

APPENDIX 2

City of London
Corporation Pension Fund

Report to the Audit and
Risk Management
Committee on the Year
Ended 31 March 2013
Pension Fund Audit

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Executive summary

We have pleasure in setting out in this document our report to the Audit and Risk Management Committee of the City of London Corporation Pension Fund for the year ended 31 March 2013 for discussion at the meeting scheduled for 23 July 2013. This report summarises the principal matters that have arisen from our audit for the year ended 31 March 2013.

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.

Status	Description	Detail
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Completion of the audit

On satisfactory completion of the outstanding items we anticipate issuing an unmodified audit opinion

We are satisfied that the status of the audit is as expected at this stage of the timetable agreed in our audit plan. N/A

We have substantially completed our audit in accordance with our Audit Plan, which was presented to you prior to the commencement of the audit, subject to the satisfactory completion of the matters set out below:

- completion of final review process on the financial statements;
- liaison with the Scheme Actuary;
- Receipt of signed management representation letter (see appendix 1); 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.

At the date of this report, and subject to the satisfactory completion of the outstanding matters referred to above, we expect to issue an unmodified audit opinion.

Key findings on audit risks

We have addressed the risks identified in our planning report

We discuss within Section 1 the results of our work in relation to key audit risks which have been identified as being significant to the 2012/13 accounts, and which were presented in our Audit Plan to the Audit and Risk Management Committee in March 2013, as follows: Section 1

Key risks

1. **Contributions:** The risk surrounding identification, calculation and payment of contributions, due to the complexities surrounding admitted bodies, has been satisfactorily addressed through our testing. No issues were noted.
2. **Benefits:** Complexities in the calculation of both benefits in retirement and ill health and death benefits have been reviewed during our testing with no issues identified.
3. **Investments:** The unquoted investments vehicles have successfully been agreed to independent returns
4. **Management override of controls:** all testing was completed with satisfactory results.

Executive summary (continued)

Identified misstatements

No factual uncorrected misstatements have been identified

As set out in our planning report, audit materiality was set at £3.9 million (2011/12 £3.9 million). N/A

We report all unadjusted misstatements greater than £195,000 (2% of materiality) (2011/12: £195,000) to you, as well as any misstatements that are qualitatively material.

There are no qualitatively material misstatements that we wish to bring to your attention, subject to completion of the above procedures.

During the course of the audit our procedures we identified two immaterial misstatements around the offset of assets and liabilities. The first of these relates to the cash in the bank account, amounting to £232,000, which has incorrectly been offset against current liabilities for the year. The second relates to amounts due to investment managers of £969,000 which have been offset against the investment balance at the year end. Neither of these misstatements have any impact on the Fund Account.

Accounting and internal control systems

The internal control systems are very strong, however further improvements could be made

We previously reported to you in our report on the 2011/12 audit that we identified two areas for improvement in relation to the internal control system. These improvements related to the review of the AAF01/SAS 70 reports on the internal control environment at the investment managers and the use of the new pension fund bank account. While we believe the former to have been effectively addressed, we still believe there are areas for improvement with regards to the latter.

The use of the bank account could be improved further to develop a higher level of governance over the pension scheme cash and clearly show that provisions of The Local Government Pension Scheme (Management and Investment of Funds) Regulations 2009 are being met.

Section 2

Current accounting and regulatory issues

We have included within this report accounting and regulatory issues that affect the pension fund industry, particularly focus areas of the Pensions Regulator (TPR). Although the City of London Corporation Pension Fund is not currently regulated by TPR these are guidelines for improving process and represent best practice in the industry.

