

London Borough of Hillingdon Pension Scheme

Report to the Audit Committee and Pension
Committee

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Executive summary

We have pleasure in setting out in this document our report to the Audit Committee and Pension Committee for the year ended 31 March 2010 for discussion at the meeting scheduled on 22 September 2010. This report summarises the principal matters that have arisen from our audit for the year ended 31 March 2010.

This summary is not intended to be exhaustive but highlights the most significant matters to which we would like to bring your attention. It should, therefore, be read in conjunction with the report and the appendices thereto.

Key findings on audit risks and other matters

In our audit plan we identified three key audit risks in relation to:

- calculation of contributions in light of there being more than one admitted body;
- the calculation of benefits given the complexities of calculating retirement, ill health and death benefits as a result of changes introduced in 2008; and
- the valuation of private equity.

We carried out testing in line with our approach set out in our Audit Plan and there were no exceptions to report to you.

Audit status

The audit is substantially complete, and subject to the finalisation of the following:

- completion of internal review processes;
- review of final draft of financial statements;
- representation letter (Appendix 3); and
- update of post balance sheet event review.

We will report to you orally in respect of any modifications to the findings or opinions contained in this report that arise on completion of these matters.

On satisfactory completion of the outstanding matters, we anticipate issuing an unmodified audit opinion on the truth and fairness of the financial statements.

Identified misstatements and disclosure deficiencies

Audit materiality has increased to £7.1m from £6m (2009 £6.4m) as set out in our Audit Plan. This is to reflect the final outturn for the year ended 31 March 2010 as opposed to the materiality determination forecasted result.

There were no uncorrected misstatements or disclosure deficiencies.

Accounting and internal control systems

During our audit we observed two areas of improvements in relation to the internal control system. The following have been discussed in detail in section 2:

- Control process for authorising the posting of journals; and
- Regular review of Fund Managers internal control reports.

1. Key audit risks

The results of our audit work on the key audit risks are set out below:

Contributions	
Risk	Contributions are a material income stream for the Scheme and in view of the complexity introduced by the participation of more than one employer, together with changes made to the Local Government Pension Scheme in April 2008 which mean that members pay different rates on the basis of their pensionable pay, we have identified this as a specific risk.
Response	<p>We have performed the following testing to address the specific risk:</p> <ul style="list-style-type: none">• design and implementation of key controls were tested by discussing with the pensions team the controls around contributions and testing and that they were in force during the year. No issues were noted;• detailed testing, by selecting a sample of employees and recalculating the employee and employer contributions to ensure these are in accordance with the contribution rates in force during the year.• analytical review was performed to get assurance over the completeness of contributions. We built an expectation for the employer and employee contributions based on the 2009 contributions and adjusted for pay rises, change in member numbers and contribution rates. The difference between our expectation and the actual contributions fell within our tolerance level. <p>Our testing proved satisfactory.</p>

1. Key audit risks (continued)

Benefits	
Risk	<p>Changes were made to the Local Government Pension Scheme from April 2008 which introduced complexities into the calculation of retirement, ill health and death benefits.</p> <p>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.</p> <p>In respect of ill health and death benefits, 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. Some administrators may not have retained all the necessary records.</p>
Response	<p>The following tests were performed to address the specific risk around contributions:</p> <ul style="list-style-type: none"> • testing of design and implementation of key controls over benefits. This involved identifying key controls in place to ensure the accuracy, completeness and validity of benefits through discussion with the pension administration team and testing to ensure in force during the year. No issues were noted; • analytical review was performed over pensions payments by building an expectation for 2009 based on the 2008 pension paid and adjusting for pension increases and change in membership numbers. This was compared to the actual pension paid in the year and the difference between the two was within our tolerance level; and • for a sample of pension and other benefit payments, we performed detailed substantive tests on their benefit calculations and compared these calculations to the Scheme rules. Member files were reviewed to verify the necessary documentation for the sample chosen. No exceptions were noted in the sample tested. <p>Our testing proved satisfactory.</p>

