

# The Audit Findings Report for London Borough of Lewisham Pension Fund

Year ended 31 March 2014

September 2014

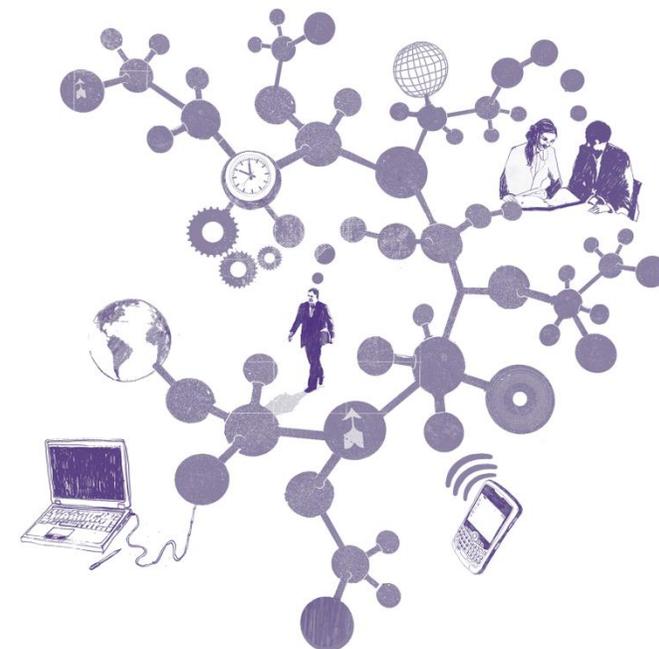
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# DRAFT

This version of the report is a draft. Its contents and subject matter remain under review and its contents may change and be expanded as part of the finalisation of the report.



The contents of this report relate only to those matters which came to our attention during the conduct of our normal audit procedures which are designed primarily for the purpose of expressing our opinion on the financial statements. Our audit is not designed to test all internal controls or identify all areas of control weakness. However, where, as part of our testing, we identify any control weaknesses, we will report these to you. In consequence, our work cannot be relied upon to disclose defalcations or other irregularities, or to include all possible improvements in internal control that a more extensive special examination might identify.

We do not accept any responsibility for any loss occasioned to any third party acting, or refraining from acting on the basis of the content of this report, as this report was not prepared for, nor intended for, any other purpose.

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## Section 1: Executive summary

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# Executive summary

## Purpose of this report

This report highlights the key issues arising from the audit of London Borough of Lewisham Pension Fund ('the Fund') financial statements for the year ended 31 March 2014. It is also used to report our audit findings to officers and the Council's Audit Panel (as those charged with governance) in accordance with the requirements of International Standard on Auditing (UK & Ireland) 260.

Under the Audit Commission's Code of Audit Practice we are required to report whether, in our opinion, the Fund's financial statements present a true and fair view of the financial position, the financial transactions of the Fund during the year and whether they have been properly prepared in accordance with the Code of Practice on Local Authority Accounting.

## Introduction

In the conduct of our audit we have not had to alter or change our planned audit approach, which we communicated to you in our Audit Plan dated June 2014.

Our audit is substantially complete although we are finalising our procedures in the following areas:

- journals, benefit payments, contributions and member data still require further testing
- review of the final version of the financial statements and Pension Fund Annual Report
- obtaining and reviewing the management letter of representation
- updating our post balance sheet events review, to the date of signing the opinion
- a technical review of investments.

We received draft financial statements and accompanying working papers at the start of our audit, in accordance with the agreed timetable.

## Key issues arising from our audit

### Financial statements opinion

We anticipate providing an unqualified opinion on the Fund's financial statements subject to the satisfactory completion of our work.

Our audit did not identify any adjustments affecting the Fund's reported financial position (details are recorded in section two of this report). The draft financial statements recorded net assets/liabilities carried forward of £904,794k; and this remains the same in the audited financial statements.

We have proposed a small number of adjustments to improve the presentation of the financial statements.

The key messages arising from our audit of the Fund's financial statements are:

- the quality of the financial statements were of a good standard.
- working papers were provided to us at the start of the audit. We noted a small number of errors in the working papers

Further details are set out in section 2 of this report.

## Acknowledgement

We would like to take this opportunity to record our appreciation for the assistance provided by the finance team and other staff during our audit.

