

# Annual Audit Letter

London Pensions Fund Authority

Audit 2008/09

November 2009



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## Status of our reports

The Statement of Responsibilities of Auditors and Audited Bodies issued by the Audit Commission explains the respective responsibilities of auditors and of the audited body. Reports prepared by appointed auditors are addressed to non-executive directors/ members or officers. They are prepared for the sole use of the audited body. Auditors accept no responsibility to:

- any director/member or officer in their individual capacity; or
  - any third party.
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# Key messages

**This report summarises the findings from our 2008/09 audit. It includes messages arising from the audit of your financial statements and the results of the work I have undertaken to assess your arrangements to secure value for money in your use of resources.**

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## Audit opinion

- 1 I issued an unqualified audit opinion on the 30 September 2009.

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## Financial Statements

- 2 During the year the Authority took clear action to strengthen its finance function. Capacity was increased, and the routine aspects of financial management and accounting significantly improved, as did the quality of working papers provided to support the financial statements.
- 3 However, there is further work to do to ensure that the financial statements presented for audit comply with accounting standards and are free from material error. I reported the detailed findings from my audit of the financial statements in my Annual Governance report to the Audit Committee in September 2009. I am pleased to note that the Authority has agreed actions to further strengthen and develop the Authority's financial reporting and internal control arrangements, particularly in relation to alternative investments.

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## Value for money

- 4 I issued an unqualified value for money conclusion on the 30 September 2009.
- 5 The Authority has adequate arrangements in place to ensure economy, efficiency and effectiveness in the use of its resources. There is clear leadership, a well defined investment strategy and effective budget monitoring arrangements. There is scope to strengthen procedures in relation to alternative investments and I made specific recommendations in relation to in my Annual Governance Report (see paragraph 3 above).

**Table 1**      **Audit fees**

	Planned	Actual
Financial statements	45,100	55,600
Value for money	27,400	27,400
<b>Total</b>	<b>72,500</b>	<b>83,000</b>

In my original audit plan, the fee for the opinion audit was based on my best estimate at the time and agreed at £45,100 (Total fee £72,500). Additional work has been required to obtain assurance on your financial statements. This includes time to discuss and clear a number of audit issues and queries relating to contributions, alternative investments, FRS17 and the cash flow statement. Our work includes additional meetings and liaison to resolve outstanding issues. The additional fee for this work is £10,500 excluding VAT.

### Actions

- 6 Recommendations are shown within the body of this report and have been agreed with the audited body.

### Independence

- 7 I can confirm that the audit has been carried out in accordance with the Audit Commission's policies on integrity, objectivity and independence.

# Financial statements and annual governance statement

**The Authority's financial statements and annual governance statement are important means by which the Authority accounts for its stewardship of public funds. I audit the financial statements and give an opinion on whether they present fairly the position of the Authority and its expenditure and income for the year.**

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## Opinion on the financial statements

- 8 I issued an unqualified audit opinion on the Authority's financial statements on the 30 September 2009.
  - 9 Before giving my opinion, I reported to those charged with governance, in this case the Audit Committee, the issues arising from the 2008/09 audit. I issued this report on 18 September 2009, only the key issues I wish to report to you are summarised here.
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## Significant issues arising from the audit

- 10 In my 2007/08 Annual Audit Letter, I recommended that the Authority should take action to strengthen its finance function and improve its internal controls particularly around cash and debtors. Substantive action was taken to increase the capacity of the finance function and tighten controls over cash and debt management. I am pleased to report that there has been a significant improvement in the operation of the routine aspects of financial management and accounting. The quality of working papers to support the financial statements has also improved.
- 11 However there is further work to do to ensure that the financial statements presented for audit comply with accounting standards and are free from material error. During the course of our audit. I experienced a number of difficulties and delays in carrying out our work in relation to testing the new contributions system, transfers in and out of the Pension Fund, FRS17 entries, auditing alternative investments and the cash flow statement.
- 12 A number of factors lead to these difficulties including the loss of key staff during the course of the audit and the introduction of the new contributions system.
- 13 Moving forward of particular importance will be how other parts of the organisation work with the finance department to ensure it has appropriate information to account for transactions appropriately. The Authority should also review the knowledge and skills required for the technical accounting requirements of investment and pension activities, and provide training and support where appropriate. Specific recommendations are set out my in my Annual Governance report which have been agreed with officers.