1. Key audit risks (continued)

Private Equity	
Risk	<p>The Pension Fund makes some use of investments in unquoted investment vehicles. A number of such investment vehicles have suffered significant losses over the last two years.</p> <p>Private Equity (PE) funds are complex to value and given the lack of marketability and externally available information to value them their valuation includes an element of judgement on the part of the fund manager. These investments form a material balance within the Pension Scheme accounts and therefore the valuation of PE funds is regarded as a risk area.</p>
Response	<p>Our key audit procedure for testing PE funds was to request direct confirmations from all fund managers and custodians and to obtain and review AAF reports relating to internal controls in place at fund managers and custodians.</p> <p>We also performed the following detailed procedures:</p> <ul style="list-style-type: none">• understood the pricing methods adopted for the PE investments and assessed whether these were appropriate;• obtained the fund manager's audited financial statements at 31 December 2009 and statements as at 31 March 2010 and understood the movements between the two dates;• values as at 31 December 2009 and 31 March 2009 were compared to custodian valuations to gain further assurance over the valuation; and• year end investments are in line with the Statement of Investment Principles. <p>As a result of our testing we have concluded that the PE valuations included in the financial statements are not materially misstated.</p>

2. Accounting and Internal Control Systems

Journal Authorisation

Issue:

During our audit we noted that there is no formal process for reviewing or authorising journals before they are posted and where such reviews do take place, there is no evidence of review. This increases the risk that unauthorised or incorrect journal may be processed and these will not be detected in a timely manner.

Recommendation:

Although there are mitigating controls in place we recommend that management introduce a formal process in the reviewing and authorisation of journals. We recommend having authorisation limits for various personnel depending on the value of journals.

Management response:

We are developing a system where journal entries will be automatically sent to managers for authorisation. Therefore this control will be implemented going forward.

2. Accounting and Internal Control Systems (continued)

Review of Fund Managers' internal control reports

Issue:

From our review of the fund managers' internal control reports, we noted some managers had a high level of control deficiencies. For each deficiency, a response has been obtained from management setting out the reason for the failure in the control and the remedial action taken to address the matter. Based on our discussions with management, it does not appear that the Pensions Committee has assessed the impact, if any, that the breakdowns in these controls may have on investments held by Hillingdon Pension Scheme.

Recommendation:

Demonstrating strong governance is an increasing area of focus by Audit Committees. We recommend that the Pension Committee perform due diligence on the investment manager internal control reports and request that the fund managers report back to the Committee on the impact that the deficiencies noted had on the Scheme. The Pension Committee may wish to supplement these reviews with visits to each of the key investments managers, such as SsgA and UBS.

Management response:

We agree with this recommendation and will add to the Pension Committee workplan.

3. Other matters for communication

As part of our obligations under International Standards on Auditing (UK & Ireland), we are required to report to you on the matters listed below.

Independence	<p>We consider that we comply with APB Revised Ethical Standards for Auditors and that, in our professional judgement, we are independent and the objectivity of the audit engagement partner and audit staff is not compromised.</p> <p>If the audit committee wishes to discuss matters relating to our independence, we would be happy to arrange this.</p>
Non-audit services	<p>We refer you to our report on London Borough of Hillingdon where we have provided further information about our non-audit services to the Borough.</p> <p>An analysis of Pension Scheme fees earned by Deloitte in the period from 1 April 2009 to 31 March 2010 is included in Appendix 2. We have not received any non-audit fees.</p>
International Standards on Auditing (UK and Ireland)	<p>We consider that there are no additional matters in respect of those items highlighted in our publication "Briefing on audit matters" to bring to your attention that have not been raised elsewhere in this report or our audit plan.</p>
Liaison with internal audit	<p>The audit team, following an assessment of the independence and competence of the internal audit department, reviewed the findings of internal audit. There were no areas where we needed to adjust our audit approach as a result of the findings of internal audit.</p>
Written representations	<p>A copy of the representation letter to be signed on behalf of the Committee has been attached to this document. Non-standard representations have been highlighted.</p>

4. Responsibility statement

The Audit Commission published a 'Statement of responsibilities of auditors and of audited bodies' alongside the Code of Audit Practice. The purpose of this statement is to assist auditors and audited bodies by summarising where, in the context of the usual conduct of the audit, the different responsibilities of auditors and of the audited body begin and end, and what is expected of the audited body in certain areas. The statement also highlights the limits on what the auditor can reasonably be expected to do.

