Deloitte.

London Borough of Hillingdon

Report to the Pension and Audit Committees

Audit Plan for the Year Ending 31 March 2013
Pension Fund Annual Report Audit

27 February 2013

Contents

Executive summary

We have pleasure in setting out in this document details of our proposed audit scope for the London Borough of Hillingdon Pension Fund for the year ending 31 March 2013. The Financial Reporting Council ("FRC") has made it clear, in its 'Update for Corporate Committees – November 2010' that it expects Audit Committees to focus activity on assessing and communicating risks and uncertainties and reliance on estimates, assumptions and forecasts. Whilst the FRC report is designed for private and public companies, the messages are equally applicable to governance and Audit Committees in other organisations. This report will describe the work we undertake in order to support this activity.

Status	Description	Detail
Audit scope		
Our audit scope is unchanged from last year	Based on guidance issued by the Audit Commission, auditors are again asked, for audit purposes, to treat the Local Government Pension Fund (LGPS) as a stand-alone body, with separate audit plan and reports to those charged with governance. Our audit of the pension fund is planned in accordance with the Code of Audit Practice issued by the Audit Commission and in accordance with additional guidance issued by the Commission in relation to the audit of pension funds. However, this only extends to the audit of the accounts and there is no requirement for a value for money conclusion on the pension fund accounts specifically. Aspects of the use of resources framework will inform the value for money conclusion for the Authority and cover issues relating to the pension fund. The pension fund accounts remain part of the accounts of the Authority as a whole. The LGPS Regulations require administering authorities to prepare an annual report for the pension fund, which should incorporate the annual accounts. Our audit report on the Authority accounts will continue to cover the pension fund section of that document. In addition, we are asked by the Commission to issue an audit report for inclusion in the annual pension fund report.	Section 1
Key audit risks		
We summarise the key audit risks identified at this stage	The key audit risks which we have identified as part of our overall audit strategy are: 1. **Contributions** – Contributions is a significant income steam for the pension scheme which contains certain complexities arising from the participation of different admitted bodies within the fund. This is compounded by the variable rates which can be paid by members depending on their pensionable pay. We have, therefore, included the calculation and payment of contributions as an area of audit risk. 2. **Benefits** – Benefit calculations continue to encompass a number of complexities for both benefits in retirement and benefits paid on ill health and death. This has been compounded in recent years with the application of CPI as an inflation factor. We continue to identify benefits payable as an area of audit risk. 3. **Financial Instruments** – The pension fund invests in private equity and derivative financial instruments. Investments of this type are often in illiquid markets and involve significant judgments in measurement, accounting and disclosure; accordingly we have identified the appropriateness of the accounting, measurement and disclosure for these investments as an audit risk. 4. **Management override of key controls** - This is a presumed area of risk within auditing standards. As consistent with previous years the presumed risk of revenue recognition continues to be rebutted for the pension fund.	Section 2

Executive summary (continued)

Materiality and prior year uncorrected misstatements and disclosure deficiencies

Planning materiality set at £7.5m

We calculate materiality on the basis of the net assets of the fund, but have restricted this to the materiality established for the audit of the Authority's financial statements as a whole.

Reporting threshold set at £0.38m

We estimate materiality for the year to be £7.5 million (2012: £7.5 million). We will report to the Pension and Audit Committees on all unadjusted misstatements greater than £0.38 million (2012: £0.38 million) and smaller adjustments that are qualitatively significant.

Further details on the basis used for the calculation of materiality are given in our audit plan for the audit of the Authority's financial statements.

Prior period recommendations

We reported a single finding from our work in 2011/12. We will follow up on this in 2012/13

In our final report to the Pension and Audit Committees, issued on 25 September 2012, we identified one area for improvement in relation to the internal control system. This improvement related to the review of the underlying private equity funds. We continue to recommend improvements in this area.

We will follow up on this area as part of our 2012/13 work.

Section 4

Prior year uncorrected misstatements and disclosure deficiencies

No prior year issues

There were no significant unadjusted misstatements or uncorrected disclosure deficiencies reported to you in respect of the 2011/12 accounts.

