my opinion, the errors are not indicative of management bias nor indicate a particular weakness in your arrangements and do not require detailed consideration by the Committee. However, for completeness and information, I highlight the amendments in appendix 3 and table 1.

Significant and specific risks and my findings

I reported to you in my 2011/12 Audit Plan the significant and 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. A significant risk is a risk that requires special audit consideration, on the grounds that it is highly likely that the risk will be realised, and will result in a material misstatement in the financial statements. A specific risk occurs where I identify an issue related to a particular item in the financial statements.

Table 1: **Risks and findings**

Risk	Finding
SIGNIFICANT: Actuarial present value of retirement benefits The present value of retirement benefits is a material item in your financial statements. The complexities involved in the valuation means there is a risk the financial statements may be materially misstated.	I completed the following work to gain assurance over the risk. ■ Reviewed the management arrangements for instructing your actuary and the controls over the completeness and accuracy of information provided to the actuary. ■ Evaluated the work of your actuary, Barnett Waddingham. ■ Used my own actuarial expert to assess the reasonableness of the actuarial assumptions used by Barnett Waddingham. ■ Reviewed the accounting entries to ensure they agreed to the IAS 26 valuation report. I identified that because of changes in the value of the scheme following submission of the draft financial statements to the actuary the fair value of the scheme did not agree to the actuarial valuation report. The actuary has revised the IAS26 valuation based on the final figures and the financial statements now agree to the valuation by the expert.
SIGNIFICANT: Actuarial valuation of pension liability The actuarial valuation of the pension fund liability is a material accounting estimate in the financial statements. The actuary uses many assumptions to calculate this complex valuation. In addition, the valuation reports in 2010/11 were materially inconsistent for a few admitted bodies and revised valuations were provided by the	I confirmed the accuracy and completeness of the valuation of the pension liability to the actuary's report. I assessed the reasonableness of the actuary's work by using my own actuary expert.

Risk	Finding
actuary.	
Valuation of freehold property The accounting for freehold property is a material accounting estimate. The portfolio is managed by DTZ and was valued by Colliers CRE at 31 March 2011 at £191 million.	I carried out audit procedures to place reliance on the work of your valuer as an expert. I also verified the accounting entries in the financial statements to the valuation report. I did not identify any issues that need to be bought to your attention.
Investment commitments The pension fund has committed money to four private equity investments. These are equity securities in operating companies that are not publicly traded on a stock exchange.	I reviewed the valuation of the investments and sample tested entries in the financial statements against the year end investment commitment reports and an independent source. I identified the following from my testing. ■ The draft financial statements included estimated year end investment balances. Update valuations were received in early July for private equity and infrastructure and pooled property investments. As the differences were above my triviality level these have been amended in the financial statements: – Henderson £8,490,100 to £8,441,500; – Partners Group 2009 £22,587,121 to £24,120,282 and 2011 £4,086,695 to £3,890,288; – HarbourVest HIPEP VI £3,997,604 to £3,880,262 and IX £1,494,132 to £1,454,120; and – Aurora £16,079,551 to £15,963,259. ■ The disclosure in note 22 for the contractual commitments with the private equity investment bodies has been improved to give a fuller description of the investments and commitments in the currency they were made and the converted amount as £ sterling. These issues have all been corrected in the revised statement of accounts presented to members.

Significant 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 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.

I did not identify any weaknesses in internal control during the audit that are relevant to preparing the financial statements.

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 practices
- 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

I highlight the following themes for your attention: accounting disclosures compared with best practice; accounting policies; and compliance with laws and regulations.

Table 2: **Other matters**

Issue	Finding
Code of Practice on Local Authority Accounting 2011/12 disclosure requirements The Code sets out expected best practice for the disclosure of financial transactions in an authority's	I reviewed the draft financial statements against the requirements of the Code disclosure checklist. I identified a few narrative issues where the Pension Fund disclosure did not meet expected best practice. The accounts have been amended for these. Some of the more significant changes are set out in the bullet points below.

Issue	Finding
accounts.	
■ Financial instruments - notes15 and 16	The notes: ■ incorrectly included freehold property totalling £222.575 million and all related accounting entries (note 15); ■ did not include cash invested by JP Morgan totalling £51.670 million within the credit risk disclosure table and included an incorrect reference to USD (note 16); ■ incorrectly reported the fair value through profit and loss of financial assets with different values for the carrying and fair values. These should be reported as the same figure at market value (note 16); and ■ prior year comparators for cash (£60.943 million) and overseas equity investments value on increase (£578.517 million) as at 31 March 2011 were misstated. The disclosures should be £73.659 million and £583.615 million respectively. All required amendments have been made to the financial statements.
■ Related party transactions – note 23 (and note 36 of the Council's financial statements)	Related party transactions with the Kent Pension Fund were incorrectly disclosed in the Council's financial statements: ■ cash held by the Council on behalf of the Pension Fund totals £3.313 million. This is cash that has been paid over to the Council but should be in the Pension Fund cash balance as at 31 March 2012. A recommendation has been made to account for the cash balance differently next year.
■ current assets - note 18	The note should disclose the amounts owed by other public sector bodies and those external to general government. The note has been correctly amended to disclose the debt profile in this way.
Accounting policies **Accounting policies set out the agreed practice to be followed in the preparation of accounts. It is important that actual practice follows the stated policies and that policies are disclosed for all key**	I reviewed the summary accounting policies of the Pension Fund and identified the following issues: ■ narrative that had previously been included in the financial statements for the foreign currency transactions policy (note 2i) was incorrectly omitted in 2011/12 policy; and ■ the actual accounting treatment adopted in 2011/12 for cash and cash equivalents

