

**London Borough of  
Hillingdon**

**Report to the Audit Committee  
and Pensions Committee**

**Audit Plan for the 31 March 2011  
year end Pension Fund Audit**

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# 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 2011.

## Audit scope

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 Audit 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 Council and cover issues relating to the pension fund.

The pension fund accounts remain part of the accounts of the Council 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 Council accounts will continue to cover the pension fund section of that document. In addition, we are asked by the Audit Commission to issue an audit report for inclusion in the annual pension fund report.

## Materiality

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 Council's financial statements as a whole. We estimate materiality for the year to be £7.3 million (2010: £6 million). We will report to the Pensions Committee on all unadjusted misstatements greater than £0.4 million (2010: £0.3 million) unless they are qualitatively material. Further details on the basis used for the calculation of materiality are given in our audit plan for the audit of the Council's financial statements.

# Executive summary (continued)

<b>Key audit risks</b>	<p>The key audit risks which we have identified as part of our overall audit strategy are:</p> <ol style="list-style-type: none"><li>1. Unlike the position in the private sector, we are not required to issue a separate statement on contributions. Nevertheless, in view of the complexity arising from the participation of different admitted bodies within the fund, together with changes to the fund introduced from April 2008 which mean that members may pay different rates depending on their pensionable pay, we have included the identification, calculation and payment of contributions as areas of specific risk.</li><li>2. There are a number of complexities to the calculation of both benefits in retirement and ill health and death benefits introduced by changes to the local government pension fund last year. We will perform testing to verify that the calculation of benefits is in accordance with the Scheme rules.</li><li>3. The pension fund in the past has made some use of investments in unquoted investment vehicles which can give rise to complexities in accounting, disclosure and measurement. There are four new fund managers in the year and the transfer of fund and transition will be an area of focus. We will review the internal control reports of the fund managers and verify how the Pensions Committee has satisfied itself of the controls at the fund manager.</li><li>4. The Code of Practice on Local Authority Accounting sets out how Local Government Pension Schemes should be applying International Financial Reporting Standard (IFRS). This has some application for the Fund.</li></ol>
<b>Prior year uncorrected misstatements and disclosure deficiencies</b>	<p>There were no significant unadjusted misstatements or uncorrected disclosure deficiencies reported to you in respect of the 2009/10 accounts.</p>
<b>Timetable</b>	<p>The timetable is set out in Section 5. The fieldwork will be carried out at the same time as our work on the Council's financial statements. We plan to finalise our audit report included within the Pension Fund Annual Report at the same time as that included in the Council's accounts.</p>

# Executive summary (continued)

<b>Independence</b>	<p>Deloitte have developed important safeguards and procedures in order to ensure our independence and objectivity.</p> <p>These are set out in the “Independence policies and procedures” section included at Appendix 1.</p> <p>We will reconfirm our independence and objectivity to the Audit Committee and Pensions Committee for the year ending 31 March 2011 in our final report to the Audit Committee and Pensions Committee. We have discussed our relationships with the Council in our separate audit plan for the audit of the Council’s financial statements.</p>
<b>Fees</b>	<p>We set out an estimate of our fees in a letter to the Council issued in July 2010. Since then we have agreed the fee estimate of £36,500 (2010: £38,000), this is accordance with the Audit Commission guidance.</p>
<b>Matters for those charged with governance</b>	<p>The “Briefing on audit matters”, previously circulated to you, includes those additional items which we are required to report upon in accordance with International Standards on Auditing (UK &amp; Ireland). We will report to you at the final audit stage any matters arising in relation to those requirements.</p>
<b>Engagement Team</b>	<p>Heather Bygrave will lead the audit and will be supported by Mark Browning. Heather is also the lead audit partner for London Borough of Hillingdon. Both Heather and Mark have significant experience in the audit of pension schemes.</p>

# 1. Scope of work and approach

## **Overall scope and approach**

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 Council and cover issues relating to the pension fund.

Our audit objectives are set out in our “Briefing on audit matters” document, as previously circulated to you.

The audit opinion we intend to issue as part of our audit report on the Council’s financial statements will reflect the financial reporting framework adopted by the pension fund. This is the Local Government Statement of Recommended Practices (SORP).

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 Council’s financial statements as a whole, which is £7.3 million. Our separate audit plan for the audit of the Council’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, and the level at which known and likely misstatements are tolerated by you in the preparation of the financial statements.

# 1. Scope of work and approach (continued)

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; and
- 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 Local Government SORP - as the financial statements included in the statement of accounts.