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### Material weaknesses in internal control

- 14 I identified some control weaknesses over the ownership and year end valuation of the Authority's alternative investments. These have been reported in my Annual Governance Report.
- 15 I have not provided a comprehensive statement of all weaknesses which may exist in internal control, or of all improvements which may be made. We have reported only those matters which have come to our attention because of the audit procedures we have performed.

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### Accounting Practice and financial reporting

- 16 I considered the qualitative aspects of your financial reporting.
- 17 I noted a significant improvement in accounting practice and financial reporting since the previous year. The draft financial statements presented fewer areas of non-compliance with the SORP. The Authority has agreed an action plan to address the residual areas.
- 18 The demands on accounting practice and financial reporting will increase with the required implementation of International Financial Reporting Standards in 2010/11. The Authority should assess its preparedness for implementation and draw up an action plan to address specific risk areas.

Recommendations	
<b>R1</b>	Implement the recommendations in my Annual Governance Report which include measures to: <ul style="list-style-type: none"><li>• improve accounting processes and controls over alternative investments</li><li>• improve links between the finance function and other parts of the organisation; and</li><li>• address areas of non-compliance with the SORP.</li></ul>
<b>R2</b>	Assess the Authority's preparedness for the implication of IFRS and draw up an action plan to address specific risk areas.

# Value for money conclusion

I assessed whether the Council put in place adequate corporate arrangements for securing economy, efficiency and effectiveness in its use of resources. This is known as the value for money (VFM) conclusion.

## VFM conclusion

- 19 I assessed your arrangements to secure economy, efficiency and effectiveness in your use of resources against criteria specified by the Audit Commission. From 2008/09, the Audit Commission will specify each year, which of the use of resources Key Lines Of Enquiry (KLOE) are relevant criteria for the VFM conclusion at each type of audited body. My conclusions on each of the areas are set out in Appendix 1.
- 20 I issued an unqualified conclusion stating that the Authority had adequate arrangements to secure economy, efficiency and effectiveness in its use of resources. My findings are summarised in table 2 below.

**Table 2 Value for money conclusion criteria**

KLOE	VFM Criterion met	Findings
Financial Planning (1.1)	Yes	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 and corporate objectives. The Authority actively deals with various stakeholders. The Authority has a strong track record of managing its spending within available resources.
Financial Reporting (1.3)	Yes	The Authority produces relevant, timely and reliable information as part of financial monitoring. This includes performance related information. There is an active Investment Committee which monitors the performance of fund managers. This is well supported by an officer led review of fund manager performance on a regular basis. The financial statements have improved since last year. However there are still further improvements to make. The Authority publishes an annual report that provides an objective, balanced and clearly understandable assessment of the Authority's current position.

KLOE	VFM Criterion met	Findings
Data Quality and Use of Information (2.2)	Yes	The Authority produces relevant and reliable data in the majority of areas. The 2008/09 audit identified some inconsistencies between finance and pensions data which has now been corrected. The Authority continues to work improve and develop the systems underpinning data production. The Authority understands the needs of its decision makers and information provided is generally fit for purpose. The Authority also plays an important role in providing data for contributing employers. The Authority has arrangements in place to ensure data is secure and for compliance with relevant statutory requirements. Performance targets are agreed annually and reviewed regularly by Corporate Management Team, Board and Committees.
Good Governance (2.3)	Yes	The Authority has adopted a Code of Corporate Governance, consistent with the principles of CIPFA/SOLACE Framework Delivering Good Governance in Local Government. This is supported by a constitutional document and registers of interests, gifts and hospitality. The Authority has a Strategic Policy Statement to provide the focus on its purpose and vision. There are strong working relationships between executive and non-executive directors, clearly demonstrated for example in the Audit and Investment Committees.
Risk Management and Internal Control (2.4)	Yes	The Authority has an established system of risk management. This is underpinned by a risk management policy and a risk appetite statement. The corporate risk register is underpinned by team risk registers. Discussions with staff supported a strong anti-fraud culture. The Authority has a good record of working with National Fraud Initiative (NFI). The Audit Committee play a strong role in overseeing the control environment, supported by officers who take responsibility for improving controls. Internal controls can still be improved in complex and technical areas (as reported in the financial statements section above).

