

Annual Audit Letter

August 2005



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London Pensions Fund Authority

Audit 2004/2005

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For further information on the work of the Commission please contact:

Audit Commission, 1st Floor, Millbank Tower, Millbank, London SW1P 4HQ

Tel: 020 7828 1212 Fax: 020 7976 6187 Textphone (minicom): 020 7630 0421

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Key messages

Accounts

- 1 We gave an unqualified audit opinion on the Authority's accounts on 20 July 2005.

Financial aspects of corporate governance

- 2 Financial aspects of the Authority's corporate governance arrangements are generally satisfactory. However, progress in developing a corporate approach to risk management and embedding a supporting culture across the organisation has been slow.
- 3 During the year, the Authority has worked with the Actuary to determine a suitable policy to address the deficits reported in the triennial valuation.

Performance management

- 4 The Authority's overall arrangements for making the best use of resources are satisfactory.

Background to our audit

- 5 This has been a year of development and change for the Authority, including:
 - preparing for the implementation of the new general ledger system (Dimensions), with a planned 'go live' date of 1 April 2005;
 - exploring options for partnership working with other bodies;
 - continuing to develop the scope of agency work performed for other public sector organisations; and
 - responding to the outcome of the triennial pension fund valuation.

Accounts

- 6 We gave an unqualified audit opinion on the Authority's accounts on 20 July 2005.

Matters arising from the final accounts audit

- 7 Members approved the Authority's financial statements on 23 June 2005. During the year, officers reviewed the format and presentation of the accounts. As a result, the Authority's operational account and the transactions and balances in respect of the residual liabilities are now reported separately, subject to a transitional arrangement applied to the cash flow statement. This change makes the accounts more understandable and informative to the reader.
- 8 Our audit identified only presentational and minor amendments to the draft accounts. Audit comments on the draft statement on internal control were addressed in the final version.
- 9 As in previous years, the Authority prepared good quality working papers and staff were helpful in responding to our queries.

Report to those with responsibility for governance in the Authority

- 10 Statement of Auditing Standard (SAS) 610 'Reporting to those charged with governance' requires auditors to report to those charged with governance certain matters before they give an opinion on the financial statements. We reported to the Audit Committee on 23 June and to the Chair of the Audit Committee on 18 July. Our reports stated that there were no matters arising from our audit that needed to be brought to members' attention. We subsequently issued an unqualified opinion on the Authority's accounts on 20 July 2005.

General ledger

- 11 Throughout 2004/05, the Authority was working on a project to introduce a new general ledger system, Dimensions. The planned 'go live' date was 1 April 2005, from which point all transactions were due to be processed through the new system. In the event, there was a period of parallel running between Dimensions and the old general ledger, SUN, to allow staff time to adapt to the operating processes of the new system. We will review Dimensions during 2005/06 to support our Opinion audit for that year.

Grant claims

- 12 The Authority completed and submitted the two required grant claim returns in a timely manner. To date, there were no issues arising from our work to bring to members' attention.

Financial aspects of corporate governance

- 13 Financial aspects of the Authority's corporate governance arrangements are generally satisfactory. However, progress in developing a corporate approach to risk-management and embedding a supporting culture across the organisation, has been slow.
- 14 The Authority is working with the Actuary to determine a suitable policy to address the deficits reported in the triennial valuation.

Financial standing

- 15 We monitor the Authority's financial standing by considering:
 - the Pension Fund;
 - fund performance;
 - the operational account; and
 - the residual liabilities account.

The Pension Fund

- 16 The results of the triennial valuation of the Fund compared to the previous valuation are set out in the table below.

