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Powys Pension Fund Annual Audit Letter

Powys County Council

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Summary

1. I am pleased to present to you my first Annual Letter (Letter) for the audit of the Powys Pension Fund (the Pension Fund).
2. The Pension Fund accounts form a self-contained part of the statement of accounts of Powys County Council (the Council) in its role as administering authority for the Pension Fund. The transactions and balances are not consolidated into the Council's accounts. The audit of the Pension Fund is not a separate audit appointment and has traditionally been undertaken as part of the audit of the Council's accounts.
3. However, the assets, liabilities, transactions and cash flows of pension funds are significant. The Auditor General has therefore determined that in 2008-09 and future years, the audit of the Pension Fund accounts must, so far as is possible, be undertaken as a separate audit engagement (but not as a separate audit appointment).
4. The revised arrangements better reflect the different audit risk profile of the Pension Fund as opposed to the Council and, at the same time, enhance transparency and governance arrangements. The revised arrangements also ensure that pension funds receive the audit attention appropriate to their scale. They also facilitate the application of auditing standards and practice notes specific to pension funds; Practice Note 15, in particular, provides a useful interpretation for the application of International Standards on Auditing (ISAs) to the audit of occupational pension schemes.
5. The Auditor General's Code of Audit and Inspection Practice (the Code) requires compliance with ISA requirements for each audit. The Pension Fund audit must therefore be planned, undertaken and reported separately, rather than simply in the context of the Council as a whole. This has the benefit of facilitating a more focused audit risk analysis and approach, and ensuring undivided audit focus on accounting and audit requirements that are specific to pension funds.
6. The Pension Fund has faced a year of change and challenges, most notably the introduction of the new Local Government Pension Scheme (LGPS). This has led to changes in employee contributions which are now tiered, with rates differing, depending on the previous year's pensionable pay. There have also been changes to the way in which retirement benefits are accrued. Pensioners' benefits must now be calculated on two different bases, increasing the complexity of benefit calculations.

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7. There have also been specific challenges associated with:
 - The volatility in the world financial markets and the consequent impact on Pension Fund investment valuation.
 - The amendment of the Local Authority Statement of Recommended Practice (SoRP) to reflect the requirements of the Pension SoRP 2007. This adopts the requirements of FRS 25 (Financial Instruments: Presentation) and FRS 26 (Financial Instruments: Recognition and Measurement) with regard to reporting fair values on derivatives and investments.
 - Revised fund manager appointments in the Pension Fund investment portfolio.
 8. In recognition of such challenges, I adopted a risk-based approach to planning the audit and my work has focused on the Pension Fund's significant financial and operational risks that are relevant to my audit responsibilities.
 9. I set out the audit work planned for the year in the Pension Fund Audit Strategy 2008-09. Your Pension Fund audit fee for 2008-09 was based on an indicative scale produced by the Auditor General for the first year of the separate audit of pension funds. We have not made any changes to the fee of £24,962 charged compared to that set out in the Audit Strategy. However, external consultants conducted a comprehensive review of our fee structure recently and recommended increases to bring it in line with both the work necessary to deliver an audit of a high-value, complex and technically demanding area. The consultant's recommendations will further inform our fee proposals for 2010-11.
 10. The Pension Fund accounts are part of the Council's accounts and consequently, those charged with governance at the Council retain this responsibility for the Pension Fund.
 11. The Council has established a Pension Panel responsible for Pension Fund governance to oversee the work of the Pension Fund, and replaced this with a Pensions and Investment Committee (the Committee) from 1 April 2009. Accordingly, I submit this Letter to advise that group of the key messages arising from the audit of the 2008-09 Pension Fund accounts. I shall also submit the letter to those charged with governance for the Council as a whole.

The 2008-09 Pension Fund accounting statements were prepared in accordance with statutory requirements and present fairly its financial position and transactions

12. It is the Council's responsibility to:
 - put systems of internal control in place to ensure the regularity and lawfulness of the Pension Fund's transactions and to ensure that its assets are secure;
 - maintain proper Pension Fund accounting records; and
 - prepare Pension Fund accounting statements in accordance with relevant requirements.
13. The Code requires me to provide an audit opinion on the Pension Fund accounts included in the Council's statement of accounts.
14. The Pension Fund accounting statements are an essential means by which the Council demonstrates its stewardship of the resources at the Pension Fund's disposal and its financial performance in the use of those resources.
15. On 30 September 2009, I issued an unqualified audit opinion on the Pension Fund accounting statements.