Independence and fees

We confirm our independence. Proposed audit fees for 2012/13 are £21,000

We confirm we are independent of the London Borough of Hillingdon Pension Scheme. We will reconfirm our independence and objectivity to the Pension and Audit Committees for the year ending 31 March 2013 in our final report to the Pension and Audit Committees.

Our responsibilities and those of the scheme are explained in the Audit Commission's publication, 'The responsibilities of Auditors and of Audited Bodies – Local Government' issued March 2010.

We propose an audit fee of £21,000 (2011/12: £35,000) for the audit of the Scheme's financial statements. This is in line with the scale fee set by the Audit Commission. The 2012/13 scale fees set by the Audit Commission include reductions of up to 40% on 2011/12 fees as a result of savings generated from the outsourcing of the Audit Commission's in-house Audit Practice and internal efficiency savings that the Commission is passing on to audited bodies. Under our new arrangements with the Audit Commission, Deloitte's net re-imbursement for external services provided remains unchanged from those previously agreed. The scale fee reductions do not therefore have an impact on our ability to continue offering a high quality service to you.

Executive summary (continued)

Operational features of our audit plan	
Our planned audit approach is similar to prior years'	Section 3 sets out our approach to considering fraud in relation to the audit. Appendices 1 and 2 set out our service team and timetable respectively.

1. Scope of work and approach

Overall scope and approach

Audit objectives are explained in more detail in our "Briefing on audit matters".

Based on guidance issued by the Audit Commission, auditors are again asked, for audit purposes, to treat the Local Government Pension Fund (LGPS) as a stand-alone body, with separate audit plan and reports to those charged with governance.

Local LGPS funds administered by administering authorities are not statutory bodies in their own right. Therefore, it is not possible for separate audit appointments to be made for LGPS audits. We are therefore appointed to the audit of the LGPS through the existing Audit Commission appointment arrangements.

Our audit of the pension fund is planned in accordance with the Code of Audit Practice issued by the Audit Commission and in accordance with additional guidance issued by the Commission in relation to the audit of pension funds. However, this only extends to the audit of the accounts and there is no requirement for a value for money conclusion on the pension fund accounts specifically. Aspects of the use of resources framework will inform the value for money conclusion for the Authority and cover issues relating to the pension fund.

Our audit objectives are set out in our "Briefing on audit matters".

The audit opinion we intend to issue as part of our audit report on the Authority's financial statements will reflect the financial reporting framework adopted by the pension fund. This is the CIPFA/LASAAC Code of Practice on Local Authority Accounting in the United Kingdom (the "Code of Practice").

For pension fund statements, we have initially considered the net assets of the fund as the benchmark for our materiality assessment as this benchmark is deemed to be a key driver of business value, is a critical component of the financial statements and is a focus for users of those statements. However, we have restricted our estimate of materiality to the amount set for the Authority's financial statements as a whole, which is £7.5 million. Our separate audit plan for the audit of the Authority's financial statements includes further information on how we derived this estimate. The concept of materiality and its application to the audit approach are set out in our Briefing on audit matters document. The extent of our procedures is not based on materiality alone but also on the quality of systems and controls in preventing material misstatement in the financial statements.

The Audit Commission has also determined that auditors should give an opinion in accordance with auditing standards on the financial statements included in the pension fund annual report. This entails the following additional work over and above giving an opinion on the pension fund accounts included in the statement of accounts:

- Comparing the accounts to be included in the pension fund annual report with those included in the statement of accounts.
- Reading the other information published within the pension fund annual report for consistency with the pension fund accounts.
- Where the pension fund annual report is not available until after the auditor reports on the financial statements, undertaking appropriate procedures to confirm that there are no material post-balance sheet events arising after giving the opinion on the pension fund accounts included in the financial statements.
- The financial statements included in the pension fund annual report are prepared on the basis of the same proper practices - the Code of Practice - as the financial statements included in the statement of accounts.
- Consider whether the annual report has been prepared in accordance with the Regulation 34 of the Local Government Pension Scheme (Administration) Regulations 2008.

