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DATE: 16 September 2013

PENSIONS INVESTMENT SUB-COMMITTEE

Meeting to be held on Wednesday 18 September 2013

Please see the attached supplementary document for consideration during the item below.

6 PENSION FUND ANNUAL REPORT 2012/13 (Pages 3 - 14)

Copies of the documents referred to above can be obtained from www.bromley.gov.uk/meetings

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London Borough of Bromley Pension Fund
Board Report 2013

Year ended 31 March 2013

Prepared for the Pensions Investment Sub-committee

Committee Meeting 18 September 2013

GP&L Committee 25 September 2013

Strictly confidential

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Code of Audit Practice and Statement of Responsibilities of Auditors and Audited Bodies

In April 2010 the Audit Commission issued a revised version of the 'Statement of responsibilities of auditors and of audited bodies'. It is available from the Chief Executive of each audited body. The purpose of the statement is to assist auditors and audited bodies by explaining where the responsibilities of auditors begin and end and what is to be expected of the audited body in certain areas. Our reports and management letters are prepared in the context of this Statement. Reports and letters prepared by appointed auditors and addressed to members or officers are prepared for the sole use of the audited body and no responsibility is taken by auditors to any Member or officer in their individual capacity or to any third party.

1 Executive summary

The purpose of this report is to provide you with feedback from the work we have performed and to communicate relevant issues which have come to our attention during the audit for the year ended 31 March 2013.

Scope of our work

Our audit was performed under International Standards on Auditing (UK & Ireland) and followed the approach set out in our Audit Plan prepared for the Committee in February 2013. We have included a summary of our audit approach and specific findings from our audit work for each of the key components within section 2 of this report. There has been no cause for us to vary the planned scope of work.

Audit status

We held a clearance meeting with key members of management on 14 August 2013 to discuss the initial findings from the audit and to agree actions required prior to completion.

Our audit of the accounts of the London Borough of Bromley Pension Fund ("the Fund") for the year ended 31 March 2013 is complete, subject to:

- review for subsequent events
- approval of the Annual Report and Accounts by the Committee
- receipt of the letter of representation, circulated separately

Our conclusions

Our final conclusions are subject to satisfactory completion of the outstanding matters above but are expected to be as follows:

- Our audit report on the truth and fairness of the accounts will be **unqualified**.
- No matters have arisen that we have been required to report to the Pensions Regulator in accordance with our whistle-blowing responsibilities under the Pensions Act 2004.

There are no uncorrected misstatements in the accounts. A schedule of audit adjustments has been summarised in section 4.

Audit issues, findings and internal control recommendations

The main issues and findings from our audit are included in section 2, along with internal control recommendations which are detailed in section 3. The most significant findings are:

- Use of the Fund bank account;
- Observations on the bank mandate;
- Monitoring of the timeliness of contributions.

Independence and objectivity

Our reputation and continued success as a firm depends on our maintaining auditor independence. We are required to communicate with you matters that, in our professional judgement, may reasonably be thought to bear on our independence and objectivity.

There are no such matters that we wish to bring to your attention.

2 Audit findings

Financial highlights

Fund account

£m	2013
Contributions	27.5
Benefits, leavers and transfers	(30.1)
Transfers in	1.9
Administrative expenses	(0.5)
Investment returns	84.1
Net increase	**82.9**
Opening net assets	501.5
Net assets	**584.4**

Net assets statement

£m	2013
Investments	583.3
Net current assets	1.1
Net assets	**584.4**

Contributions

Key figures

£m	2013	2012
Employer normal	14.9	15.1
Augmentations	1.3	1.7
Deficit funding	5.8	5.5
Member normal	5.5	5.8
Contributions	**27.5**	**28.1**

Commentary

Balances have remained broadly consistent year on year.

Planned approach	Matters arising
Review the controls over payroll and validate on a sample basis that these are operating as expected.	None
Undertake analytical review of contributions for reasonableness compared with the prior year, allowing for changes in membership, pay and rates of contributions.	None
Test on a sample basis that the contributions are calculated and paid in accordance with the relevant schedules.	None
Review the timing of the payment of contributions according to bank details compared with statutory requirements.	See section 3 for an internal control recommendation around the monitoring of contribution timing.