Table 1 Actuarial position of the Pension Fund

	31 March 2001	31 March 2004
Active sub-fund surplus/(deficit)	£47.2 million	(£486 million)
Active sub-fund funding level	103%	74%
Pensioner sub-fund surplus/(deficit)	(£12.3 million)	(£129 million)
Pensioner sub-fund funding level	99%	91%

- 17 The deterioration in the funding levels is a result of the significant volatility in global stock markets during the inter-valuation period and the increase in liabilities due to rising longevity of scheme members.
- 18 In order to bring the fund back to the recommended 100 per cent funded level over a recovery period of 20 years, employer bodies will have to increase their contribution rate and/or make additional payments into the fund. If no additional payments were made and recovery was through employers' contributions only, the actuary has assessed that, for the active sub-fund, the total common employers' contribution rate would need to be 18.8 per cent of pensionable pay, compared with the current 11 per cent. Applying the same scenario to the pensioner sub-fund, the common employers' total contribution would need to be 48 per cent, compared to the current rate of 18.5 per cent.
- 19 Given the implications of such a high contribution rate, the Authority is working with the Actuary to calculate fixed payments that should be made by pensioner sub-fund employer bodies, as an alternative. In addition, the Authority is reviewing its investment strategy to determine whether higher returns could be earned while preserving the current risk profile of the Fund.

Fund performance

- 20 Both the active and the pensioner sub-funds underperformed compared to their benchmark this year, achieving a return of 10.7 per cent and 6.1 per cent respectively, against a benchmark of 11.9 per cent and 6.3 per cent respectively. The active sub-fund has also underperformed against the benchmark for the medium-term (three years) and longer-term (ten years), although performance on the pensioner sub-fund is slightly above its benchmark for these time periods.

- 21 Although the returns earned in 2004/05 are not as good as expected, this is partly due to the impact of the Authority's investment strategy. A long-term view of investments is taken in an attempt to match the returns to the liability profiles of the Fund; this can result in achieving less than optimal short term gains. However, the Board has initiated an open tender process for new style portfolios and managers.

The operational account

- 22 Expenditure incurred by the Authority on its own operations was £0.1 million less than budgeted, at £7.5 million. The main reason for the underspend was staff vacancies.

Residual liabilities account

- 23 The residual liabilities account is funded by a levy on London Boroughs, which is determined by taking account of budgeted expenditure and contributions from previous years' surpluses. Outturn expenditure for 2004/05 was £0.6 million less than budgeted and income was £0.3 million more than forecast. The surplus income for 2004/05 will be used to reduce the levy requirement in future years.
- 24 Following the year-end, the Authority disposed of the war loan and repurchased the majority of the outstanding London County Council (LCC) stock. These transactions generated a surplus of £20.5 million, which will be recognised in 2005/06 and will be used to reduce future levy requirements.

Systems of internal financial control

- 25 As in previous years, we reviewed a sample of Internal Audit's files and found that they complied with relevant professional standards. We continue to be able to place reliance upon Internal Audit's work.

Risk-management

- 26 For 2003/04, the Authority reported in its Statement on Internal Control (SIC) that further work was needed to develop and embed risk-management across the organisation. The Authority commissioned Internal Audit to recommend arrangements for establishing a robust framework. However, progress has been disappointing and a number of proposed actions detailed in the 2003/04 SIC were not implemented until after 31 March 2005. The Authority therefore reported risk-management as an exception to its otherwise sound control environment in the 2004/05 SIC.

- 27 During 2005/06, a number of steps have been taken to drive forward the risk-management agenda:
- day-to-day responsibility for implementing the action plan on risk-management has been set as a key objective for the Senior Finance Manager, working directly to the Chief Executive;
 - a risk workshop has been held for the Board;
 - an implementation plan and risk framework has been approved by the Audit Committee; and
 - training and documented guidance will be provided to all staff in the autumn.
- 28 If the current momentum is maintained and the planned actions are implemented in accordance with the timetable, then adequate risk-management arrangements will be in place by the end of 2005/06.

