

Annual governance report

Lancashire County Pension Fund

Audit 2010/11



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Traffic light explanation
Red ■ Amber ◆ Green ●

Key messages

This report summarises the findings from the 2010/11 audit which is substantially complete. It includes the messages arising from my audit of your financial statements.

	Our findings
Unqualified audit opinion	●
Adequate internal control environment	●

Audit Opinion and Financial Statements

I will issue two audit reports on the financial statements of the Pension Fund. The two reports will cover:

- the Pension Fund's financial statements as presented in the Lancashire Pension Fund Annual Report; and
- the Pension Fund's financial statements included within the administering authority's accounts for Lancashire County Council.

My audit of the Pension Fund financial statements is substantially complete and I expect both reports to include an unqualified opinion by 30 September 2011.

Internal Control Environment

The Fund has an adequate control environment in place, and officers have carried out effective actions to address issues identified in the previous year.

- Control processes implemented provide greater assurance over the valuation of private equity investments.
- Actions enabled officers to achieve the effective implementation of a separate investment portfolio for internally managed funds, and a separate bank account for the Pension Fund by 1 April 2011.

Officers have dealt effectively with significant events during the year without detriment to the control environment, including:

- implementation of a new pensions administration system;
- disinvestment of one of the fund investment portfolios; and
- the tendering of the custodian contract.

Before I complete my audit

I confirm to you

My report includes only matters of governance interest that have come to my attention in performing my audit. My audit is not designed to identify all matters that might be relevant to you.

Independence

I identified the following threat to independence.

- A member of our audit team is related to a member of the pensions service.

I applied the following safeguard that reduced this threat to an acceptably low level.

- Our member of staff does not undertake, or is responsible for the review of, any of our work that assesses the work of the pensions service.

The Audit Commission's Audit Practice has not undertaken any non-audit work for the Council during 2010/11.

I ask you to confirm to me

I ask the audit committee to:

- take note of the adjustments to the financial statements as set out in this report (pages 9 to 10); and
 - approve the letter of representation, provided alongside this report, on behalf of the Fund before I issue my opinion and conclusion.
-

Financial statements

Opinion on the financial statements

Subject to satisfactory clearance of outstanding matters, I plan to issue two audit reports, as detailed in the key messages, including an unqualified opinion on the financial statements. Appendix 1 contains copies of my draft reports.

Errors in the financial statements

Audit work has not identified any errors in the principal financial statements. Amendments have been agreed to ensure full compliance with disclosure requirements (see pages 9 to 10).

Significant weaknesses in Internal Control

No significant weaknesses in internal control have been identified.

I have identified a number of areas for improvement within the ICT control environment within Lancashire County Council. The Pension Fund is wholly reliant on the Council's ICT infrastructure and therefore I bring these to your attention here. I review the overall Information Technology (IT) environment each year to identify if this presents any risks of material misstatement to the Council's accounts. I have concluded there is a low risk of such mis-statement arising as a result of the standard of IT controls the Council applies to its financial systems. I have identified some areas which could be improved and am satisfied that effective implementation of the existing strategic partnership improvement plans for IT should address them.

Improvement areas include:

- access to live financial systems by IT application support staff is more widely available than usual with some staff having permanent access to live systems application facilities;
- password controls for access to the network are weaker than usually seen at similar authorities; and
- the prompt removal of leavers' access rights to the network and to individual applications is not consistent.

Financial statements

The Pension Fund's financial statements and annual governance statement are important means by which the Fund accounts for its stewardship of public funds. The Council has a final responsibility for these statements. It is important that you consider my findings before you adopt the financial statements and the annual governance statement.

In planning my audit I identified specific risks and areas of judgement that I have considered as part of my audit.

Key audit risk and our findings

Key audit risk	Finding
<p>1. Financial Reporting Requirements</p> <p>Adoption of International Financial Reporting Standards (IFRS) required for the first time, including disclosure of information about future promised retirement benefits.</p>	<p>Actions were taken to gain an actuarial estimate of future promised retirement benefits at the required date, and appropriate disclosures made. In common with other Pension Funds there were some gaps identified in other areas of the new disclosure requirements. A summary of agreed amendments is included on pages 9 to 10.</p>
<p>2. Changes in Key Staff</p> <p>Changes in key staff increase the inherent risk of material error or non-compliance with accounting standards within the Fund's financial statements.</p>	<p>Staffing changes have not resulted in poorer quality of accounts.</p>
<p>3. Pensions Administration</p> <p>During the financial year a new financial system was introduced for calculating and paying pensions. The pension administration service has also dealt with significantly increased workloads because of redundancy and early retirement programmes of admitted bodies.</p>	<p>I have not identified any weakening of the system of internal control in the pension administration service. The transition to the new pensions system was effectively managed.</p> <p>I gained significant assurance from detailed testing undertaken by Internal Audit of pension benefits, and the transfer to the new pensions system.</p>

Key audit risk

Both of these changes increase the inherent risk of material error in pension payments and could also impact on the accuracy of data provided to the scheme actuary.