2. Key audit risks

Based upon our initial assessment we will concentrate specific audit effort in 2012/13 on the following areas:

Contributions	
Tiered contribution rates increase complexity	Unlike the position in the private sector, we are not required to issue a statement about contributions in respect of the LGPS. Contributions for the year ended 31 March 2012 were £30.5 million, of which Scheduled bodies contributed £30.0 million, showing that this is a material income stream for the pension fund. This is expected to continue in the current period with there being no significant change to the active membership paying contributions. This coupled with the complexity introduced by the participation of more than one employer in the fund, together with the introduction of the new benefit structure with its tiered contribution rates; we have identified this as a specific risk.
Deloitte response	We will perform the following procedures to ascertain whether employer and employee contributions have been calculated, scheduled and paid in accordance with the schedule: • Review the design and confirm the implementation of key controls present at the Fund for ensuring contributions from all Scheduled and Admitted bodies are identified and calculated correctly. • Recalculate contributions for a sample of individual members to ensure they are calculated in accordance with the schedule of rates. • Perform analytical review procedures to gain assurance over the total contributions received in the year. • Reconcile the membership movements in the year to the Financial Statements, ensuring that these include members from the admitted bodies. We note that the Authority is not responsible for the calculation of contributions and will therefore perform such tests with the assistance of the other scheduled and admitted bodies.

2. Key audit risks (continued)

Benefits	
There are a number of complexities to the calculation of both benefits in retirement and ill health and death benefits.	The complexities surrounding the calculation of both benefits in retirement and ill health and death benefits remains a key area of audit risk. In respect of benefits in retirement, benefits are accumulated on two different bases for service pre and post 1 April 2008; the calculation of the pensionable pay on which benefits will depend may be varied by the individual opting to take account of pay earned in any of the 10 years prior to retirement; and individuals now enjoy greater flexibility in their choice of the mix of pension and lump sum. In respect of ill health and death benefits, the calculation of the pensionable pay on which benefits will depend may be varied by the same options as discussed above. The completion of the legislation leading to the change in the revaluation basis to Consumer Price Index adds a further complexity to the above calculations going forward. In the year ended 31 March 2012, total benefits paid were £35.5 million with £32.0 million (£6.4 million relating to lump sums) being paid to members in retirement. The scheduled bodies make up the main part of the scheme with £31.9 million being paid out to members of these bodies. We understand there is no significant change in the current period. The material values of these benefits further indicate that this is an area or key audit risk.
Deloitte response	We will perform the following procedures to ascertain whether benefits payable have been calculated correctly in accordance with the fund rules. • Review the design and confirm the implementation of controls present at the Fund for ensuring the accuracy, completeness and validity of benefits. • Test a sample of new pensioner calculations and other benefits paid by tracing to supporting documentation and reviewing the calculation, to ensure it is in line with the relevant rules. • Perform analytical review procedures over the pensions paid in the year based on prior year audited numbers adjusted for changes in pensioner numbers and any pension increases.

2. Key audit risks (continued)

Financial instruments	
Private equity and derivatives are complex to value	The pension fund makes some use of investments in private equity and derivative financial instruments. The fund had a total of £36.6 million in private equity funds as at 31 March 2012. Private equity funds are complex to value and include an element of judgement on the part of the investment manager. Given that these funds form a material balance within the pension fund accounts, we have identified the valuation of these funds as a specific risk. The fund also makes use of derivatives which can be complex in terms of accounting, measurement and disclosure requirements. During 2012/13, the scheme has transferred investments between investment managers using Nomura as transition managers. The assets were transferred the equity portfolio from Marathon to both Kempen Global and Newton Global via a holding period at State Street Global Advisors.
Deloitte response	For the private equity investments we will seek to understand the approach adopted in the valuation of such investments and inspect supporting documentation such as cash flow reports, quarterly investment advisor reports and audited financial statements. We will tailor further procedures depending on the outcome of that work and our assessment of the risk of material error taking into account the fund's investment holding at the year end. We will update our understanding of the rationale for the use of the derivatives and then test compliance with the accounting, measurement and disclosure requirements of the Code of Audit Practice on Local Authority Accounting. We will consult with our internal specialists and where considered necessary ask them to perform tests of these balances through re-calculation of the value attributable to them. We will review the transition reports for the two transitions in the period and assess the accuracy of the transition holdings.

