

City of London Corporation Pension Fund

Report to the Audit and Risk Management  
Committee on the Year Ended 31 March 2014  
Pension Fund Audit

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the  
Distinctive  
audit

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The big picture

# The Big Picture

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 2014 for discussion at the meeting scheduled for 22 July 2014. This report summarises the principal matters that have arisen from our audit for the year ended 31 March 2014.

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.

## Audit Scope

The scope of our audit is unchanged from the previous period and from the scope set out in our Planning Report dated 16 January 2014.

Our reporting responsibilities as auditor of the Fund are to:

- Form an opinion on the Corporation's financial statements which are prepared under CIPFA/ LASAAC Code of Practice on Local Authority Accounting in the United Kingdom ("the Code of Practice").
- Report to "those charged with governance" on certain additional matters, including any adjusted and unadjusted errors identified by our audit, our independence and any other issues we consider should be brought to their attention.

## Significant representations

A copy of the representation letter to be signed on behalf of the Audit and Risk Management Committee has been included in Appendix 1 of this report. There are no new representations to highlight to those included for the 2013 audit.

## Independence

We have identified no matters which would affect our independence as auditor. Our reporting requirements in respect of independence matters, including fees, are covered in Appendix 4.

**"I am delighted to present our final report on the findings from our 2013/14 audit."**

**Heather Bygrave, Audit Partner**

## A reminder of our audit plan:

- Materiality: £4.5m (2012/13: £3.9m).
- Threshold for reporting misstatements: £0.225m (2012/13: £0.195m).
- Significant risks over contributions, benefits, investments and management override of controls.

# The Big Picture (continued)

## Status of the audit

At the date of this report, we have not received the Annual Report which is a key component of our reporting timetable agreed in our audit plan. The later timing for the issue of our audit report on the pension scheme annual report, caused by the delay in preparation of the annual report, will delay the issue of our audit certificate for the City Fund. This is discussed further in our separate paper for the City Fund.

We have substantially completed our remaining audit work 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:

- Receipt of the Annual Report;
- Receipt of the 1 year performance summary from Pyford, Artemis and LSV to support our audit work for the Change in Market Value movements for the these investment managers;
- Awaiting explanation for the difference in the Change in Market Value balance on the Fund account (£30.2m) and the Net Assets Statement (£23.7m). Management are currently reviewing the reason for this difference and once resolved by management, we will audit this balance;
- Receipt of signed management representation letter (see appendix 1); and
- Update of post balance sheet event review.

We will update you 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.



# Significant audit risks

This section explains the nature of the significant risks we have identified, how these risks have been addressed by our audit work and our conclusions. We also explain related presentational and disclosure matters within the financial statements.

# 1. Completeness and accuracy of contributions

## Significant audit risk

### Nature of risk

Unlike the position 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.

### Impact on the financial statements and our audit challenge

Errors in processing contributions can lead to issues such as deducting incorrect amounts from active members' payroll, which can be costly to rectify and result in reputational damage.

### Work completed to address the significant risk

We have performed the following testing to address the significant risks around contributions:

- reviewed the design and implementation of controls present in the Fund for ensuring contributions from all Scheduled and Admitted bodies are identified and calculated correctly;
- we performed sample 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 contribution rates to analytically review the contributions received in the year, the results of which fell within our tolerance level.

We note the following from our testing:

- Employer contributions for one member selected within our sample were overpaid in the current and prior years. The Employer rate was changed from 18.5% on April 2011 to 17.5% as part of the change in Fund Rules. A manual correction was made in the month of April 2011 as this member transferred department in this month and wasn't captured in the automatic update. It would appear from May 2011, the old rate of 18.5% continued to be applied until the member left in November 2013. After flagging this error to management they tested all salary changes in that month and found a total error of £55k overpayment in relation to this. We sample tested this population identified by management and tested completeness of the population with no further issues noted. Although this amount is not quantitatively material and falls below our reporting threshold, this represents a weakness in the system which is therefore qualitatively material and management are currently reviewing.