## Economic climate

- 21 The economic downturn and banking crisis is having a significant impact on public finances and the bodies that manage them. The Authority has avoided significant losses from banking failures such as Lehman Brothers and the Icelandic banking collapse. Within three days of the Lehman Brothers bankruptcy, the Authority prepared a board report to address the risks arising from this event. The report dealt with Lehman Brothers specifically, noting that no direct losses and only very minor losses relating to counter party exposure had been incurred.

## Value for money conclusion

- 22 The Authority considered the exposure of its directly held investments, investments held through other parties and through facilitation arrangements performed by investment banks. The report enabled the Board to assess the risks relating to the 'credit crunch' and inform future decisions to safeguard its investments.
- 23 The risk to investments, highlighted by the Icelandic banking collapse, was mitigated by existing procedures within the Authority. These include a review of credit ratings and obtaining appropriate advisor advice on a regular basis. In light of the collapse, the Authority has responded by increasing the frequency of these procedures.
- 24 The investments of the Authority consist of two parts.
- Active Sub-Fund, has two thirds of the investment value and is largely equity based for long term pension liabilities.
  - The Pensioner Sub-Fund, one third of investment value, and is largely invested in bonds to match cash outflows for short term pension liabilities.
- 25 Our work on Use of Resources identified robust arrangements for monitoring investment performance. The value of investments has reduced due to the impact of the credit crunch on global capital markets. This reduction is consistent with the performance of other Pension Funds. Due to the current downturn, the Authority initiated a review of the Investment strategy. This review did not highlight any shifts which would necessitate a change. Therefore, the Authority continues with its investment strategy focussing on diverse, global equities for its Active Sub-Fund.

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# Closing remarks

- 26** 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 on 12 February 2010 and will provide copies to all board members.
- 27** 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.

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**Table 3**

Report	Date issued
Audit Plan	12 June 2008
Opinion audit plan	10 February 2009
Annual governance report	23 September 2009
Auditor's report giving an opinion on the financial statements	30 September 2009
Annual audit letter	12 November 2009

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

Andrea White  
District Auditor  
November 2009

# Appendix 1 – Action plan

Page no.	Recommendation	Priority 1 = Low 2 = Med 3 = High	Responsibility	Agreed	Comments	Date
7	<p>R1 Implement the recommendations I have made in my Annual Governance Report which includes measures to:</p> <ul style="list-style-type: none"> <li>• improve accounting processes (alternative investments and FRS17) and provider staff training, where required;</li> <li>• implement controls to provide assurance for all aspects of alternative investments; and</li> <li>• review and address areas of non-compliance with the SORP.</li> </ul>	3	Adrian Bloomfield	Yes	Developments in accounting and reporting processes are being identified through training, and meetings with auditors and the custodian. These will be implemented to be included in the year end process.	March 2010
7	R2 Identify risk areas and plans to address work required to move to IFRS.	2	Adrian Bloomfield	Yes	An initial report outlining risk areas and plans to address these will be provided to the next Audit Committee.	February 2010

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# The Audit Commission

The Audit Commission is an independent watchdog, driving economy, efficiency and effectiveness in local public services to deliver better outcomes for everyone.

Our work across local government, health, housing, community safety and fire and rescue services means that we have a unique perspective. We promote value for money for taxpayers, auditing the £200 billion spent by 11,000 local public bodies.

As a force for improvement, we work in partnership to assess local public services and make practical recommendations for promoting a better quality of life for local people.

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