4. Private Equity Valuations

The Fund has material investments placed in private equity funds. These investments are not traded in open markets, and the valuation is estimated by the private equity fund operators. It was agreed that Fund staff would undertake detailed work around the valuation of these investments in line with recognised industry guidance.

5. Pension Fund Bank Account

Regulations required the administering authority to introduce a separate bank account specifically for the Fund by 1 April 2011.

7. Stock-Lending Arrangements

The Fund has entered stock-lending arrangements during the financial year. Specific restrictions and accounting arrangements apply to such arrangements.

8. Disinvestment of Portfolio

During the year there has been a disinvestment of an investment portfolio to ensure the investment profile is in line with applicable policies. The funds have been placed with a transition fund manager before the portfolio goes out to tender. This raises the inherent risk that the transfer of funds is incomplete.

Finding

Work undertaken by Fund staff to gain assurance about the valuations has reduced the risks involved. My staff have discussed with the accountancy team how they might further strengthen their work in this area.

My own testing has provided sufficient assurance about the material accuracy of private equity valuations provided by the fund manager and the underlying funds.

Actions taken have enabled the Fund to have a separate bank account in line with applicable regulation.

Identifying a separate portfolio for the in-house investments has been dealt with reasonably, ensuring:

- book values reconcile to Pension Fund records;
- investments are suitable for a pension fund; and
- the investments reflect a reasonable spread of Lancashire County Council managed investments at that time.

The stock lending is in line with agreed restrictions and is accounted for correctly. Expanded disclosures have been agreed to explain the nature and basis of valuation of the collateral held.

I have confirmed the disinvestment during the year was correctly valued and complete.

Financial statements

Quality of your financial statements

I consider aspects of your accounting practices, accounting policies, accounting estimates and financial statements disclosures.

These are the issues I want to raise with you.

Accounting practices, policies, estimates and financial closures

Issue	Findings and recommendations
1. IFRS Restatement The need to produce IFRS compliant financial statements for the first time in 2010/11 required a restated Net Assets Statement as at 1 April 2009.	The additional disclosure was not made on the face of the Net Assets Statement. The accounts have been amended to include the required figures.
2. Accounting Policies Accounting policies outlined within the financial statements need to reflect accounting standards and practice.	The draft accounting policies did not include the method of attributing investment manager expenses to the correct accounting periods, or the treatment of commission (or other acquisition costs) relating to the investment activities of the Fund. Officers of the Fund have expanded their disclosure of policies to reflect these items.
3. Financial Instruments Disclosure Changed reporting requirements of the disclosure notes relating to financial instruments.	The disclosures relating to financial instruments, and the Fund's exposure to risk, did not meet the reporting requirements applicable to the financial statements. Quantitative disclosures are now included, and the property portfolio has been removed from the relevant tables as this investment does not meet the criteria for classification as a financial instrument. Officers have amended the financial statements to include compliant disclosures on financial instruments.

Issue	Findings and recommendations
<p>4. Estimation Uncertainties Disclosure</p> <p>Disclosure included within the financial statements outlining future and major sources of estimation uncertainty, as required by the new reporting requirements.</p>	<p>The draft financial statements did not include disclosure of the estimation uncertainty involved in estimating the promised future retirement benefits. The disclosure note has been amended to cover this estimation uncertainty.</p>
<p>5. Annual Report</p> <p>The Fund's financial statements are also included within the Annual Report.</p>	<p>The commentary on additional voluntary contributions (AVCs) in the draft Annual Report was inconsistent with the financial statements. The note in the Annual Report will be amended to reflect the information in the financial statements.</p> <p>Local Government Pension Scheme (LGPS) Administration Regulations 2008 (reg. 34) set out the required content of the Annual Report. For some items of content, the Fund had included hyperlinks to the information rather than including them in the Annual Report. Officers have agreed to amend the Annual Report to include these items in full.</p>

Financial statements

Letter of representation

Before I issue my opinion, auditing standards require me to ask you and management for written representations about your financial statements and governance arrangements. These representations are set out within the letter of representation which is on the same agenda as this report.

Appendix 1 – Draft independent auditor’s report for the Pension Fund Annual report

Independent auditor’s report to Members of Lancashire County Council

Opinion on the pension fund accounting statements

I have audited the pension fund accounting statements for the year ended 31 March 2011 under the Audit Commission Act 1998. The pension fund accounting statements comprise the Fund Account, the Net Assets Statement and the related notes. These 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 Lancashire County Council in accordance with Part II of the Audit Commission Act 1998 and for no other purpose, as set out in paragraph 48 of the Statement of Responsibilities of Auditors and of Audited Bodies published by the Audit Commission in March 2010.