Our audit plan has been prepared on the basis of the Code and the Statement of Responsibilities, copies of which have been provided to Boroughs by the Audit Commission, and our audit work carried out in accordance with these documents.

The audit may include the performance of national studies developed by the Audit Commission, where the auditors are required to follow the methodologies and use the comparative data provided by the Commission. A responsibility for the adequacy and appropriateness of these methodologies and the data rests with the Audit Commission. The audit may also include reviews such as this report which address locally determined risks and issues the scope of which is agreed with management in advance of the work. In this case it is for management to determine whether the scope is adequate and appropriate to their needs.

While our reports may include suggestions for improving accounting procedures, internal controls and other aspects of your business arising out of our audit, we emphasise that our consideration of the Pension Scheme's system of internal control was conducted solely for the purpose of our audit having regard to our responsibilities under Auditing Standards and the Code of Audit Practice. We make these suggestions in the context of our audit but they do not in any way modify our audit opinion which relates to the financial statements as a whole. Equally, we would need to perform a more extensive study if you wanted us to make a comprehensive review for weaknesses in existing systems and present detailed recommendations to improve them.

Any conclusion, opinion or comments expressed herein are provided within the context of our opinion on the financial statements and our conclusion on value for money as a whole, which was expressed in our auditors' report.

We view this report as part of our service to you for Corporate Governance purposes and it is to you alone that we owe a responsibility for its contents. We accept no duty, responsibility or liability to any other person as the report has not been prepared, and is not intended, for any other purpose. It should not be made available to any other parties without our prior written consent

Deloitte LLP

Chartered Accountants

Birmingham

September 2010

Appendix 1: Analysis of professional fees

The professional fees earned by Deloitte in the period from 1 April 2009 to 31 March 2010 are as follows:

	2009/10 £
Fees payable to the company's auditors for the audit of London Borough of Hillingdon Pension Scheme accounts	38,000

Appendix 2: Representation letter

(Client's Letterhead)

Deloitte LLP

4 Brindley Place

Birmingham B1 2HZ

Our Ref: GM/HP/GK/2010

Date:

Dear Sirs

London Borough of Hillingdon Pension Scheme (the "Scheme")

This representation letter is provided in connection with your audit of the financial statements of the scheme for the year ended 31 March 2010 for the purpose of expressing an opinion as to whether the financial statements are true and fair, in accordance with the Code of Practice on Local Authority Accounting in the United Kingdom 2009 in respect of the financial transactions of the Pension Scheme during the year ended 31 March 2010, and the amount and disposition of the scheme's asset and liabilities as at 31 March 2010, other than liabilities to pay pensions and other benefits after the end of the scheme year.

We acknowledge as members of the London Borough of Hillingdon our responsibilities for ensuring that the financial statements are prepared which give a true and fair view, for keeping records in respect of active members of the Scheme and for making accurate representations to you.

We confirm, to the best of our knowledge and belief, the following representations.

1. All the accounting records have been made available to you for the purpose of your audit and all the transactions undertaken by the Scheme have been properly reflected and recorded in the accounting records. All other records and related information, including minutes of Officer and Committee member meetings, have been made available to you.
2. We acknowledge our responsibilities for the design, implementation and operation of internal control to prevent and detect fraud and error.
3. 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.
4. We are not aware of any significant facts relating to any frauds or suspected frauds affecting the Scheme involving:
 - (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.

