

# Annual Audit Letter

London Pensions Fund Authority

Audit 2010/11



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**Traffic light explanation**

Red  Amber  Green 

# Key messages

**This report summarises the findings from my 2010/11 audit. My audit comprises two elements:**

- **the audit of your financial statements; and**
- **my assessment of your arrangements to achieve value for money in your use of resources.**

Key audit risk	Our findings
Unqualified audit opinion	
Proper arrangements to secure value for money	

## Value for money

I issued an unqualified value for money conclusion on the 29 September 2010 stating the Authority has proper arrangements to secure economy, efficiency and effectiveness in the use of its resources.

## Audit opinion and financial statements

I issued an unqualified audit opinion on the Authority's financial statements on 29 September 2011.

- The financial statements presented for audit included six material classification errors and a number of minor presentational errors which management amended.
- The financial statements were supported by comprehensive working papers in the majority of areas.
- Overall the Authority responded well to the introduction of International Financial Reporting Standards (IFRS), requiring significantly more disclosures within the financial statements than in previous years.

# Current and future challenges

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The Authority is operating in an environment of significant change and uncertainty. There is huge volatility in world wide markets, unprecedented downward pressure on public sector spending and the prospects of a new public sector pension scheme. It is a challenging time for the Authority, more efficient ways of working must be delivered, business expansion is required and an a long term resolution to pension fund deficits must be found. The role of the Authority board and its committees remains crucial to ensuring plans are delivered and resources are utilised effectively. Strong leadership, clear direction and effective performance management is required if the Authority is to achieve its goals.

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Economic downturn and pressure on the public sector

All public sector bodies are required to make significant savings and efficiencies. The Authority achieved its efficiency plans in 2010/11, delivering more than 7% efficiency savings. The Authority's budget for 2011/12 reflects the growth in business from two new contracts to deliver pension administration services. The Authority did however lose two contracts in mid 2011/12 which would have led to a 2% deficit on the budget, but additional Value Added Business and cost reductions in Commercial Pensions means that the latest forecast is back in line with budget.

Saving plans in other local government bodies are driving the need for back office efficiencies, including savings in pension fund administration. This is both an opportunity and threat for the LPFA, who must deliver pension fund administration services at a competitive price with the appropriate quality to sustain business growth. Some success has been achieved in 2010/11 with the addition of two large contracts. Where it has not been successful, the Authority has recognised the learning needed to improve its position in the pensions market going forward.

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Sustainability of the fund

The Fund is notionally divided into two sub-funds; the Active sub-fund and the Pensioner sub-fund. Each fund has different characteristics and liability profiles. The Active sub-fund comprises employers that continue to accept new members and has a younger age profile. As a result the investments are mostly in 'growth assets'. The Pensioner sub-fund comprises mostly employers that either no longer exist or that no longer provide access to the Fund. The underlying members are mostly deferred beneficiaries and pensioners, so have a higher average age. As a result the investments are mostly in cash flow matching assets, such as bonds and fixed income.

The overall value of the fund at 31 March 2011 was just over the £4.1 billion. The last full triennial valuation of the pension fund was carried as at 31 March 2010.

The active sub-fund employers of the LPFA fund had a funding level of 83% ie the assets amounted to 83% of the liability promises made as at that valuation date. This corresponded to a deficit of £480 million at that time.

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The common contribution rate was set at 18.1% of payroll assuming the funding level was to be restored over a 20-year period.

The pensioner sub-fund employers of the LPFA fund had a funding level of 77% ie the assets amounted to 77% of the liability promises made as at that valuation date. This was equivalent to a deficit of £390 million at that time.

The deficit in the pensioner sub-fund is to be recovered through a combination of employer contributions.

The funding level of the active sub-funds is broadly similar to the position at the 2007 triennial valuation, whereas the pensioner sub-fund level had decreased since that time. The decrease in the pensioner sub-fund largely relates to revised assumptions on mortality rates.

The funding gap on the pensioner sub-fund is expected to grow over time as members live longer. The Authority cannot look to employer or employee contributions to fill the growing gap and are continuing to make representations to Government to secure remedial action.

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#### Changes to the Local Government Pension Scheme

The review of public sector pensions by the Independent Public Service Pension Commission (led by Lord Hutton) commenced in June 2010 and reported in March 2011.. The review made a number of recommendations, including:

- a switch to career average pensions;
- a retirement age linked to the state pension age; and
- independent oversight of the running of public sector pensions.

On 19 July 2011 the Government issued a written statement on public service pensions. The statement outlines progress being made with trade union discussions over pension reform and discussions over the proposed 3% increase in employee contributions. The Government had already committed to retaining a defined benefit scheme and to protect benefits accrued up to the point the new scheme is introduced. The statement also confirms that consultation on a new scheme will take place in the Autumn with the implementation planned in 2015.