### Deloitte view

Apart from the one member noted who's contributions were overpaid, we have formed a satisfactory conclusion in this area based on the results from the procedures performed.

## 2. Valuation of investments

### Significant audit risk

#### Nature of 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 unquoted investment vehicles as a significant risk.

#### Impact on the financial statements and our audit challenge

Incorrect valuations of investments can lead to misstatements in the financial statements impacting investment decisions and future recovery plans.

#### Audit procedures completed to address the focus area

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 the custodian, 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 engaged our internal financial instrument experts to ensure our testing approach was appropriate given the Fund's specific investment strategy and portfolio;
- 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 £0.6m 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 less than 0.01% 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.

#### Deloitte view

No issues were identified during the completion the testing.

We confirm there are no matters we wish to bring to the attention of the Committee.



## 3. Accuracy of benefit calculations

### Significant audit risk

#### Nature of 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.

The risk noted was that benefits payable could be inaccurately recorded and that unauthorised payments could be made to non-existent members.

#### Impact on the financial statements and our audit challenge

Incorrect benefit calculations or making payments to members who are not eligible can lead to misstatements in the financial statements, financial loss, pensioner's being wrongly paid and reputational damage.

#### Work completed to address the focus area

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

- 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, Fund 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.

#### Deloitte view

We have formed a satisfactory conclusion in this area based on the results from the procedures performed. There are no matters to bring to the attention of the Committee.

## 4. Management override of controls

### Presumed significant audit risk

#### Nature of risk

In accordance with ISA 240 (UK and Ireland) management override is always a significant risk. The primary risk areas surrounding the management override of internal controls are over the processing of journal entries and the key assumptions and estimates made by management.

#### Work completed to address the significant risk

Our audit work included:

- we reviewed the controls around the financial reporting process, including segregation of duties, existence of reporting manuals, reviews and processing and approval of journal entries;
- 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;
- we have made enquiries of those charged with governance as part of our planning and detailed audit processes; and
- we reviewed and challenged the financial statements and management judgements against the SORP, LGPS and UK pension regulations.

#### Deloitte view

There remains 4 journals outstanding which relate to postings of weekend journals to complete our audit work in this section.

Currently, there are no matters to bring to the attention of the Committee.

We have not identified any significant judgements or estimates used by management and there is no indication of significant bias.

# Insight - Internal control and risk management

In this section we set out our comments regarding your internal control and risk management processes. We communicate any significant deficiencies in the internal control environment to the Audit & Risk Management Committee.



# Accounting and internal controls

## We highlight one observation from our audit procedures

We are required to provide a view, based on our audit procedures, on the effectiveness of your system of internal control relevant to risks that may affect financial reporting; and other risks arising from the entity's business model and the effectiveness of related internal controls.

### Observation

As observed in the prior year, following the implementation of The Local Government Pension Scheme (Management and Investment of Funds) Regulations 2009 that applied from 1 April 2011, the Regulations require 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.

We continue to note that whilst the Fund has set up the account in line with the required timeframe, it has not been used in line with the guidance as set out in the Regulations. 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 Fund bank account following the close of monthly accounting to clear down the pooling account.

This means that at any point in time there may be pension Fund cash within the main corporation pooling account which is not in line with the Regulations.

### Recommendation

This is the third time this recommendation has been raised to the Committee. The cash balance at the yearend of £18m is three times greater than materiality and this issue needs to be rectified going forward. This will give the Fund greater clarity over the transactions undertaken by the scheme and demonstrate governance and compliance with regulations.

### Management response

We have established a separate bank account for the pension fund. The desirability of placing individual financial transactions through the account was discussed at several Chamberlain's department meetings prior to implementation. We are currently experiencing problems in utilising the account for all cash transactions as all feeder systems such as payroll, payment of creditors, income collection, would require major reconfiguration to enable input directly into the account.

We believe that there is a workable solution that can be implemented and this is currently being investigated with the aim of implementing it by December 2014.

# Consideration of fraud

# Consideration of fraud

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

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 the Fund and the internal control that management has established to mitigate these risks. It also requires us to presume there is a risk of fraud in respect of revenue recognition; however, considering the nature of the Fund and the revenue streams (mainly contributions and investment income) we have rebutted this risk.