Section 3

1. Key audit risks

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

Contributions	
Audit risk	Unlike the positions in the private sector, we are not required to issue a separate statement on contributions for the Fund. Nevertheless, in view of the complexity arising from the participation of different employers within the Fund, we have included the identification, calculation and payment of contributions as an area of significant risk.
Deloitte response	<p>We have performed the following testing to address the significant risks around contributions:</p> <ul style="list-style-type: none">• reviewed the design and implementation of controls present at the Fund for ensuring contributions from all Scheduled and Admitted bodies are identified and calculated correctly;• we performed tests of details to test whether each material income stream was calculated in accordance with the actuarial valuation and schedule of rates; and• we developed an expectation based on changes in membership numbers and changes in contribution rates to analytically review the contributions received in the year, the results of which fell within our tolerance level. <p>All testing was completed with satisfactory results.</p> <p>We note that City of London as the administering authority is not responsible for the calculation of contributions. We have therefore performed our testing, where necessary, with the assistance of the scheduled and admitted bodies.</p>

1. Key audit risks (continued)

Benefits	
Audit risk	Changes were made to the Fund from April 2008 which introduced complexities into the calculation of both benefits in retirement and ill health and death benefits which are in addition to the annual increases required by the 1997 Regulation and Pension (Increases) Act 1971.
Deloitte response	<p>The following tests were performed to address the significant risk around benefits:</p> <ul style="list-style-type: none">• we reviewed the design and implementation of controls present at the Fund for ensuring the accuracy, completeness and validity of benefits through discussion with the pensions team and testing that controls were in force during the year under review;• we obtained a schedule of benefits paid and selected a sample of benefits for detailed testing. The sample was tested through agreement to supporting documentation, and review of the calculation, by reference to the qualifying service, scheme rules and benefit choices made by the member; and• we developed an expectation based on the prior year balance, adjusted for changes in membership numbers and pension increases to analytically review the pension benefits paid in the year. <p>All testing was completed with satisfactory results.</p>

1. Key audit risks (continued)

Investments

Audit risk

The Fund makes some use of investments in unquoted investments vehicles, such as private equity houses.

Although these funds are normally subject to external audit, up to date audited accounts were not available at the time that the pension fund accounts were compiled and audited. In such cases, year end fair values of investments in such funds will need to be estimated on the basis of unaudited information. In addition, market volatility raises questions about how to value these investments. It would normally be expected that the reasonableness of the fund managers' valuation could be assessed by comparison with the funds' latest available audited accounts as adjusted for subsequent cash movements (investments and distributions) between the pooled investment vehicle and the investors. However, market volatility means such comparison may be inappropriate especially when there is a significant time period between the latest audited accounts and the fund year end.

As these investments are more complex to value we have identified the Fund's investments in pooled investment vehicles as a significant risk.

In addition there is increasing volatility in the Eurozone following recent sovereign debt crisis across many countries. The Fund has approximately £7.8 million of investments in Eurozone government backed assets which could be exposed to increased variance of returns if the Eurozone continues to de-stabilize.

Deloitte response

The following tests were performed to address the significant risk around investments:

- we have reviewed the design and implementation of controls present at the Fund for ensuring investments are valued correctly;
- we have obtained a further understanding of the valuation of investments. The value of unquoted investments vehicles represents less than 2% of the assets of the Fund as a whole. The majority of the investments held by the Fund being in investments which have a quoted value;
- we have reconciled the total value of the investments held by the Fund as reported in the investment report from BNY Mellon to the value of investments reported in the Net Assets Statement;
- we have compared the valuations provided by BNY Mellon to the reports provided by the investment manager;
- we have performed a test of detail on a sample basis of quoted investment and compared the value reported by the BNY Mellon to the quoted price obtained from Bloomberg, DataStream or other third party sources; and
- we have performed a test of detail on a sample basis of the unquoted pooled investments to the valuations received from the external investment managers.

It was identified that the value per the investment manager reports was £1.5m lower than the value provided by the custodian. The differences largely arise over the level of accrued income that the custodian believes could be recognised as an asset where the investment manager doesn't consider there is sufficient certainty. The difference represents 0.21% of the overall assets of the Fund and is common throughout pension funds which have a similar custodial relationship. It is understood that this is a matter of judgment taken by management and the conclusion reached by management is considered satisfactory.