The Authority have taken an active role in dispelling some of the myths around the LGPS and in making the case for considered change to the scheme. Lord Hutton's final report contained some surprises but met the majority of the Authority's objectives for an adequate yet sustainable LGPS.

In the budget the Chancellor accepted the report as the basis for further consultation and said proposals would be published in October 2011.

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# Financial statements and annual governance statement

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**The Authority's financial statements and annual governance statement are an important means by which the Authority accounts for its stewardship of public funds.**

## **Overall conclusion from the audit**

I issued an unqualified audit opinion on the 29 September 2011.

- The financial statements presented for audit included six material classification errors which management amended. These were classification errors with no material impact on the reported surplus for the Pension Fund and Operating account. The Residual Liability account included a non-material increase in its reported surplus arising from the material amendments.
- I identified a number of minor presentational errors which the Authority adjusted. There was no impact on the Authority's reported financial position.
- The financial statements were generally supported by comprehensive working papers which I received at the start of the audit. Working papers to support the asbestosis provision, IAS19 and Cash Flow Statements were received later in the audit process.

It has been a challenging year for local government bodies. The introduction of IFRS required significantly more financial statement disclosures than previous years. More resources have been required to address the additional requirements, adding to already pressurised finance teams. Overall, the Authority has responded well. The draft financial statements were presented in good time to the June Audit Committee. The recruitment of a specialist pension fund accountant has brought valuable financial reporting skills to the Authority.

During the course of my audit I identified two non trivial, non-material errors management have not amended (Operating account).

- My cut off testing of transactions in March and April 2011 identified failures from our sample of expenditure items. Cut off testing seeks to assess whether transactions are processed in the correct accounting period. The cumulative value of erroneous invoices is £787. When applied to all the transactions being tested in March and April, this indicates there is a possible error of £10,195 overstated expenditure. If amended, this would increase the reported surplus.
- My testing of IT expenditure identified a prepayment which was not identified. The actual error has been adjusted. When applied to the IT expenditure tested, the possible error is £12,278. If amended, this would increase the reported surplus.

As a result of the additional work performed to gain assurance over cut off, I have agreed an additional fee of £3,000 with the Director of Finance. The additional fee also reflects that more than anticipated audit work was required on the first year implementation of IFRS, which was not included in the original planned fee.

The financial statements contained a number of presentation and disclosure errors arising from the implementation of IFRS which management have amended.

The Authority prepares its three accounts from one trial balance. This process involves extracting the raw data into excel and mapping this into the three financial statements. There are additional processes related to moving the presentation from UK GAAP to IFRS and some manual entries related to provisions and IAS19. This process is now overly complex and we have recommended these processes streamlined in 2011/12.

### **Significant weaknesses in internal control**

I did not identify any significant weaknesses in your internal control arrangements.

# Value for money

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**I considered whether the Authority is managing and using its money, time and people to deliver value for money. I assessed your performance against the criteria specified by the Audit Commission and have reported the outcome as the value for money (VFM) conclusion.**

I assess your arrangements to secure economy, efficiency and effectiveness in your use of resources against the criteria specified by the Audit Commission. My overall conclusion is that the Authority has adequate arrangements to secure, economy, efficiency and effectiveness in its use of resources.

My conclusion on each of the areas is set out below.

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## Value for money criteria and key messages

Criterion	Key messages
Managing finances	
<b>1. Financial planning and financial health.</b>	<p>The Authority has a long term investment plan in place for the Pension Fund. The plan is clearly defined and well supported by executive and non-executive directors. Three-year plans for the Operating account, Residual liability account and the Pension Fund are approved by the Board and the Mayor of London. These plans are aligned with the business plans, annual budgets and corporate objectives.</p> <p>Strong treasury management arrangements are in place, and the credit worthiness of potential investees is regularly considered against the minimum standards and limits set by the Authority.</p> <p>The Authority uses its reserves to manage future costs in conjunction with its budgets and its business plans. The Authority has a clearly defined investment strategy, well supported by effective management from executive directors and members.</p>