Management override of controls	
Audit guidance includes a presumed risk of management override of key controls.	Auditing standards recognise that management may be able to override controls that are in place to present inaccurate or even fraudulent financial reports. They include a presumption of a risk of management override of key controls.
Deloitte response	We will focus our work on testing of journals, significant accounting estimates and any unusual transactions, including those with related parties.

3. Consideration of fraud

Characteristics

Misstatements in the financial statements can arise from either fraud or error. The distinguishing factor between fraud and error is whether the underlying action that results in the misstatement of the financial statements is intentional or unintentional. Two types of intentional misstatements are relevant us as auditors – misstatements resulting from fraudulent financial reporting and misstatements resulting from misappropriation of assets.

Responsibilities

The primary responsibility for the prevention and detection of fraud rests with management and those charged with governance, including establishing and maintaining internal controls over the reliability of financial reporting, effectiveness and efficiency of operations and compliance with applicable laws and regulations. As auditors, we obtain reasonable, but not absolute, assurance that the financial statements as a whole are free from material misstatement, whether caused by fraud or error.

Fraud inquiries

We will make the following inquiries regarding fraud:

Management	Internal Audit	The Audit Committee
Management's assessment of the risk that the financial statements may be materially misstated due to fraud including the nature, extent and frequency of such assessments. Management's process for identifying and responding to the risks of fraud in the entity. Management's communication, if any, to those charged with governance regarding its processes for identifying and responding to the risks of fraud in the entity. Management's communication, if any, to employees regarding its views on business practices and ethical behaviour. Whether management has knowledge of any actual, suspected or alleged fraud affecting the entity.	Whether internal audit has knowledge of any actual, suspected or alleged fraud affecting the entity, and to obtain its views about the risks of fraud.	How the Audit Committee exercises oversight of management's processes for identifying and responding to the risks of fraud in the entity and the internal control that management has established to mitigate these risks. Whether the Audit Committee has knowledge of any actual, suspected or alleged fraud affecting the entity.

3. Consideration of fraud (continued)

We will make inquiries of others within the Council as appropriate. We will also inquire into matters arising from your whistle blowing procedures.

Representations

We will ask for you and management to make the following representations towards the end of the audit process:

- We acknowledge our responsibilities for the design, implementation and maintenance of internal control to prevent and detect fraud and error.
- We have disclosed to you the results of our assessment of the risk that the financial statements may be materially misstated as a result of fraud.
- We are not aware of any fraud or suspected fraud / We have disclosed to you all information in relation to fraud or suspected fraud that we are aware of and that affects the entity or group and involves:

  (i) management;

  (ii) employees who have significant roles in internal control; or

  (iii) others where the fraud could have a material effect on the financial statements.
- We have disclosed to you all information in relation to allegations of fraud, or suspected fraud, affecting the entity's financial statements communicated by employees, former employees, analysts, regulators or others.

4. Prior period recommendations

Control observation

During the course of our audit for 2011/12 we identified one area for improvement in the internal control system which is detailed below:

Review of private equity funds financial statements	
Observation	Whilst an annual review process has been implemented to review the annual statements received from the private equity firms, there remained no procedure in place to complete a detailed review of the underlying private equity funds annual audited financial statements. It was again noted that the audit opinion on some of the funds was modified to include an emphasis of matter paragraph raising attention to the possibility the valuation may differ from that shown due to the illiquid market for these securities. This could lead to incorrect valuation of these funds in the pension scheme financial statements.
Recommendation	We recommended that a process is implemented to review annually the audited financial statements for all private equity funds. The committee should consider any issues identified by the auditors and the impact on the scheme should be assessed and disclosure included in the accounts to explain any uncertainties identified.
Management response	Management agree with the intention of the recommendation and will undertake an annual review through the Investment Sub Committee who meets at a time more suitable to the audit timetable.
Owner	Nancy LeRoux