We have made enquiries of management and others within the Fund as appropriate, regarding their knowledge of any actual, suspected or alleged fraud affecting the Fund. In addition, we are required to discuss the following with the Committee:

1. Whether the Committee have knowledge of any fraud, alleged or suspected fraud
2. The role that the Committee exercise in oversight of the:
  - assessment of the risks of fraud and
  - design and implementation of internal controls to prevent and detect fraud
3. The Committees’ assessment of the risk that the financial statements may be materially misstated as a result of fraud.
4. Whether the Committee has disclosed to us all information in relation to any fraud, alleged or suspected fraud

Representations from the Committee in this area are included in the draft letter of representation included in Appendix 1 of this report.

## 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 included:

- understanding and evaluating the financial reporting process and the controls over journal entries and other adjustments made in the preparation of the financial statements, we tested the appropriateness of a sample of such entries and adjustments.
- 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 also perform a retrospective review of management’s judgements and assumptions relating to significant estimates reflected in last year’s financial statements.
- obtaining 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 Fund and its environment.

# Responsibility Statement

# Purpose of our report and responsibility statement

## Our report is designed to help you meet your governance duties

### What we report

Our report is designed to help the Audit & Risk Management Committee discharge their governance duties. It also represents one way in which we fulfil our obligations under ISA 260 to communicate with you regarding your oversight of the financial reporting process and your governance requirements. Our report includes:

- Any internal control observations; and
- Insights we may have identified from our audit.

### What we don't report

- As you will be aware, our audit was not designed to identify all matters that may be relevant to the Committee.
- Also, there will be further information you need to discharge your governance responsibilities, such as matters reported on by management or by other specialist advisers.
- Finally, our views on internal controls and business risk assessment should not be taken as comprehensive or as an opinion on effectiveness since they have been based solely on the audit procedures performed in the audit of the financial statements.

### The scope of our work

- Our observations are developed in the context of our audit of the financial statements.
- We described the scope of our work in our audit plan dated 16 January 2014.

We welcome the opportunity to discuss our report with you and receive your feedback.



**Deloitte LLP**  
Chartered Accountants

St Albans  
14 July 2014

This report has been prepared for the Audit and Risk Management Committee, 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. Except where required by law or regulation, it should not be made available to any other parties without our prior written consent.



# Appendices

# Appendix 1: Draft representation letter

Deloitte LLP  
3 Victoria Square  
Victoria Street  
St Albans  
AL1 3TF

**Our Ref:** *DWB/GYW/2014*

**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 2014 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 2013/14, the financial transactions of the Pension Fund during the year ended 31 March 2014, and the amount and disposition of the Fund's asset and liabilities as at 31 March 2014, other than liabilities to pay pensions and other benefits after the end of the Fund year.

We acknowledge as members of City of London Corporation 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 2013/14: 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 2014 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 2014 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

# Appendix 2: Audit adjustments

## Unadjusted misstatements detail

### Uncorrected misstatements

We report all individual identified uncorrected misstatements in excess of £225,000 (2013: £195,000) for the financial statements:

	Credit/ (charge) to current year fund account £'000	Increase/ (decrease) in net assets £'000	Increase/ (decrease) in prior year net assets £'000	Increase/ (decrease) in contributions £'000
<b>Uncorrected misstatements</b>				
None noted				