Benefits

Key figures

£m	2013	2012
Pensions	22.0	20.5
Lump sums – retirement	5.0	5.7
Lump sums – death	0.6	0.8
Transfers out and refunds	2.5	1.8
Total	**30.1**	**28.8**

Average pension per pensioner member

£	2013	2012
Pension	4,713	4,473

Commentary

The average pension per pensioner increased by 5.4% from last year, closely matching the 5.2% increase awarded to pensions in payment in April 2012. Other benefits payable are driven by membership movements and have remained broadly consistent year on year.

Planned approach	Matters arising
Review the controls operated by the administration team (including over the pension payroll) and validate on a sample basis that these are operating as expected.	None
Perform substantive testing on a sample basis over material types of benefit payments.	None
Undertake analytical review of pensions paid for reasonableness compared to the prior year, allowing for changes in membership and the effects of the pensions increase.	None
Consider the monthly total pensions paid and investigate any unusual fluctuations.	None
Compare membership statistics and movements reported against the supporting data from the administration system and review for reasonableness compared with our expectations.	None
Review the results of any pensioner existence checking exercise completed during the year.	None

Investments

Key figures

£m	2013	2012
Equities	295.0	261.0
Pooled investment vehicles	280.8	225.8
Cash deposits	7.5	12.8
Other	0.0	(0.3)
Investments	**583.3**	**499.3**

Investment returns

£m	2013	2012
Investment income	8.4	8.5
Change in market value (CIMV)	77.0	2.0
Investment management expenses	(1.4)	(1.2)
Investment returns	**84.0**	**9.3**

Commentary

There was new investments to both the Baillie Gifford and Standard Life funds which explains the increase in pooled vehicles; otherwise the movements are attributable to market movements.

The overall investment return in the year was around 16.5%. This closely reflects equity indices in the year which is as we would expect as most of the Fund's investments are in equities or equity based funds.

Planned approach	Matters arising
Existence Understand the Committee and management monitoring controls, including reviewing Committee meeting minutes. Obtain independent confirmations of assets from the custodian and investment managers. Review internal controls reports (ISAE/SSAE etc) on investment management and custody.	None
Valuation Test valuation of quoted investments against third party sources. Understand how the Committee and management validate asset values provided by investment managers for investments which are not quoted. Review valuations for pooled investment vehicles, including reviewing recent transaction prices, the most recent audited accounts and any available internal controls reports as applicable to achieve comfort.	None
Completeness Review the reconciliations of cash inflows and outflows from the Fund's bank account compared to contributions and other income, benefits and expenses and the movements in investments. Review the reconciliations performed in-house between investment manager and custodian assets.	A number of adjustments have been noted during the audit relating to investment income, purchases and sales which have been summarised in section 4.
Complete an analytical review of investment returns for reasonableness compared with the Fund's benchmark and other external indices.	None

Planned approach	Matters arising
Review the allocation of investments compared with the requirements of the SIP.	The latest SIP has an allocation range for UK aggregate bonds as a percentage of the Fidelity portfolio of 5% - 15%; however it was actually 23.6% at year end. This appears to be a drafting issue with the SIP which should show 15% - 25% for this asset class. This technical breach should be briefly explained in the annual report.

Cash

Planned approach	Matters arising
Review balances compared with the prior year and against our expectations from testing of income and expenditure. Obtain independent confirmation of cash balances. Review controls over cash movements and bank account authority levels.	See section 3 for two internal control recommendations relating to cash – use of the Fund bank account and an observation on the bank mandate.

Significant risks

ISAs recommend that we communicate how we propose to respond to significant risks (those which require special audit consideration) identified during the audit. Because of the potential link to fraud, the risk of **management override of controls** is always considered a significant risk. We addressed this risk by performing testing of journals, reviewing any estimates made by management, and reviewing minutes in connection with any significant or unusual transactions. There are no matters to report as a result of this testing.

3 Internal control recommendations

Significant internal control recommendations from this year's audit

We have graded the impact of the matters in this section on the following basis:

HIGH	A significant issue which could result in material financial, regulatory or reputational risk.
MEDIUM	A less significant issue but still relating to an area where we think controls should be improved as a priority.
LOW	Areas where we recommend enhancements be made to existing controls or matters of best practice.