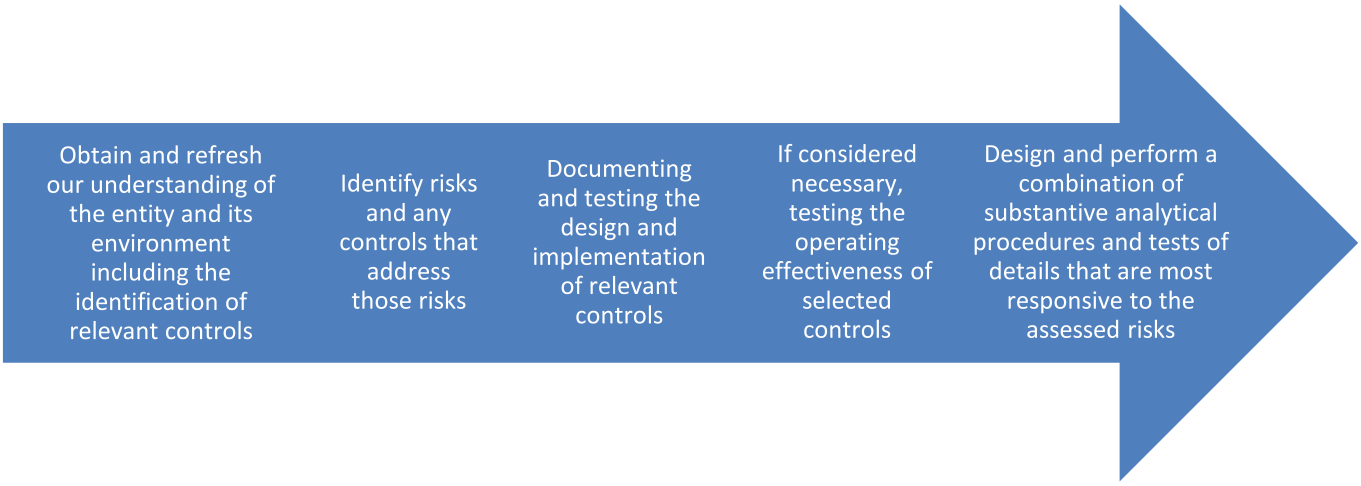
We will report to you whether this recommendation has been addressed in the current period.

5. Internal control

What audit work do we do on controls?

We will evaluate the design and implementation of controls relevant to the audit

As set out in "Briefing on audit matters" circulated to you previously, our risk assessment procedures will include obtaining an understanding of controls considered to be ‘relevant to the audit’. This involves evaluating the design of the controls and determining whether they have been implemented (“D&I”). Our audit approach consists of the following:



We will consider the results of our procedures in respect of the Council’s controls and the extent of any impact our findings have on our substantive audit procedures.

Our audit is not designed to provide assurance as to the overall effectiveness of the controls operating within the Council, although we will report to management any recommendations on controls that we may have identified during the course of our audit work.

6. Responsibility statement

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 and this report is prepared on the basis of, and our audit work is carried out, in accordance with that statement.

This report should be read in conjunction with the "Briefing on audit matters" circulated to you previously and sets out those audit matters of governance interest which have come to our attention during the planning of our audit to date. Our audit is not designed to identify all matters that may be relevant to the members and our final report on the audit will not necessarily be a comprehensive statement of all deficiencies which may exist in internal control or of all improvements which may be made.

This report has been prepared for the Pension and Audit Committees, as a body, and we therefore accept responsibility to you alone for its contents. We accept no duty, responsibility or liability to any other parties, since this report has not been prepared, and is not intended, for any other purpose.

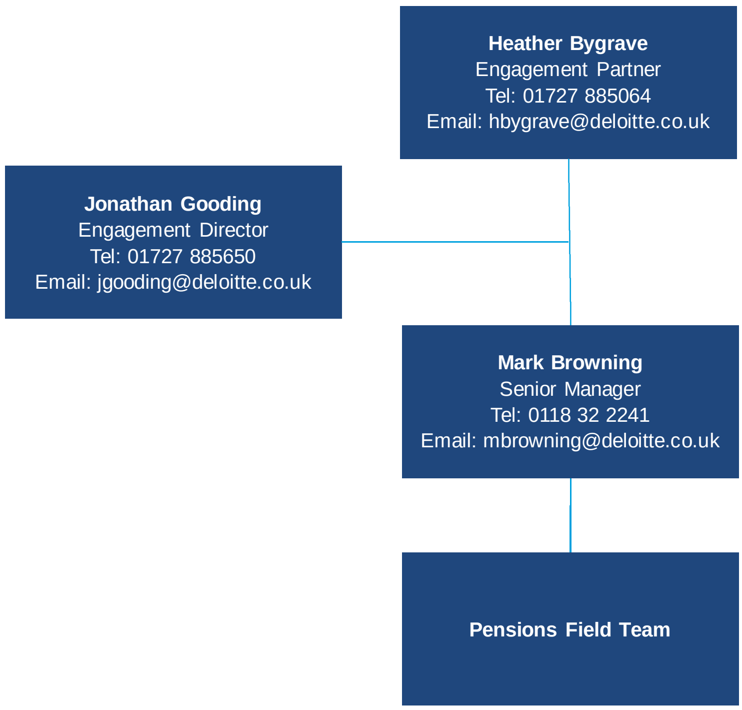
Deloitte LLP.