5. We have disclosed to you our knowledge of any allegations of fraud, or suspected fraud, affecting the Scheme's financial statements communicated by members, former members, employers, regulators or others.
6. We are not aware of any actual or possible instances of non-compliance with laws and regulations, the effects of which should be considered when preparing financial statements.
7. Where required, the value at which assets and liabilities are recorded in the net asset statement is, in the opinion of the Authority, the fair value. We are responsible for the reasonableness of any significant assumptions underlying the valuation, including consideration of whether they appropriately reflect our intent and ability to carry out specific courses of action on behalf of the Scheme. Any significant changes in those values since the balance sheet date have been disclosed to you.
8. We confirm the completeness of the information provided regarding the identification of related parties, and the adequacy of related party disclosures in the financial statements.
9. We have made enquiries of any key managers or other individuals who are in a position to influence, or who are accountable for the stewardship of the Scheme and confirm that we have disclosed in the financial statements all transactions relevant to the Scheme and we are not aware of any other such matters required to be disclosed in the financial statements, whether under Statement of Recommended Practice – Financial Reports of Pension Schemes (revised May 2007) ("Pensions SORP 2007") or other requirements.
10. We confirm that the financial statements have been prepared on the going concern basis. We do not intend to wind up the scheme. We are not aware of any material uncertainties related to events or conditions that may cast significant doubt upon the Scheme's ability to continue as a going concern. We confirm the completeness of the information provided regarding events and conditions relating to going concern at the date of approval of the financial statements, including our plans for future actions.
11. You have been informed of all changes to the Scheme rules during the year and up to the current date.
12. We have not commissioned advisory reports which may affect the conduct of your work in relation to the Scheme's financial statements.
13. No claims in connection with litigation have been or are expected to be received.
14. We have no plans or intentions that may materially affect the carrying value or classification of assets and liabilities reflected in the financial statements.
15. There have been no events subsequent to 31 March 2010 which require adjustment of or disclosure in the financial statements or notes thereto.
16. There have been no irregularities involving management or employees who have a significant role in the accounting and internal control systems or that could have a material effect on the financial statements.
17. The pension scheme accounts and related notes are free from material misstatements, including omissions.
18. The Scheme has complied with all aspects of contractual agreements that could have a material effect on the financial statements in the event of non-compliance. There has been no non-compliance with requirements of regulatory authorities that could have a material effect on the financial statements in the event of non-compliance.
19. The Scheme has satisfactory title to all assets.
20. We have recorded or disclosed, as appropriate, all liabilities, both actual and contingent.

21. No transactions have been made which are not in the interests of the members of the Scheme during the Scheme year or subsequently.
22. All trades in complex financial instruments are in accordance with our risk management policies, have been conducted on an arm's length basis and have been appropriately recorded in the accounting records, including consideration of whether the complex financial instruments are held for hedging, asset/liability management or investment purposes. None of the terms of the trades have been amended by any side agreement and no documentation relating to complex financial instruments (including any embedded derivatives and written options) and other financial instruments has been withheld.
23. We confirm that the Pension Scheme Annual Report is compliant with the requirements of Regulations 34(1) (e) of the Local Government Pension Scheme (Administration) Regulations 2008 and related guidance.
24. We confirm that the information that is contained within the Pension Scheme Annual Report and Accounts for the year to 31 March 2010 is complete, accurate and consistent with the information that is contained within the Accounts.

We confirm that the above representations are made on the basis of adequate enquiries of other officials of the Scheme (and where appropriate, inspection of evidence) sufficient to satisfy ourselves that we can properly make each of the above representations to you.

Yours faithfully

Signed on behalf of the London Borough of Hillingdon

Appendix 3: Draft Opinion

Independent auditor's report to the Members of London Borough of Hillingdon

We have audited the pension scheme accounting statements for the year ended 31 March 2010. The pension scheme accounting statements comprise the Scheme Account, the Net Assets Statement and the related notes 1 to 17. The pension scheme accounting statements have been prepared under the accounting policies set out in the Statement of Accounting Policies.