**Grant Thornton UK LLP**  
**September 2014**

## Section 2: Audit findings

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# Audit findings

In this section we present our findings in respect of matters and risks identified at the planning stage of the audit and additional matters that arose during the course of our work. We set out on the following pages the work we have performed and findings arising from our work in respect of the audit risks we identified in our audit plan, presented to the Audit Panel on 24 June 2014. We also set out the adjustments to the financial statements from our audit work and our findings in respect of internal controls.

## **Changes to Audit Plan**

We have not made any changes to our Audit Plan as previously communicated to you.

## **Audit opinion**

We anticipate that we will provide the Fund with an unqualified opinion as set out in Appendix B.

## Audit findings against significant risks

"Significant risks often relate to significant non-routine transactions and judgmental matters. Non-routine transactions are transactions that are unusual, either due to size or nature, and that therefore occur infrequently. Judgmental matters may include the development of accounting estimates for which there is significant measurement uncertainty" (ISA 315).

In this section we detail our response to the significant risks of material misstatement which we identified in the Audit Plan. As we noted in our plan, there are two presumed significant risks which are applicable to all audits under auditing standards.

	Risks identified in our audit plan	Work completed	Assurance gained and issues arising
1.	<p><b>Improper revenue recognition</b></p> <p>Under ISA 240 there is a presumed risk that revenue may be misstated due to improper recognition</p>	<p>We have rebutted this presumption and therefore do not consider this to be a significant risk for the London Borough of Lewisham Pension Fund since:</p> <ul style="list-style-type: none"> <li>• The nature of the Pension Fund's revenue is in many respects relatively predictable and does not generally involve cash transactions.</li> <li>• The split of responsibilities between the Pension Fund, its fund managers and the custodian, provides a very strong separation of duties reducing the risk around investment income.</li> <li>• Revenue contributions are made by direct salary deductions and direct bank transfers from admitted/scheduled bodies, are supported by separately sent schedules and are directly attributable to gross pay, making any improper recognition unlikely.</li> <li>• Transfers into the scheme are all supported by an independent valuation of the amount which should be transferred and which is subject to agreement between the transferring and receiving funds.</li> </ul>	<p>Our audit work has not identified any issues in respect of revenue recognition.</p>
2.	<p><b>Management override of controls</b></p> <p>Under ISA 240 there is a presumed risk of management over-ride of controls</p>	<p>We have completed the following work to address this risk:</p> <ul style="list-style-type: none"> <li>• review of accounting estimates, judgements and decisions made by management</li> <li>• testing of journals entries – these planned procedures are still outstanding</li> <li>• review of unusual significant transactions</li> </ul>	<p>Our audit work has not identified any evidence of management override of controls. However journals testing has not yet been completed.</p> <p>We set out later in this section of the report our work and findings on key accounting estimates and judgements.</p>

# Audit findings against other risks

In this section we detail our response to the other risks of material misstatement which we identified in the Audit Plan.

Transaction cycle	Description of risk	Work completed	Assurance gained & issues arising
<b>Investments</b>	<ul style="list-style-type: none"> <li>• Investments not valid</li> <li>• Alternative investments not valid</li> <li>• Investment activity not valid</li> <li>• Fair value measurements not correct</li> </ul>	<p>We have undertaken the following work in relation to this risk:</p> <ul style="list-style-type: none"> <li>• documented our understanding of processes and key controls over the transaction cycle</li> <li>• undertaken walkthrough of the key controls to assess whether those controls are designed effectively</li> <li>• reconciled investments information provided by the Custodian and Fund Manager to the Fund's accounts</li> <li>• confirmed the existence of investments directly with Fund Managers and the Custodian</li> <li>• tested sales and purchases during the year back to detailed information provided by the Custodian</li> <li>• compared the valuation of HarbourVest private equity unquoted investment to the latest available audited financial statements of the respective investment fund</li> <li>• recalculated the fair value of HarbourVest quoted investments using an independently obtained price</li> <li>• reviewed the Fund's compliance with its Statement of Investment Principles</li> <li>• reviewed the ISAE3402 internal control reports for the fund managers and noted that the expected controls are in place and operating as designed.</li> </ul>	<p>Our audit work has not identified any significant issues in relation to the risk identified.</p>
<b>Benefit Payments</b>	<ul style="list-style-type: none"> <li>• Benefits improperly computed/ liability understated</li> </ul>	<p>We have undertaken the following work in relation to this risk:</p> <ul style="list-style-type: none"> <li>• reviewed and tested the key control that all calculations of pension lump sum payments are subject to review by a separate officer in the pensions administration team</li> <li>• ensured the pensioner payments calculated by the pensions administration system were correctly input onto the payroll system</li> <li>• selected a sample of individual transfers, new pensions in payment and lump sum benefits and tested them by reference to the benefit calculations on the respective member file</li> <li>• rationalised pensions paid with reference to changes in pensioner numbers and increases applied in the year together with comparing pensions paid on a monthly basis to ensure that any unusual trends are satisfactorily explained</li> </ul>	<p>Our testing is not complete in this area due to outstanding information.</p>