No issues were identified during the completion of the other tests detailed above.

1. Key audit risks (continued)

Management override of controls

Audit risk

We are required by ISA 240 'The auditors responsibility to consider fraud in an audit of the financial statements' to presume there is a significant risk of management override of the system of internal control.

Deloitte response

Our audit work included:

- we have reviewed analysis and supporting documentation for journal entries, key estimates and judgements;
- we have performed substantive testing on journal entries to confirm that they have a genuine, supportable rationale;
- we have reviewed ledgers for unusual items and on a test basis investigated the rationale of any such postings;
- we have reviewed significant management estimates and judgements such as year end accruals and provisions and consider whether they are reasonable; and
- we have made enquiries of those charged with governance as part of our planning and detailed audit processes.

All testing was completed with satisfactory results.

2. Accounting and internal control systems

Control observation

During the course of our audit we identified one area for improvement in the internal control systems which is detailed below

Internal controls reports

Observation	<p>Following the implementation of The Local Government Pension Scheme (Management and Investment of Funds) Regulations 2009 that apply from 1 April 2011 is a new requirement for each pension fund to have a separate bank account. This change is being adopted because it will enable pension fund monies to be clearly ring-fenced from other monies of the local authority, and thus reflects a longstanding Audit Commission view on best practice.</p> <p>We noted that whilst the scheme has set up the account in line with the required timeframe, it has not been used for all transactions within the pension scheme. The current process is such that all transactions are monitored within the pooled cash account as before, with a net monthly transfer to the pension scheme bank account following the close of monthly accounting to clear down the pooling account.</p> <p>This means that at any point in time there may be pension scheme cash within the main corporation pooling account.</p>
Recommendation	<p>Whilst this process could be considered to comply with the 2009 regulations, we recommend that it be amended to utilise this account for all cash transactions regarding the pension scheme, in particular the receipt of contributions. This will give the Fund greater clarity over the transactions undertaken by the scheme and demonstrate improved governance and compliance with regulations.</p>
Management response	<p>The establishment of a separate bank account for the pension fund and the desirability of placing individual financial transactions through the account was discussed at several Chamberlain's department meetings prior to implementation. It was however concluded that it would not be feasible to utilise the account for all cash transactions as this would require all feeder systems such as payroll, payment of creditors, income collection, to input directly into the account which would require major reconfiguration.</p> <p>It was concluded that a monthly 'reconciliation' of pension fund transactions between the City's and the pension fund accounts would be the optimum way forward and this was introduced. However, it is recognised that this arrangement is probably not "best practice" and pension fund accountants will re-examine the options with financial systems colleagues in due course.</p>

3. Current Accounting and Regulatory Issues

Upcoming financial reporting developments

For reference, the following developments in the pension industry may impact the governance arrangements and financial statements of the City of London Corporation Pension Fund.

Pensions Act 2013

The Pension Act 2013 has received Royal Assent in parliament and hence will come into force from 2015. The key changes of the bill are:

- reform the state pension system through the introduction of a single-tier state pension;
- manage future changes to the State Pension age including bringing forward the increase in State Pension age to 67;
- reform the range of benefits associated with bereavement;
- boost the consolidation of small pension pots;
- introduce a new statutory objective for the Pensions Regulator; and
- strengthen existing legislation relating to occupational pensions.

It is anticipated that LGPS will begin to be regulated by the Pension Regulator as part of this bill from 2015. This will mean that the schemes will need to consider the guidance put in place by the regulator and comply with the best practice advice from 2015.

Further information can be found at:

https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/197840/pensions-bill-ia-summary.pdf

4. 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

We confirm that we comply with APB Revised Ethical Standards for Auditors and that, in our professional judgement, we are independent and our objectivity is not compromised.