Respective responsibilities of the Treasurer and auditor

As explained more fully in the statement on the Responsibilities for the Statement of Accounts, the Treasurer is responsible for the preparation of the pension fund’s Statement of Accounts in accordance with proper practices as set out in the CIPFA/LASAAC Code of Practice on Local Authority Accounting in the United Kingdom. My responsibility is to audit the accounting statements in accordance with applicable law and International Standards on Auditing (UK and Ireland). Those standards require me to comply with the Auditing Practice’s Board’s Ethical Standards for Auditors.

Scope of the audit of the financial statements

An audit involves obtaining evidence about the amounts and disclosures in the accounting statements sufficient to give reasonable assurance that the accounting statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of: whether the accounting policies are appropriate to the fund’s circumstances and have been consistently applied and adequately disclosed; the reasonableness of significant

accounting estimates made by the fund; and the overall presentation of the accounting statements. I read all the information in the annual report to identify material inconsistencies with the audited accounting statements. If I become aware of any apparent material misstatements or inconsistencies I consider the implications for my report.

Opinion on accounting statements

In my opinion the pension fund's accounting statements:

- give a true and fair view of the financial transactions of the pension fund during the year ended 31 March 2011 and the amount and disposition of the fund's assets and liabilities as at 31 March 2011, and
- have been properly prepared in accordance with the CIPFA/LASAAC Code of Practice on Local Authority Accounting in the United Kingdom.

Opinion on other matters

In my opinion, the information given in the annual report for the financial year for which the accounting statements are prepared is consistent with the accounting statements.

Matters on which I report by exception

I have nothing to report in respect of the governance statement on which I report to you if, in my opinion the governance statement does not reflect compliance with the Local Government Pension Scheme (Administration) Regulations 2008 and related guidance.

Clive Portman
District Auditor

Audit Commission
2nd Floor Aspinall House
Aspinall Close
Middlebrook
Bolton
BL6 6QQ

September 2011

Appendix 2 – Draft independent auditor’s report for the financial statements of the Council

Independent auditor’s report to Members of Lancashire County Council

Pension fund extract only

Opinion on the pension fund accounting statements

I have audited the pension fund accounting statements for the year ended 31 March 2011 under the Audit Commission Act 1998. The pension fund accounting statements comprise the Fund Account, the Net Assets Statement and the related notes. These accounting statements have been prepared under the accounting policies set out in the Statement of Accounting Policies.

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Scope of the audit of the financial statements

An audit involves obtaining evidence about the amounts and disclosures in the accounting statements sufficient to give reasonable assurance that the accounting statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of: whether the accounting policies are appropriate to the fund's circumstances and have been consistently applied and adequately disclosed; the reasonableness of significant accounting estimates made by the fund; and the overall presentation of the accounting statements. I read all the information in the explanatory foreword to identify material inconsistencies with the audited accounting statements. If I become aware of any apparent material misstatements or inconsistencies I consider the implications for my report.

Opinion on accounting statements

In my opinion the pension fund's accounting statements:

- give a true and fair view of the financial transactions of the pension fund during the year ended 31 March 2011 and the amount and disposition of the fund's assets and liabilities as at 31 March 2011 and
- have been properly prepared in accordance with the CIPFA/LASAAC Code of Practice on Local Authority Accounting in the United Kingdom.

Opinion on other matters

In my opinion, the information given in the explanatory foreword for the financial year for which the accounting statements are prepared is consistent with the accounting statements.

End of extract

Appendix 3 – Glossary

Annual governance statement

A statement of internal control prepared by an audited body and published with the financial statements.

Audit closure certificate

A certificate that I have completed the audit following statutory requirements. This marks the point when I have completed my responsibilities for the audit of the period covered by the financial statements.

Audit opinion

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

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

Opinion

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

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

Materiality and significance

The Auditing Practices Board (APB) defines this concept as ‘an expression of the relative significance or importance of a particular matter for the financial statements as a whole. A matter is material if its omission would reasonably influence users of the financial statements, such as the addressees of the auditor’s report; also a misstatement is material if it would have a similar influence. Materiality may also be considered for any individual primary statement within the financial statements or of individual items included in them. We cannot define materiality mathematically, as it has both numerical and non-numerical aspects’.

The term 'materiality' applies only to the financial statements. Auditors appointed by the Commission have responsibilities and duties under statute, as well as their responsibility to give an opinion on the financial statements, which do not necessarily affect their opinion on the financial statements.

'Significance' applies to these wider responsibilities and auditors adopt a level of significance that may differ from the materiality level applied to their audit in relation to the financial statements. Significance has both qualitative and quantitative aspects.

Weaknesses in internal control

A weakness in internal control exists when:

- a control is designed, set up or used in such a way that it is unable to prevent, or detect and correct, misstatements in the financial statements quickly; or
- a control necessary to prevent, or detect and correct, misstatements in the financial statements quickly is missing.

An important weakness in internal control is a weakness, or a combination of weaknesses that, in my professional judgement, are important enough that I should report them to you.

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