## Audit findings against other risks

In this section we detail our response to the other risks of material misstatement which we identified in the Audit Plan.

Transaction cycle	Description of risk	Work completed	Assurance gained & issues arising
<b>Contributions</b>	<ul style="list-style-type: none"> <li>Recorded contributions not correct</li> </ul>	<p>We have undertaken the following work in relation to this risk:</p> <ul style="list-style-type: none"> <li>sample tested employee and employer pensions contributions for the administering authority staff to payslips and to HR records to ensure gross salary and contributions to the fund were correctly calculated</li> <li>rationalised contributions received with reference to changes in contributor numbers and average pay</li> <li>sample tested contributions received from Scheduled and Admitted bodies to ensure the contributions received agreed to underlying records.</li> </ul>	<p>Our testing is not complete in this area due to outstanding information.</p>
<b>Member data</b>	<ul style="list-style-type: none"> <li>Member data not correct</li> <li>Regulatory/scheme rules requirements not met</li> </ul>	<p>We have undertaken the following work in relation to this risk:</p> <ul style="list-style-type: none"> <li>reconciled the member data numbers within the financial statements to the pensions administration system</li> <li>sample tested starters, leavers and changes in circumstances to ensure that the member database has been updated accordingly.</li> </ul>	<p>Our testing is not complete in this area due to outstanding information. We will update you at your meeting on 11 September.</p>

# Accounting policies, estimates & judgements

In this section we report on our consideration of accounting policies, in particular revenue recognition policies, and key estimates and judgements made and included with the Fund's financial statements.

Accounting area	Summary of policy	Comments	Assessment
<b>Revenue recognition</b>	<ul style="list-style-type: none"> <li>Income and expenditure to the Fund are accounted for on an accruals basis with the exception of transfers.</li> </ul>	<ul style="list-style-type: none"> <li>The Fund's accounting policies are appropriate under IAS 18 Revenue and the Code of Practice on Local Authority Accounting</li> </ul>	 Green
<b>Judgements and estimates</b>	<ul style="list-style-type: none"> <li>Key estimates and judgements include:               <ul style="list-style-type: none"> <li>The actuarial valuation of the fund at 31 March 2013</li> <li>The valuation of private equity investments.</li> </ul> </li> </ul>	<ul style="list-style-type: none"> <li>The policies adopted for accounting estimates are appropriate under the Fund's accounting framework</li> <li>The actuarial valuations has been undertaken by the actuary as a management expert</li> <li>The level of judgement required by the Fund is low. Estimates used are supported by adequate workings.</li> <li>Disclosure of judgements and estimates has not been tested</li> </ul>	
<b>Other accounting policies</b>	<ul style="list-style-type: none"> <li>The Fund's accounting policies are in accordance with the requirements of the Code of Practice on Local Authority Accounting.</li> </ul>	<ul style="list-style-type: none"> <li>We have reviewed the Fund's accounting policies against the requirements of the Code of Practice on Local Authority Accounting. The Fund's accounting policies comply with the Code.</li> </ul>	 Green

## Assessment

● Marginal accounting policy which could potentially attract attention from regulators

● Accounting policy appropriate but scope for improved disclosure

● Accounting policy appropriate and disclosures sufficient

## Adjusted and Unadjusted misstatements

Our audit has identified the following errors within the financial statements. The errors are not material individually, or in aggregate. We are required to report all misstatements to the Audit Panel, whether or not the financial statements have been adjusted by officers. The table below provides details of adjustments identified during the audit which we request be processed, but which have not been made within the final set of financial statements. The Audit Panel is required to approve management's proposed treatment of all items recorded within the table below:

Detail	Fund Account £'000	Net Asset Statement £'000	Reason for not adjusting
1 Difference between the Custodian calculation of private equity investments and the sum of the independently confirmed capital account balances translated to Sterling at 31 March 2014.	(1,695)	1,695	Accounts produced using Custodian figures
2 A duplicated investment management fee payment which was recorded in the fund account in error.	(53)	53	Too late to make the adjustment in the ledgers
3 Difference between contributions: scheduled and admitted bodies - per accounts and per client schedule.	(96)	96	Client has not responded to query
4 BlackRock investment management fees relating to the period 21/11/12-31/03/13 recorded in the year ended 31 March 2014.	(70) 70 – b/f		Invoices came in late
<b>Overall impact</b>	<b>(£1,844)</b>	<b>£1,844</b>	

## Misclassifications & disclosure changes

The table below provides details of misclassification and disclosure changes identified during the audit which have been made in the final set of financial statements.

Adjustment type	Value £'000	Account balance	Impact on the financial statements
1 Misclassification	756	Benefit payments	There was a misclassification of £756k between pension benefit payments and lump sum benefit payments in the prior year (2012/13) figures in the fund account. They did not agree to the audited 2012/13 accounts. This was done in error and management have agreed to amend.

# Internal controls

The purpose of an audit is to express an opinion on the financial statements.

Our audit included consideration of internal control relevant to the preparation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of internal control. The matters reported here are limited to those deficiencies that we have identified during the course of our audit and that we have concluded are of sufficient importance to merit being reported to you in accordance with auditing standards.

Assessment	Issue and risk	Recommendations
<p>1</p> <p></p> <p>Amber</p>	<p>Public Sector Internal Audit Standards require the internal audit function to act independently and objectively. The Council's Head of Corporate Resources has responsibility for financial management of the pension fund as well as overseeing internal audit. We note the Council is aware of this potential threat to independence and has taken steps to mitigate this. Where a potential conflict exists the Internal Audit Contract Manager is able to report directly to the Executive Director of Resources and Regeneration. The contract manager has confirmed there are no such conflicts in 2013/14.</p>	<p>We recommend the Council keeps the appropriateness of this arrangement under review, particularly when the internal audit function is brought in-house.</p>
<p>2</p> <p></p> <p>Amber</p>	<p>We have previously reported that the Pension Fund was in breach of LGPS Regulations, as it was not using the separate Pension Fund bank account for all pension fund transactions.</p> <p>Over the last two years the Council has been increasing its use of the Pension Fund Bank Account, but is still not fully compliant with LGPS Regulations.</p>	<p>The Regulations are mandatory and the Council should take steps to ensure that this Bank Account is being used for all Pension Fund transactions as soon as possible.</p>

## Assessment

-  Significant deficiency – risk of significant misstatement
-  Deficiency – risk of inconsequential misstatement

## Other communication requirements

We set out below details of other matters which we, as auditors, are required by auditing standards to communicate to those charged with governance.

	Issue	Commentary
1.	<b>Matters in relation to fraud</b>	<ul style="list-style-type: none"> <li>We have previously discussed the risk of fraud with the Audit Panel. We have not been made aware of any other incidents in the period and no other issues have been identified during the course of our audit.</li> </ul>
2.	<b>Matters in relation to laws and regulations</b>	<ul style="list-style-type: none"> <li>We are not aware of any significant incidences of non-compliance with relevant laws and regulations.</li> </ul>
3.	<b>Written representations</b>	<ul style="list-style-type: none"> <li>A standard letter of representation has been requested from the Fund.</li> </ul>
4.	<b>Disclosures</b>	<ul style="list-style-type: none"> <li>Our review of disclosures has not been completed.</li> </ul>
5.	<b>Matters in relation to related parties</b>	<ul style="list-style-type: none"> <li>There is a minor query outstanding in relation to related party transactions.</li> </ul>
6.	<b>Going concern</b>	<ul style="list-style-type: none"> <li>Our work has not identified any reason to challenge the Fund's decision to prepare the financial statements on a going concern basis.</li> </ul>

## Section 3: Fees, non audit services and independence

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# Fees, non audit services and independence

We confirm below our final fees charged for the audit and confirm there were no fees for the provision of non audit services.