The Pension Fund had appropriate financial systems in place during the year

16. As part of my audit, I am required to document and understand the Pension Fund's accounting and internal control system, and test key controls in its significant financial systems. This year, I have documented the systems and key controls for:
 - Receiving contributions
 - Benefits payable
 - Transfer of benefits
 - Investment income
 - Investment management
17. I have concluded the Pension Fund's significant financial systems may be relied upon to produce materially correct outputs. The Pension Fund has successfully implemented changes to the terms of the LGPS in 2008-09, being revised calculation of benefits payable and deducting members' contributions at the correct rates.
18. The Committee has arrangements in place to reconcile the total employer contributions received in the year with total employee contributions at each admitted body. I consider this provides good assurance for subsequent entries in the statement of accounts for employer contributions receivable.

The Pension Fund had appropriate governance arrangements in place during the year

19. A Pensions and Investments Committee is responsible for governance of the Pension Fund. Members receive induction training on joining the Committee including a starter pack that outlines the key issues. The Committee is served by a number of senior officers from the Council and external investment advisers also attend the Committee meetings. This should ensure the Committee has access to a good level of expertise.
20. The next triennial valuation of the Pension Fund is due at 31 March 2010. Whilst the last valuation at 31 March 2007 highlighted a rise in the funding level from 63 per cent to 73 per cent, falling markets in 2008-09 meant that the Pension Fund produced a negative return of -13.8 per cent in the year. Expectations of a continued slow recovery in the main economies indicate further pressures on Pension Fund returns in the current financial year and the need to monitor financial performance rigorously.
21. The Pension Fund has investments valued at £258 million at 31 March 2009 in a diverse portfolio of equities, fixed interest securities, property and a small private equity investment. Managing the investment portfolio is central to ensuring the Pension Fund's continued financial health and the Committee has appointed an external investment adviser for guidance in setting the direction for investment, and employs a number of fund managers to manage the investment portfolio. The Committee has agreed a Statement of Investment Principles and a Funding Strategy Statement that are updated every three years.
22. The Committee has implemented arrangements to monitor the performance of its fund managers and two of the managers were replaced in 2008-09 due to continued poor performance. Investment performance is monitored by:
 - setting targets for the investment managers to attain;
 - employing an independent team, WM Group, to monitor performance against these agreed targets; and
 - agreeing reporting arrangements to the Investment Panel for consideration of performance achieved and action required.
23. Overall, I consider this provides a robust basis for effective investment management.
24. The Council's Internal Audit provides an internal audit to the Pension Fund on a cyclical basis, although there was no coverage for 2008-09. The Committee should receive and approve the risk assessment setting out the planned internal audit to the Pension Fund each year.
25. The Pension Fund relies on external service providers to manage all aspects of its investment portfolio. Fund managers submit monthly portfolio summaries and audited annual valuation. These are the Committee's main source of assurance that the data provided is reliable. Annual valuations are accompanied by reports from an independent accountant that express an opinion on the design of the fund manager's internal financial control systems for a number of key headings.

26. My review of reports received at the 2008-09 audit shows that a varying level of information is produced. Some reports conclude on the design of controls only, whilst others extended the report to include an assessment of whether the controls had operated effectively in the period under review. In other cases, the report contains a disclaimer on a number of areas not considered because the fund manager had further outsourced that activity to another external provider. This indicates the level of assurance received is variable. The Committee should consider:
- determining the level of assurance it wishes to receive each year from the fund managers; and
 - recording whether that level has been attained and assessing whether further action is required by discussion with the managers.
27. Revised arrangements for the LGPS were required from 1 April 2008-09 when new employee contribution rates were defined by regulations. As part of our audit, we have tested that the correct employee contribution rates were being applied at the Council, and concluded the correct rates were applied. The Committee does not, however, seek assurances from admitted bodies about arrangements they have for ensuring the correct contribution rates are being applied each year. These assurances should be sought before the accounts are prepared.

Recommendations

R1	The Committee should consider determining the level of assurance it wishes to receive each year from the fund managers.
R2	The Committee should then evaluate whether that level has been attained and assess whether further discussion is needed with fund managers.
R3	Confirmation from admitted bodies that the correct contribution rates are applied should be sought annually before the accounts are prepared.



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