Standards of financial conduct and the prevention and detection of fraud and corruption

- 29 In September 2004, we invited all staff to complete a fraud awareness survey. The response rate was high at almost 75 per cent. The survey demonstrated that the Authority has made good progress in establishing a robust anti-fraud culture. The overall results were favourable when compared to responses from other local government bodies. However, this is to be expected given the size and nature of the Authority and we recommend that the results are used to set a benchmark against which improvements can be monitored.
- 30 The survey was followed-up with a workshop attended by 12 senior officers. The workshop addressed national and emerging issues regarding fraud, followed by consideration of the arrangements currently in place at the Authority. The issues and risks discussed were translated into an action plan to further strengthen existing anti-fraud and corruption arrangements.

Legality of financial transactions

- 31 The Authority's overall arrangements to ensure the legality of financial transactions are sound.
- 32 We reviewed the Authority's overall arrangements to maintain the legality of transactions with financial consequences. We are satisfied that appropriate arrangements are in place to identify and address emerging legal issues and new legislation. Following the year end, the Authority disposed of its war loan and repurchased the majority of the London County Council loan stocks that form part of the residual liabilities account. The Authority sought appropriate legal advice over the arrangements for the repurchases and disposals and we have no issues to report.
- 33 Statutory roles are vested in individuals with appropriate status in the organisation. Between July and September 2005, the section 151 officer responsibilities have been delegated to another officer. We are satisfied that this delegation has been executed appropriately.

Performance management

- 34 The Authority's overall arrangements for making the best use of resources are satisfactory.
- 35 Through ongoing liaison with officers and a review of minutes, we have considered the Authority's overall arrangements for making the best use of resources and found them to be satisfactory. The 2004/05 audit plan included one specific review, as detailed below.

Review of audit processes

- 36 The Authority has a number of agency contracts with other public sector bodies under which it maintains, amongst other things, pension fund membership records. The Authority has previously stated that a number of requests are received from the internal auditors of these other bodies. We were told that these requests can be repetitive in nature and can take up an estimated 50 days of staff time per annum. A review of the work performed by the other bodies' internal auditors to identify areas for possible rationalisation, was therefore included in the audit plan.

- 37 Our audit work on this review is still in progress. We are experiencing some difficulty in establishing exactly what work has recently been completed by the other bodies' internal auditors. We have also been unable to substantiate the estimate of staff time required to deal with the auditor requests. The Authority's own Internal Audit has recently completed a review of the agency contracting process and we will consider with officers how our review should now progress in light of that report.

Conclusion

Future audit work

- 38 The statutory requirements governing our audit work, are contained in:
- the Audit Commission Act 1998; and
 - the Code of Audit Practice (the Code).
- 39 The Code has been revised with effect from 1 April 2005. Further details are included in our Audit Plan which was agreed with the Audit Committee in June 2005. The key changes include:
- the requirement to draw a positive conclusion regarding the Authority's arrangements for ensuring value for money in its use of resources; and
 - a clearer focus on overall financial and performance management arrangements.
- 40 We will discuss the timetable for delivering the 2005/06 audit with officers later this year.

Closing remarks

- 41 This Letter was discussed and agreed with the Chief Executive. The Letter was presented to the Audit Committee in September 2005 and a copy will be provided to all Board Members.
- 42 I would like to take this opportunity to express my appreciation for the assistance and co-operation provided during the course of the audit. Our aim is to deliver a high standard of audit which makes a positive and practical contribution which supports the Authority's own agenda. We recognise the value of your co-operation and support.

Availability of this letter

- 43 This letter will be published on the Audit Commission website at www.audit-commission.gov.uk and also on the PCT website.