This report is made solely to the members of London Borough of Hillingdon in accordance with Part II of the Audit Commission Act 1998 and for no other purpose, as set out in paragraph 49 of the Statement of Responsibilities of Auditors and of Audited Bodies prepared by the Audit Commission. Our audit work has been undertaken so that we might state to the Authority those matters we are required to state to them in an auditors' report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Authority, as a body, for our audit work, for this report, or for the opinions we have formed.

Respective responsibilities of the Director of Finance & Resources and auditor

The Director of Finance & Resources is responsible for preparing the pension scheme accounting statements, in accordance with relevant legal and regulatory requirements and the Code of Practice on Local Authority Accounting in the United Kingdom 2009: A Statement of Recommended Practice. In preparing this pension scheme accounting statements, the Director of Finance & Resources is responsible for:

- selecting suitable accounting policies and then applying them consistently;
- making judgments and estimates that were reasonable and prudent;
- keeping proper accounting records which were up to date;
- taking reasonable steps for the prevention and detection of fraud and other irregularities.

Our responsibility is to audit the pension scheme accounting statements and related notes in accordance with relevant legal and regulatory requirements and International Standards on Auditing (UK and Ireland).

We report to you our opinion as to whether the pension scheme accounting statements give a true and fair view, in accordance with relevant legal and regulatory requirements and the Code of Practice on Local Authority Accounting in the United Kingdom 2009: A Statement of Recommended Practice, the financial transactions of the pension scheme during the year and the amount and disposition of the scheme's assets and liabilities, other than liabilities to pay pensions and other benefits after the end of the scheme year. We also report to you whether, in our opinion, the information which comprises the commentary on the financial performance included within the Pension Scheme Annual Report, is consistent with the pension scheme accounting statements. That information comprises the Management Report for the year ended 31 March 2010.

We review whether the governance compliance statement published in the Pension Scheme Annual Report reflects compliance with the requirements of the Local Government Pension Scheme (Administration) Regulations 2008 and related guidance. We report if it does not meet the requirements specified by the Department of Communities and Local Government or if the statement is misleading or inconsistent with other information we are aware of from our audit of the accounting statements. We are not required to consider, nor have we considered, whether the governance statement covers all risks and controls. Neither are we required to form an opinion on the effectiveness of the Authority's corporate governance procedures or its risk and control procedures

We read other information published with the accounting statements and related notes as described in the contents section and consider whether it is consistent with the audited accounting statements.

Basis of audit opinion

We conducted our audit in accordance with the Audit Commission Act 1998, the Code of Audit Practice issued by the Audit Commission and International Standards on Auditing (UK and Ireland) issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the pension scheme accounting statements and related notes. It also includes an assessment of the significant estimates and judgments made by the Authority in the preparation of the pension scheme accounting statements and related notes, and of whether the accounting policies are appropriate to the Authority's circumstances, consistently applied and adequately disclosed.

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the pension scheme accounting statements and related notes are free from material misstatement, whether caused by fraud or other irregularity or error. In forming our opinion we also evaluated the overall adequacy of the presentation of information in the pension scheme accounting statements and related notes.

Opinion

In our opinion:

- the pension scheme accounting statements and related notes give a true and fair view, in accordance with the Code of Practice on Local Authority Accounting in the United Kingdom 2009: A Statement of Recommended Practice, of the financial transactions of the Pension Scheme during the year ended 31 March 2010, and the amount and disposition of the scheme's assets and liabilities as at 31 March 2010, other than liabilities to pay pensions and other benefits after the end of the scheme year; and
- the information given in the commentary on financial performance included within the Pension Scheme Annual Report is consistent with the pension scheme accounting statements.

Gus Miah (Engagement Lead)
For and on behalf of Deloitte LLP

Appointed Auditor

Birmingham, UK

Date

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