Issue	**Use of pension scheme bank account** MEDIUM
Observation and implication	The Local Government Pension Scheme (Management and Investment of Funds) Regulations 2009 required that all pension schemes have their own back account effective 1 April 2011. Specifically the regulations state the following: "On and after 1st April 2011, an administering authority must hold in a separate account kept by it with a deposit-taker in accordance with this regulation— (a) all monies held by the authority on that date; and (b) all monies received by it on or after that date for the purpose of its pension fund." Although a separate bank account has been set up for the Fund it is not being used. Instead transactions with the council and admitted bodies are being accounted for by using journal allocations. The cash attributable to the Fund in relation to such transactions is therefore still held in the Authority's bank account. As a result the Fund is not fully compliant with the requirements of the legislation.
Recommendation	We recommend that the Fund take the appropriate action in order to ensure that the bank account becomes fully operational in accordance with the above regulation. We note that most LGPS we audit have now fully implemented and are using a separate bank account for their pension funds.
Response and timescale	The use of a separate account will be reviewed and considered with a view to full implementation by 1st April 2014.

Issue	**Observation on bank mandate** **MEDIUM**
Observation and implication	When reviewing the Fund's bank mandate, we noticed two individuals on it who have no longer at the London Borough of Bromley. This potentially increases the level of fraud risk.
Recommendation	We recommend that the mandate is amended appropriately and is reviewed regularly in future and when relevant personnel leave to ensure signatories remain valid.
Response and timescale	The bank mandate was sent to HSBC on 19th August and is now in place. This will be kept up to date to reflect any future changes in personnel.

Issue	**Monitoring of timeliness of contributions** **MEDIUM**
Observation and implication	There are currently no procedures in place for the Fund to record when contributions paid by cheque are actually received. As a result of this, there were 22 contribution amounts in the year which we could not verify were received on time. They were processed after the 19 day deadline but the cheque may have been received on time. These contributions total around £152,000, 0.6% of total contributions, and hence are not deemed to be material for reporting to the Pensions Regulator. The lack of an effective control here though does limit the Fund's ability to monitor compliance with the contributions deadline. 12 of the 22 items relate to one particular school.
Recommendation	We have agreed with management that they will discuss this with Liberata with a view to putting a control in place in this area, and also to reinforce to schools paying by cheque that BACS is preferable.
Response and timescale	These actions are scheduled to be completed by 1 October 2013.

4 Audit adjustments

The following adjustments are required to correct misstatements that have come to our attention during the audit process. They have all been agreed with management and are expected to be corrected in the final version of the accounts.

No	Description	Income statement		Balance sheet	
		Dr £'000	Cr £'000	Dr £'000	Cr £'000
1	Investment income	369			
	Cash deposits held by investment managers				369
	Double recognition of income from Fidelity (the debit had been included in cash).				
2	Investment income	2,114			
	Change in market value (reducing purchases)		2,114		
	Investment income should be disclosed as change in market value per LBB's accounting policy as it is a distribution from a pooled investment vehicle (PIV) which is then directly reinvested in the same PIV.				
3	Change in market value (reducing sales)	1,354			
	Change in market value (reducing purchases)		1,354		
	Upon investigation the sales figure for PIVs was found to be incorrect as it had been put through as a balancing figure. Purchases were also amended accordingly.				
4	Accrued income			737	
	Investment income		737		
	Income from investments which have gone ex-dividend with Baillie Gifford has not been recognised at year end for 2012/13.				
5	Normal employer contributions	1,357			
	Augmentations		1,357		
	Reclassification of augmentations currently included in normal employer contributions balance.				

Disclosure matters

We have reviewed disclosures in the draft accounts and provided comments. The main disclosure matter noted was with regards to related parties, as there was no related parties note in the first draft of the accounts. We have recommended that a note be included to cover details of Committee members who are also active or pensioner members of the Fund, and any payments made to Committee members for their Committee duties. This has been reflected in the revised version of the accounts.

Also, during the year the investment managers bought and sold £26m worth of fixed interest securities which had been currently disclosed as part of the equities balance. This was incorrect as these should be disclosed separately. Note that there is no impact on the income statement or balance sheet from this adjustment (given the fixed interest balance was zero at both year ends) but it impacts the detailed investment reconciliation in the accounts. The disclosure has been amended appropriately in the revised version of the accounts.

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