Jon Hayes
District Auditor
September 2005

Appendix 1 – Background to this Letter

The purpose of this letter

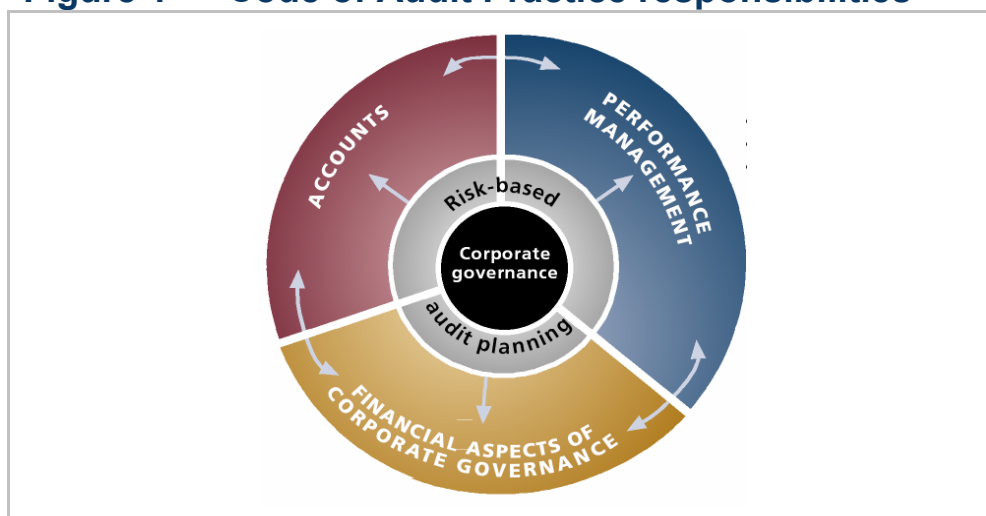
- 1 This annual audit letter summarises for members the significant issues and conclusions from our 2004/05 audit, together with our comments on other current issues.
- 2 More detail can be found in the separate reports we have issued this year which are listed in Appendix 2 for information. These reports have been discussed and agreed with officers and presented to the Audit Committee.
- 3 The Audit Commission has circulated to all audited bodies a statement that summarises the key responsibilities of auditors. Our audit has been conducted in accordance with the principles set out in that statement. What we say about the results of our audit should be viewed in the context of that more formal background.
- 4 Appendix 3 provides information about the fee charged for our audit.

Audit objectives

- 5 Our main objective as your appointed auditor is to plan and carry out an audit that meets the requirements of the Code of Audit Practice. We adopt a risk-based approach to planning our audit, and our audit work has focused on your significant risks that are relevant to our audit responsibilities.

6 Figure 1 illustrates our responsibilities under the Code.

Figure 1 Code of Audit Practice responsibilities



7 Central to our audit are your corporate governance arrangements. Our audit is then structured around three areas as shown below.

Accounts

- Whether the accounts present fairly the financial position of the Authority.

Financial aspects of corporate governance

- How well the Authority manages its finances.
- Whether the Authority has effective financial systems and internal controls.
- How the Authority ensures that its financial decisions remain within its legal powers.
- How well the Authority works to stop or find fraud and corruption.

Performance management

- Does the Authority have adequate arrangements to ensure the best use of the resources at its disposal.

Appendix 2 – Reports Issued During the Year

Table 2

Report	Date issued
Audit Plan 2004/05	June 2004
Fraud Awareness Workshop	January 2005
SAS 610 report to those charged with governance	June 2005
Regularity Report	August 2005
Annual Audit Letter	September 2005

We also provide the Audit Committee with regular updates on progress against the Audit Plan.

Appendix 3 – Audit Fee

The proposed fee for the 2004/05 audit was set out in our audit plan agreed at the start of the audit. The table below shows the planned and actual fees.

Table 3 Audit fee update

Audit area	Plan 2004/05	Anticipated actual 2004/05
Accounts	£17,170	£19,570
Financial aspects of corporate governance	£17,570	£15,070
Performance management	£4,571	£4,571
Total Code of Audit Practice fee	£39,311	£39,311
Grant claim certification	£1,500	£1,500*
Total fee	£40,811	£40,811

* our audit of the 2004/2005 grant claims is currently in progress. The planned outturn fee is reported here.