Our audit objectives are set out and explained in more detail in our “Briefing on audit matters” document, as previously circulated to you.

## 2. Key audit risks

Based upon our initial assessment we will concentrate specific audit effort in 2010/11 on the following areas:

### Contributions

#### **Audit Risk**

Unlike the position in the private sector, we are not required to issue a statement about contributions in respect of the LGPS. However, this remains a material income stream for the pension fund and in view of 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 tests of controls in this area in order to take a controls reliance approach for our substantive audit testing. We will perform procedures to ascertain whether employer and employee contributions have been calculated, scheduled and paid in accordance with the schedule.

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## 2. Key audit risks (continued)

### Benefits

#### Audit Risk

Changes were made to the local government pension fund from April 2008 which introduced complexities into the calculation of both benefits in retirement and ill health and death benefits.

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 individual opting to take account of pay earned in any of the 10 years prior to retirement. Some employers may not have retained all the necessary records.

#### Deloitte response

We will perform tests of controls in this area in order to take a controls reliance approach for our substantive audit testing. We will perform procedures to ascertain whether benefits payable have been calculated correctly in accordance with the fund rules.

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## 2. Key audit risks (continued)

### Investment Assets

#### Audit Risk

- The pension fund makes some use of investments in unquoted investment vehicles, like private equity houses. Nationally, a number of such investment vehicles have suffered significant losses over the last two years. 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.
- There are four new investment managers in the year and the transition of fund and management of these funds from one to the other is identified as a specific risk.

#### Deloitte response

- We will seek to understand the approach adopted in the valuation of such investments and inspect documentation relating to data sources used by the Council. 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.

The fund also makes use of derivatives which can be complex in terms of accounting, measurement and disclosure requirements. We will first understand the rationale for the use of the derivatives and then test compliance with the accounting, measurement and disclosure requirements of the Local Government SORP. The use of expert advice may be required for testing these balances.

- As there are four new fund managers in the year we will need to verify the correct transfer of funds between the fund managers to ensure there were no errors in the transition.

We will perform standard procedures like obtaining direct investment confirmations and reviewing the internal control reports of these fund managers. We will also gain an understanding of the Pension Committee review over these internal control reports to verify how it satisfies itself over the controls in place at the fund managers.

We will also review the updated Statement of Investment Principles (SIP) to ensure investments have been made in line with these.

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## 2. Key audit risks (continued)

### International Financial Reporting Statements (IFRS)

#### Audit Risk

The Code of Practice on Local Authority Accounting sets out how Local Government Pension Schemes should be applying International Financial Reporting Statements (IFRS). The main implications for the Hillingdon Pension Fund are as follows:

- requirement for actuarial present value of promised retirement benefits to be disclosed – with three options for disclosure:
  - Option A - in the Net Asset Statement disclosing the resulting deficit or surplus;
  - Option B – in the notes to the Financial Statements; or
  - Option C – by referring to the actuarial information in an accompanying actuarial report.
- additional note disclosures required around the actuarial position of the fund and the significant actuarial assumptions made; and
- additional note disclosure requirements in IFRS 7, in relation to financial instruments disclosures, to report on the risks to which financial instruments expose the entity.

#### Deloitte response

We will review the additional disclosures in the Pension Fund accounts for compliance with the Code of Practice on Local Authority Accounting.

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# 3. Consideration of fraud

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.

ISA (UK and Ireland) 240 – ‘The auditor’s responsibility to consider fraud in an audit of financial statements’ requires us to document an understanding of how those charged with governance exercise oversight of management’s processes for identifying and responding to the risks of fraud in Hillingdon Council and its local government pension fund and the internal control that management has established to mitigate these risks.

We will make inquiries of management, internal audit and others within the Council as appropriate, regarding their knowledge of any actual, suspected or alleged fraud affecting the Council. In addition we are required to discuss the following with the Pensions Committee:

- Whether the Pensions Committee has knowledge of any fraud, alleged or suspected fraud?
- The role that the Pensions Committee exercises in oversight of:
  - Hillingdon Council’s assessment of the risks of fraud in respect of the pension fund; and
  - the design and implementation of internal control to prevent and detect such fraud?
- The Pensions Committee’s assessment of the risk that the pension fund financial statements and annual report may be materially misstated as a result of fraud.

We will be seeking representations in this area from the Nancy LeRoux, Senior Finance Manager - Corporate Finance, in due course.