Deloitte LLP
Chartered Accountants

St Albans
27 February 2013

Appendix 1: Audit engagement team

We set out below our audit engagement team. We manage our audit on a basis that is consistent with prior year and which draws on the expertise of our local government and pension scheme specialists within the firm.



Appendix 2: Timetable

	2013	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep
Management	Prepare plan based on discussions with management								
	Early discussion of Authority's approach to risks areas								
	Performance of detailed audit planning fieldwork								
	Audit fieldwork/audit issues meetings								
	Review of pension fund annual report								
	Preparation of our report on the 2012/13 audit								
Pensions and Audit Committees	Audit plan								
	Report to the Pension and Audit Committees on the 2012/13 audit								

Our work during these visits will be closely co-ordinated with the work carried out on other parts of main audit of Hillingdon.

Appendix 3: Industry update

Public Service Bill

The Public Service Bill 2012/13 will create the unified legal framework underpinning the new public sector CARE arrangements, which have now been agreed in principle between the Government and unions. The Bill enables the detailed regulations needed to be drafted for the new schemes. The Bill picks up many of the Hutton Report's other recommendations, for example, on strengthening scheme governance. Some of the key areas of change are:

- The Pension Regulator's role will be expanded to cover public sector schemes.
- Introduction of two roles relating to governance, Pension Board and Scheme Manager.
- Pension Boards will need to appropriate level of knowledge and understanding, this includes that members are conversant with the rules of the scheme, policies of the scheme and an understanding of the law relating to pensions.
- Scheme Manager is to be responsible for the administration and management of the scheme, expected to be the Administering Authority.
- Fair Deal - "Broadly comparable" DB Benefits are to continue to be offered by companies taking on public sector work.

The bill has had its third reading in the House of Lords and we await any final amendments.

LGPS admission agreements

Admission Agreements allow private contractors to participate in the LGPS in respect of members transferred from the public sector.

The Miscellaneous Regulations made the following amendments for Admission Agreements from 1 October 2012:

- it will no longer be possible for an admission agreement to cover more than one outsourcing contract;
- the distinction between transferee and community admission agreements will be removed. This means that the requirement to obtain a bond or indemnity will apply equally to both forms of admitted body; and
- in future, to address a loophole, a valuation must be made at the date an employing authority ceases to be a scheme employer in respect of the liabilities relating to its current and former employees.

In addition, following changes to allow for auto-enrolment, contractors need to be careful that existing Admission Agreements permit only employees eligible for the LGPS to be auto-enrolled.

Appendix 3: Industry update (continued)

The new LGPS 2014 project
On 22 December an agreement reached by the Local Government Association (LGA) and local government unions on how to take forward the future reform of the Local Government Pension Fund (LGPF) in England and Wales was accepted by the Government. The agreement consists of: • A set of principles covering: - The design of a new LGPF. - The future management and cost of the fund. - Governance of the LGPF. • A timetable for implementing the new fund by April 2014. • A project outline for managing the process of agreeing, by April 2012, the 'big ticket' elements of the new fund. During April 2012, following the acceptance by Government of a principles document submitted by the Local Government Association, UNISON and GMB on how to take forward the reform of the Local Government Pension Fund (LGPF) in England and Wales, a project has been set up to reach agreement on the elements of the new fund together with the management and governance of the fund going forward. Further information is available at: http://www.lgps.org.uk/lge/core/page.do?pageId=15431012