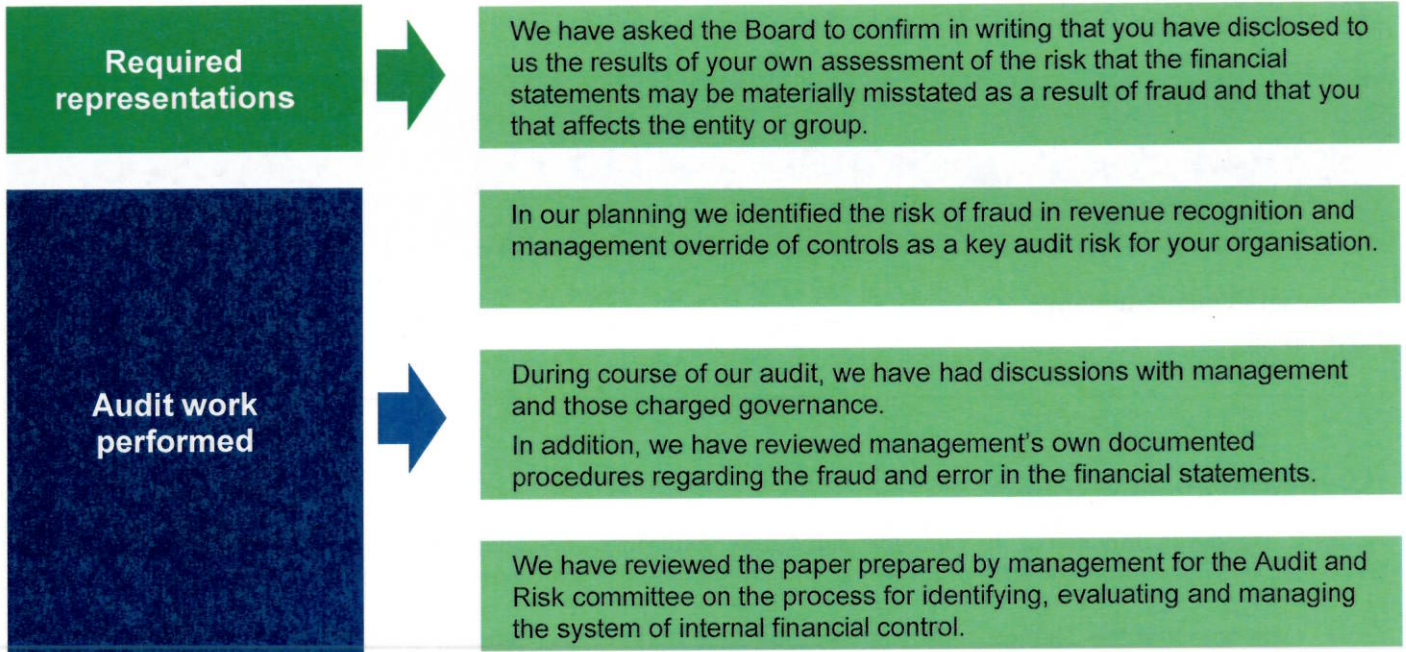
### Disclosure misstatements

Auditing standards require us to highlight significant disclosure misstatements to enable those charged with governance to evaluate the impact of those matters on the financial statements.

- We note that the Change in Market Value balance on the Fund account (£30.2m) differs to the Net Assets Statement (£23.7m) by £6.5m. Management are currently reviewing the reason for this difference and once resolved by management, we will audit this balance.

We will provide an update at the meeting and include other matters in the final updated version of this report.

# Appendix 3: Fraud: responsibilities and representations



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.

## Appendix 4: Independence and fees

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

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### Independence confirmation

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

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### Fees

Our fee for the audit of the 2014 accounts was £21,000 plus disbursements and VAT (2013: £21,000).

In March 2014 the Audit Commission agreed a rebate to be distributed across local audit bodies. The announcement came following a meeting of the Audit Commission's Board, who met to discuss the strategy for managing any retained earnings prior to its closure at the end of March 2015. The decision was made as part of the Board's role in setting the Commission's strategy and objectives and for determining its budget and the way it carries out its functions. The rebate was set at 13.7 per cent of the 2012/13 annual audit fee. The rebate sent to City of London Corporation Pension Fund was £2,874.

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### 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. We continue to review our independence and ensure that appropriate safeguards are in place including, but not limited to, the rotation of senior partners and professional staff and the involvement of additional partners and professional staff to carry out reviews of the work performed and to otherwise advise as necessary.

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### Relationships

We are required to provide written details of all relationships between us and the audited entity, its senior management and its affiliates, including all services provided by us and the DTTL network to the audited entity, its 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.

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