# 3. Consideration of fraud (continued)

## **Management override of controls**

In addition to the procedures above we are required to design and perform audit procedures to respond to the risk of management's override of controls which will include:

- having understood and evaluated the financial reporting process and the controls over journal entries and other adjustments made in the preparation of the financial statements, test the appropriateness of a sample of such entries and adjustments. We will again make use of our computer audit specialists to analyse the whole population of journals and identify those which have unusual features for further testing;
- a review of accounting estimates for biases that could result in material misstatement due to fraud, including whether any differences between estimates best supported by evidence and those in the financial statements, even if individually reasonable, indicate a possible bias on the part of management. We will also perform a retrospective review of management's judgements and assumptions relating to significant estimates reflected in last year's financial statements; and
- obtain an understanding of the business rationale of significant transactions that we become aware of that are outside the normal course of business or that otherwise appear to be unusual given our understanding of the Council and its environment.

# 4. Internal control

## **Obtaining an understanding of internal control relevant to the audit**

As set out in "Briefing on audit matters", for controls considered to be 'relevant to the audit' we are required to evaluate the design of the controls and determine whether they have been implemented ("D & I"). The results of our work in obtaining an understanding of controls and any subsequent testing of the operational effectiveness of controls will be collated and the impact on the extent of substantive audit testing required will be considered. Our audit is not designed to provide assurance as to the overall effectiveness of the controls operating within the Council or its pension fund administration, although we will report to management any recommendations on controls that we may have identified during the course of our audit work.

## **Liaison with internal audit**

We will be meeting with Helen Taylor, the Council's Head of Internal Audit and Corporate Governance, and agree on a constructive and complementary liaison between the external auditors and the Council's internal audit function, to maximise the combined effectiveness and eliminate duplication of effort. This co-ordination will enable us to derive full benefit from the Council's internal audit functions, their systems documentation and risk identification during the planning of the external audit.

Following an assessment of the organisational status, scope of function, objectivity, technical competence and due professional care of the internal audit function we will review any findings relevant to the pension scheme adjust the audit approach as is deemed appropriate.

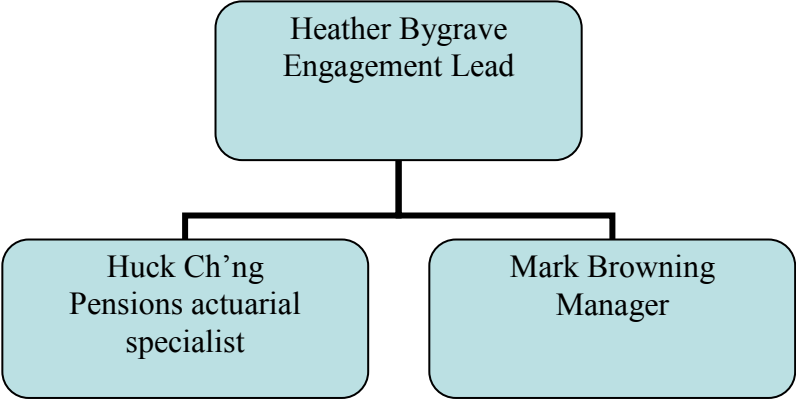
# 5. Timetable

		2010		2011											
		Nov	Dec	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	
<b>Management</b>	Prepare plan based on discussions with management				■										
	Early discussion of Council's approach to risks areas				■										
	Performance of detailed planning and controls work					■									
	Feedback on outcome of interim procedures						■								
	Audit fieldwork/audit issues meetings								■	■	■				
	Review of pension fund annual report										■	■			
	Preparation of our report on the 2010/11 audit											■			
<b>Audit Committee and Pensions Committee</b>	Audit plan				■										
	Report to the Audit Committee & Pensions Committee on the 2010/11 accounts audit											■			

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

# 6. Client service team

We set out below our Pension scheme audit engagement team.





# 7. 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” and sets out those audit matters of governance interest which came to our attention during the audit to date. Our audit was not designed to identify all matters that may be relevant to members and this report is not necessarily a comprehensive statement of all weaknesses which may exist in internal control or of all improvements which may be made.

This report has been prepared for the Members of Hillingdon Council, 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**  
Chartered Accountants

St Albans  
February 2011

# Appendix 1: Analysis of professional fees

We summarise below our proposed audit fees as discussed with management, including details of any scope changes:

Pension scheme Audit	
2009/10	£38,000
<b>2010/11</b>	<b>£36,500</b>

**Note 1** - We have not made any adjustment to the fee for inflation in line with the Audit Commission's recommendation.

**Note 2** - In setting the fee at this level, we have assumed that the general level of risk in relation to the audit of the financial statements is not significantly different from that identified in respect of 2009/10.



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