Criterion	Key messages
<p><b>2. Financial reporting</b></p>	<p>Budgetary arrangements are sound, balanced budgets are set and monitored, with clear corrective action taken where necessary. Enhancements have been made to improve the financial reporting of agency contracts versus tenders in 2011/12 in the management accounts.</p> <p>The Authority has a track record of meeting statutory deadlines for its accounts and the audited accounts are compliant with relevant accounting standards. These provide a clear understanding of the Authority's position. The most recent accounts and annual audit letter are available on the internet site.</p>
<p><b>Governing the business</b></p> <p><b>3. Use of information</b></p>	<p>The Authority has developed a three-year plan for the ICT department to achieve six ISO certifications. The first of these applications for accreditation is ISO27001, a specification for an Information Security Management System (ISMS). The target date to achieve ISO27001 is 31 October 2011. Monitoring by the British Standards Institute (BSI) will take place annually once the standard is gained.</p> <p>The Authority sets corporate targets which are used to manage performance. These are aligned with strategic objectives and priorities. These are reported to the performance committee. Information is used to identify areas of underperformance and to enable appropriate action to be taken to achieve improvements.</p>
<p><b>4. Risk management and internal control</b></p>	<p>A corporate risk register and a risk appetite statement (risk management) is used as a tool to identify and manage corporate business risks in line with the risk management plan. The Authority has a Fraud Control Framework which sets out the approach and commitment to fraud prevention and detection. All codes of practice and standing orders in relation to the detection and prevention of fraud are Board approved.</p> <p>A strong Audit Committee is in place, including an independent Audit Committee member, which provides challenge and support to officers.</p>

In 2011/12, I will apply the Audit Commission's revised approach to my VFM conclusion work inline as set out in the Commission's 2011/12 Work programme and fee scales. The revised approach involves:

- reviewing the annual governance statement (AGS);
- reviewing the results of the work of other relevant regulatory bodies or inspectorates, to consider whether there is any impact on the auditor's responsibilities at the audited body; and
- other local risk-based work as appropriate, or any work mandated by the Commission.

I will be required to conclude whether or not there are any matters arising from my VFM work that I need to report.

# Closing remarks

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I have discussed and agreed this letter with the Chief Executive and the Director of Finance. I will present this letter at the Audit Committee in February 2012 and will provide copies to all board members.

Further detailed findings, conclusions and recommendations in the areas covered by our audit are included in the reports issued to the Authority during the year.

Report	Date issued
2010/11 Opinion Plan	February 2011
Interim report	April 2011
Information Technology Risk Assessment (ITRA) report	April 2011
Annual Governance Report	September 2011

The Authority has taken a positive and constructive approach to our audit. I wish to thank the Authority staff for their support and co-operation during the audit.

Andrea White  
District Auditor  
  
October 2011

# Appendix 1 – Fees

	Actual	Proposed	Variance
Financial statements	51,000	54,000	3,000
Value for money	24,800	24,800	-
<b>Total audit fee</b>	<b>75,800</b>	<b>78,800</b>	<b>3,000</b>

The planned audit fee for LPFA did not include the Audit Commission's standard uplift of 6 per cent for the introduction of IFRS, on the basis that the impact on pension funds was expected to be minimal. However, more work was required on the implementation of IFRS than anticipated and additional audit work was required to obtain adequate assurance over our cut off assurance and to agree the financial statements to the trial balance. The additional fee for this work is £3,000 excluding VAT.

In July 2009, in recognition of the financial pressures that public bodies are facing in the current economic climate, the Audit Commission confirmed that it would subsidise the 'one-off' element of the cost of transition to International Financial Reporting Standards (IFRS) for local authorities and police and fire and rescue authorities from 2010/11. To avoid any confusion with the annual audit fee, the Commission refunded 6 per cent of the scale fee to individual bodies directly in April 2010. For the London Pension Fund Authority the rebate was £4,548.

# Appendix 2 – Glossary

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## **Annual governance statement**

Governance is about how local government bodies ensure that they are doing the right things, in the right way, for the right people, in a timely, inclusive, open, honest and accountable manner.

It comprises the systems and processes, cultures and values, by which local government bodies are directed and controlled and through which they account to, engage with and where appropriate, lead their communities.

The annual governance statement is a public report by the Authority on the extent to which it complies with its own local governance code, including how it has monitored the effectiveness of its governance arrangements in the year, and on any planned changes in the coming period.

## **Audit opinion**

On completion of the audit of the financial statements, I must give my opinion on the financial statements, including:

- whether they give a true and fair view of the financial position of the audited body and its spending and income for the year in question; and
- whether they have been prepared properly, following the relevant accounting rules.

## **Opinion**

If I agree that the financial statements give a true and fair view, I issue an unqualified opinion. I issue a qualified opinion if:

- I find the statements do not give a true and fair view; or
- I cannot confirm that the statements give a true and fair view.

## **Value for money conclusion**

The auditor's conclusion on whether the audited body has put in place proper arrangements for securing economy, efficiency and effectiveness in its use of resources based on criteria specified by the Audit Commission.

If I find that the audited body had adequate arrangements, I issue an unqualified conclusion. If I find that it did not, I issue a qualified conclusion.

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