Non-audit services

In our opinion there are no inconsistencies between APB Revised Ethical Standards for Auditors and the Fund's policy for the supply of non-audit services or of any apparent breach of that policy. To confirm we have not performed any non-audit services in the year or previous year.

Fees

Our fee for the audit of the 2013 accounts was £21,000 plus disbursements and VAT (2012: £35,000). Our fee is consistent with the scale fee determined by the Audit Commission.

Relationships

We are required to provide written details of all relationships between us and the audited entity, its trustees and senior management and its affiliates, including all services provided by us and the DTTL network to the audited entity, its trustees and senior management and its affiliates that we consider may reasonably be thought to bear on our objectivity and independence and the related safeguards that have been put in place. We can confirm that we are not aware of any such relationships.

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

Our audit was not designed to identify all matters that may be relevant to City of London Corporation Pension Fund and this report is not necessarily 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 City of London Corporation, 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
23 July 2013

Appendix 1: Draft representation letter

Deloitte LLP

Our Ref: *DWB/HB/2013*

Date:

Dear Sirs

City of London Corporation Pension Fund (the “Fund”)

This representation letter is provided in connection with your audit of the financial statements of the fund for the year ended 31 March 2013 for the purpose of expressing an opinion as to whether the financial statements give a true and fair view of the financial position of the Fund, in accordance with the Code of Practice on Local Authority Accounting in the United Kingdom 2012/13, the financial transactions of the Pension Fund during the year ended 31 March 2013, and the amount and disposition of the fund’s asset and liabilities as at 31 March 2013, other than liabilities to pay pensions and other benefits after the end of the fund year.

We acknowledge as members of City of London Corporations Pension Fund 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 Fund 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 Fund 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 Fund 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 Fund’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.

Appendix 1: Draft representation letter (continued)

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 Fund. 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.

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 Fund and confirm that we have disclosed in the financial statements all transactions relevant to the Fund 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”), Code of Audit Practice on Local Authority Accounting in the United Kingdom in 2012/13: based on International Financial Reporting Standards or other regulations.

9. We confirm that the financial statements have been prepared on the going concern basis. We do not intend to wind up the fund. We are not aware of any material uncertainties related to events or conditions that may cast significant doubt upon the Fund’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.
10. You have been informed of all changes to the Fund rules during the year and up to the current date.
11. We have not commissioned advisory reports which may affect the conduct of your work in relation to the Fund’s financial statements.
12. No claims in connection with litigation have been or are expected to be received.
13. We have no plans or intentions that may materially affect the carrying value or classification of assets and liabilities reflected in the financial statements.
14. There have been no events subsequent to 31 March 2013 which require adjustment of or disclosure in the financial statements or notes thereto.
15. 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.
16. The pension fund accounts and related notes are free from material misstatements, including omissions.
17. The Fund 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.
18. The Fund has satisfactory title to all assets.
19. We have recorded or disclosed, as appropriate, all liabilities, both actual and contingent.

Appendix 1: Draft representation letter (continued)

20. No transactions have been made which are not in the interests of the members of the Fund during the Fund year or subsequently.
21. We confirm that:
- all retirement benefits and schemes, including UK, foreign, funded or unfunded, approved or unapproved, contractual or implicit have been identified and properly accounted for;
 - all settlements and curtailments have been identified and properly accounted for;
 - all events which relate to the determination of pension liabilities have been brought to the actuary's attention;
 - the actuarial assumptions underlying the valuation of the scheme liabilities (including the discount rate used) accord with the directors' best estimates of the future events that will affect the cost of retirement benefits and are consistent with our knowledge of the business;
 - the actuary's calculations have been based on complete and up to date member data as far as appropriate regarding the adopted methodology; and
 - the amounts included in the financial statements derived from the work of the actuary are appropriate.
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 Fund 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 Fund Annual Report and Accounts for the year to 31 March 2013 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 Fund (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 City of London Corporation Pension Fund

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