## Fees

	Per Audit plan £	Actual fees £
Fund audit	21,000	21,000
<b>Total audit fees</b>	<b>21,000</b>	<b>21,000</b>

## Fees for other services

Service	Fees £
None	Nil

## Independence and ethics

We confirm that there are no significant facts or matters that impact on our independence as auditors that we are required or wish to draw to your attention. We have complied with the Auditing Practices Board's Ethical Standards and therefore we confirm that we are independent and are able to express an objective opinion on the financial statements.

We confirm that we have implemented policies and procedures to meet the requirements of the Auditing Practices Board's Ethical Standards.

## Section 4: Future developments

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# Developments relevant to your Pension Fund and the audit

Political	Environmental	Social	Technological
Developments relevant to the next financial year			
<p><b>1. Financial reporting</b></p> <p>CIPFA has published best practice guidance relating to the identification and disclosure of administrative and investment management expenditure. This applies from 2014/15 and will enable consistent reporting across the LGPS facilitating more meaningful comparisons in this area. The definition is separated into three distinct categories of costs.</p>	<p><b>2. Legislation</b></p> <p>Under the Local Government Pension Scheme (LGPS 2014), pensions will be calculated on Career Average Revalued Earnings (CARE) rather than a final salary basis from 1 April 2014. Administering authorities will need to ensure their updated administration systems are calculating new pensions accruals correctly from 1 April 2014; dealing effectively with more complex data requirements and that new contribution rates are being correctly applied by employers.</p>	<p><b>3. Actuarial valuation</b></p> <p>Following the 31 March 2013 actuarial valuation all employers will need to consider the level of additional employer deficit contributions required and how to fund them.</p>	<p><b>4. Other issues</b></p> <p>The number of LGPS employers continues to grow as local authorities outsource services. Affected funds need to consider the impact this has on its exposure to risks and reflect on the impact this has for their investment strategies.</p>
Developments relevant to future periods			
<p><b>1. Financial reporting</b></p> <p>Changes to the Pension SORP may affect the investment disclosures in the Net Asset Statement and Fair Value determination (changing the classification from level 1, 2 &amp; 3 to A, B &amp; C). A revised SORP will be issued in 2014 and may find its way into the LG code in 2015/16.</p>	<p><b>2. Legislation</b></p> <p>From April 1 2015 The Pensions Regulator will have formal powers and responsibilities for oversight of the LGPS. This will include monitoring implementation of new governance arrangements, which require the creation of a scheme manager and pension board for each LGPS.</p> <p>The Administering Authority will need to determine how it will meet the requirement to have a pension board and the consequent changes it will need to make to its general governance arrangements.</p>	<p><b>3. Structural reform</b></p> <p>DCLG is consulting on the potential use of Collective Investment Vehicles and passive management of funds.</p> <p>The outcome of this consultation may lead to a change in administration of some schemes and significant changes in investment strategies.</p>	<p><b>4. Other issues</b></p> <p>The Pensions Regulator, Financial Conduct Authority and HMRC continue to commit resources to combat pension liberation schemes. More guidance and potential changes to HMRC registration of new schemes is likely.</p>

## Section 5: Communication of audit matters

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# Communication of audit matters to those charged with governance

International Standards on Auditing (ISA) 260, as well as other ISAs, prescribe matters which we are required to communicate with those charged with governance, and which we set out in the table opposite.

The Audit Plan outlined our audit strategy and plan to deliver the audit, while this Audit Findings report presents the key issues and other matters arising from the audit, together with an explanation as to how these have been resolved.

## Respective responsibilities

The Audit Findings Report has been prepared in the context of the Statement of Responsibilities of Auditors and Audited Bodies issued by the Audit Commission ([www.audit-commission.gov.uk](http://www.audit-commission.gov.uk)).

We have been appointed as the Fund's independent external auditors by the Audit Commission, the body responsible for appointing external auditors to local public bodies in England. As external auditors, we have a broad remit covering finance and governance matters.

Our annual work programme is set in accordance with the Code of Audit Practice ('the Code') issued by the Audit Commission and includes nationally prescribed and locally determined work. Our work considers the Fund's key risks when reaching our conclusions under the Code.

It is the responsibility of the Fund to ensure that proper arrangements are in place for the conduct of its business, and that public money is safeguarded and properly accounted for. We have considered how the Fund is fulfilling these responsibilities.