Issue	Finding
matters. - note 2	(note 2j) was not in line with the policy. The accounting policies have been correctly revised.
Compliance with laws and regulations: **Preparation of the accounts assumes that all material laws and regulations are followed.** **-** Contributions receivable - note 5 Regulation 42(2) of the Local Government Pension Scheme (Administration) Regulations 2008. This requires employer authorities to pay employee contributions to the administering authority within 19 days of the end of the month to which they relate.	I reviewed the timing of contributions receivable by the pension fund and sample tested the contributions receivable to corroborate the accuracy and classification of these in the financial statements. Some 4.7% of contributions received in 2011/12 from admitted and scheduled bodies of the scheme breached regulation 42(2). This includes seven larger scheduled bodies. Officers monitor this monthly through a key performance indicator and contact relevant bodies to ensure they are aware payment is late. The timeliness of receiving contributions within 19 days improved during 2011/12 financial year. I also noted a classification error in the disclosure of contributions receivable. Two schools that transferred to foundation school status (and therefore should be a scheduled body) are still shown as KCC schools. Because of the analysis of KCC schools contributions it is not possible to identify the amount relating to the two schools. However, I can confirm that this could not be material as the schools would not pay more than £100,000 a month so the maximum error in 2011/12 (and the prior year) would be £2.4 million. This is an uncertainty in the classification of contributions receivable and does not impact on the total contributions receivable in 2011/12.

Recommendations

R1 The pension fund bank reconciliation process should ensure that cash held on behalf of the fund by the Council should be transferred back to it on a regular basis, with the cash held as at 31 March being shown as cash in transit in the reconciliations and financial statements.

R2 Officers should ensure that the requirements of IAS32 (Financial Instruments: Presentation) are met when producing the financial instruments notes for the Pension Fund.

R3 Officers should continue improvements made in the year in taking prompt corrective action to ensure payments from admitted and scheduled bodies do not breach 19 days.

Pension Fund Annual Report

The Pension Fund has not yet prepared its Annual Report. As a result I have not yet reviewed the financial statements contained within the Annual Report and am not able to report on them. The Pension Fund plans to produce its Annual Report by 10 August 2012 and I anticipate reporting on the financial statements included in the Annual Report by 30 September.

Fees

I reported my planned audit fee in the 2011/12 Audit Plan.

I will complete the audit within the planned fee.

Table 3: **Fees**

	Planned fee 2011/12 (£)	Expected fee 2011/12 (£)
Audit	49,170	49,170
Total	**49,170**	**49,170**

The Audit Commission has paid a rebate of £3,933 to reflect attaining internal efficiency savings, reducing the net amount payable to the Audit Commission to £45,237.

Appendix 1 – 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 and Investment notes 13 and 14	Two changes have been made to the prior year comparators:				
	■ The cash internally invested by the Pension Fund was previously treated as a cash balance. In 2011/12 officers decided to present the cash as part of the cash deposit investments (cash equivalents) and not as cash held by the pension fund. This required a restatement of the prior period figures for cash for these deposits:				
	– 2010/11 investments cash deposits			12,061	
	– 2010/11 current assets cash				12,061
	■ Investment management fees were shown in 10/11 as the net position. Officers feel it is more transparent to show the gross fees:				
	– 2010/11 investment management fees	3,562			
	– 2010/11 income from investments		3,562		

Appendix 2 – 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 Panel] and the Audit Committee.

Appendix 3 – Action plan

Recommendations	
Recommendation 1	
The pension fund bank reconciliation process should ensure that cash held on behalf of the fund by the Council should be transferred back to it on a regular basis, with the cash held as at 31 March being shown as cash in transit in the reconciliations and financial statements.	
Responsibility	Treasury and Investments Manager
Priority	High
Date	31 March 2013
Comments	Arrangements to be made for the cash balance at 31 March 2012 to be transferred from KCC to the Pension Fund. The cash reconciliation to be completed monthly and the cash balance at 31 March 2013 to be transferred and accounted for as recommended.
Recommendation 2	
Officers should ensure that the requirements of IAS32 (Financial Instruments: Presentation) are met when producing the financial instruments notes for the Pension Fund.	
Responsibility	Principal Accountant – Treasury / Senior Accountant - Investments
Priority	Low
Date	31 March 2013
Comments	Agreed
Recommendation 3	
Officers should continue improvements made in the year in taking prompt corrective action to ensure payments from admitted and scheduled bodies do not breach 19 days.	

Responsibility	Treasury and Investments Manager / Principal Accountant - Pension Fund
Priority	Low
Date	31 March 2013
Comments	The receipts of Contributions continue to be monitored monthly and corrective action taken accordingly.

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Augustly 2012