Our communication plan	Audit Plan	Audit Findings
Respective responsibilities of auditor and management/those charged with governance	✓	
Overview of the planned scope and timing of the audit. Form, timing and expected general content of communications	✓	
Views about the qualitative aspects of the entity's accounting and financial reporting practices, significant matters and issues arising during the audit and written representations that have been sought		✓
Confirmation of independence and objectivity	✓	✓
A statement that we have complied with relevant ethical requirements regarding independence, relationships and other matters which might be thought to bear on independence. Details of non-audit work performed by Grant Thornton UK LLP and network firms, together with fees charged Details of safeguards applied to threats to independence	✓	✓
Material weaknesses in internal control identified during the audit		✓
Identification or suspicion of fraud involving management and/or others which results in material misstatement of the financial statements		✓
Compliance with laws and regulations		✓
Expected auditor's report		✓
Uncorrected misstatements		✓
Significant matters arising in connection with related parties		✓
Significant matters in relation to going concern		✓

# Appendices

# Appendix A: Action plan

**Priority**

**High** - Significant effect on control system

**Medium** - Effect on control system

**Low** - Best practice

Rec No.	Recommendation	Priority	Management response	Implementation date & responsibility
	<p>The Council's Head of Corporate Resources has responsibility for financial management of the pension fund as well as overseeing internal audit. We recommend the Council keeps the appropriateness of this arrangement under review, particularly when the internal audit function is brought in-house.</p>	Medium		
	<p>Over the last two years the Council has been increasing its use of the Pension Fund Bank Account, but is still not fully compliant with LGPS Regulations.</p> <p>The Regulations are mandatory and the Council should take steps to ensure that this Bank Account is being used for all Pension Fund transactions as soon as possible.</p>	Medium		

# Appendix B: Audit opinion

**We anticipate that we will provide the Fund with an unmodified audit report**

## **INDEPENDENT AUDITOR'S REPORT TO THE MEMBERS OF LONDON BOROUGH OF LEWISHAM PENSION FUND**

### **Opinion on the pension fund financial statements**

We have audited the pension fund financial statements of London Borough of Lewisham Pension Fund for the year ended 31 March 2014 under the Audit Commission Act 1998. The pension fund financial statements comprise the Fund Account, the Net Assets Statement and the related notes. The financial reporting framework that has been applied in their preparation is applicable law and the CIPFA/LASAAC Code of Practice on Local Authority Accounting in the United Kingdom 2013/14.

This report is made solely to the members of London Borough of Lewisham Pension Fund 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 Audited Bodies published by the Audit Commission in March 2010. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Authority and the Authority's Members as a body, for our audit work, for this report, or for the opinions we have formed.

### **Respective responsibilities of the Executive Director for Resources and Regeneration and auditor**

As explained more fully in the Statement of the Executive Director for Resources and Regeneration's Responsibilities, the Executive Director for Resources and Regeneration is responsible for the preparation of the Authority's Statement of Accounts, which includes the pension fund financial statements, in accordance with proper practices as set out in the CIPFA/LASAAC Code of Practice on Local Authority Accounting in the United Kingdom, and for being satisfied that they give a true and fair view. Our responsibility is to audit and express an opinion on the financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland). Those standards require us to comply with the Auditing Practices Board's Ethical Standards for Auditors.

### **Scope of the audit of the pension fund financial statements**

An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial 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 Executive Director for Resources and Regeneration; and the overall presentation of the financial statements.

In addition, we read all the financial and non-financial information in the explanatory foreword and the annual report to identify material inconsistencies with the audited financial statements and to identify any information that is apparently materially incorrect based on, or materially inconsistent with, the knowledge acquired by us in the course of performing the audit. If we become aware of any apparent material misstatements or inconsistencies we consider the implications for our report.

### **Opinion on the pension fund financial statements**

In our opinion the pension fund's financial statements: give a true and fair view of the financial transactions of the pension fund during the year ended 31 March 2014 and the amount and disposition of the fund's assets and liabilities as at 31 March 2014, other than liabilities to pay pensions and other benefits after the end of the scheme year; and have been properly prepared in accordance with the CIPFA/LASAAC Code of Practice on Local Authority Accounting in the United Kingdom 2013/14 and applicable law.

### **Opinion on other matters**

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

Darren Wells  
Director  
for and on behalf of Grant Thornton UK LLP, Appointed Auditor

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September 2014



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