

# Annual Governance Report

London Borough of Lewisham Pension Fund

Audit 2008/09

September 2009

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## Status of our reports

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. Reports prepared by appointed auditors are addressed to non executive directors, members or officers and are prepared for the sole use of the audited body. Auditors accept no responsibility to:

- any member or officer in their individual capacity; or
  - any third party.
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## 2008/09 Annual Governance Report

I am pleased to present the draft version of my report on the results of my audit work for 2008/09 which is currently in progress.

A draft of the report will be discussed and agreed with the Head of Corporate Resources and Group Manager, Capital & Treasury on 24 August 2009 and will be updated thereafter as appropriate if issues are resolved.

The report sets out the key issues that you should consider before I complete the audit.

It asks you to:

- consider the matters raised in the report before approving the financial statements (pages 6 to 10);
- take note of the adjustments to the pension fund's accounts which are set out in this report (Appendix 2);
- agree to adjust the errors in the pension fund's accounts I have identified, which management has declined to amend or set out the reasons for not amending the errors; (Appendix 3);
- approve the letter of representation on behalf of the Council before I issue my opinion (Appendix 4); and
- agree your response to the proposed action plan (Appendix 5).

Yours faithfully

Susan M. Exton

District Auditor

XX September 2009

# Key messages

This report summarises the findings from the 2008/09 audit which is substantially complete. It includes the messages arising from my audit of your financial statements.

Financial Statements	Results	Pages
Unqualified audit opinion	Yes	6
Financial statements free from material error	Yes	6-10
Adequate internal control environment	Yes	10

## Audit opinion

- 1 As a result of the testing performed on the financial statements, I propose to give an unqualified opinion on the pension fund accounts subject to the satisfactory completion of our work.

## Financial statements

- 2 The Council provided its pension fund accounts for audit on 30 June 2009 as part of the financial statements for the Council as a whole. The accounts submitted for audit were complete and were supported by good working papers in line with our expectations. This is a clear improvement on 2007/08 when the working papers provided were limited
- 3 Our work on the financial statements is substantially complete, although we have not yet reviewed the Pension Fund Annual Report for 2008/09 as this is still being prepared.
- 4 The detailed section of this report highlights the significant findings from our audit work and the specific audit procedures performed in relation to the specific risks we reported to the Pension Investments Committee and Audit Panel as part of our opinion audit plan in May 2009.

# Next steps

**This report identifies the key messages that you should consider before I issue my opinion on the pension fund's accounts, which forms part of my report on the Council's financial statements. It includes only matters of governance interest that have come to my attention in performing my audit. My audit is not designed to identify all matters that might be relevant to you.**

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**5** I ask the Pension Committee/Audit Committee to:

- consider the matters raised in the report before approving the financial statements (pages 6 to 10);
- take note of the adjustments to the Pension Fund's accounts which are set out in this report (Appendix 2);
- agree to adjust the errors in the Pension Fund's accounts I have identified which management has declined to amend or set out the reasons for not amending the errors (Appendix 3);
- approve the letter of representation on behalf of the Council before I issue my opinion (Appendix 4); and
- agree your response to the proposed action plan (Appendix 5).

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# Financial statements

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

## Opinion on the financial statements

- 6 Subject to satisfactory clearance of outstanding matters, I plan to issue an audit report on the Council's financial statements that includes an unqualified opinion on the pension fund accounts. Appendix 1 contains a copy of my draft audit report in respect of the pension fund accounts.
- 7 We have not yet reviewed the Pension Fund Annual Report for 2008/09 as this is still being prepared. Officers advise they expect to provide this to us in sufficient time to review it prior to signing the opinion on the pension fund accounts. We will report any significant findings to members separately if required.

## Recommendation

- R1** Provide the Pension Fund Annual Report to audit at the same time as the draft accounts in 2009/10.

## Errors in the financial statements

- 8 We identified errors in the financial statements (other than those of a clearly trivial nature) and discussed these with officers. Officers have agreed to adjust the financial statements for the errors identified in Appendix 2.
- 9 We have identified one additional error since this report went to Pension Investments Committee on 2 September 2009. This relates to the disclosure of sale proceeds, derivative receipts and changes in market value as set out in Note 5 (Investment Analysis) to the pension fund accounts. We have agreed an amendment with officers, which re-states total sale proceeds and derivative receipts of £1,652m per the draft accounts to £1,554m (a decrease of £98m), with a corresponding increase of £98m to the change in market value, which changes from £80m in the draft accounts to £177m.
- 10 This amendment is included in Appendix 2. The error is a presentational one only and has no impact on reported fund performance or the fund's worth, as measured by the Net Assets Statement.

### Letter of representation

11 Before I issue my opinion, auditing standards require me to obtain appropriate written representations from you and management about your financial statements and governance arrangements. Appendix 3 contains the draft letter of representation I seek to obtain from you.

### Key areas of judgement and audit risk

12 In planning the audit specific risks were identified and areas of judgement were considered as part of the audit and reported to you as part of our 2008/09 opinion audit plan in May 2009. The findings are set out in Table 1.

**Table 1**      **Key areas of judgement and audit risk**

Issue or risk	Finding
<p>At 31 March 2009, HarbourVest held investment assets of £20.6m on behalf of Lewisham, of which £6.3m was invested in equity and £14.3m in private equity. This is equivalent to 4% of total investment assets of £517m.</p> <p>In 2007/08 HarbourVest was unable to provide a SAS 70 report, an independent auditors' report on the fund manager's internal controls and procedures as far as they relate to client assets and cash.</p>	<p>During 2008/09 the Council has worked with HarbourVest to ensure a SAS70 report is obtained. To date Ernst &amp; Young, HarbourVest's external auditor has provided the Council with a 'Type 1' SAS70 report, which indicates that the auditor is satisfied that the system of internal control is appropriately designed. This report does not provide assurance that controls operated effectively throughout the period under review Officers advise that Ernst &amp; Young's 'Type 2' report will provide assurance over the 2008/09 period in its entirety and is expected by early October 2009.</p> <p>We identified a discrepancy of £98k between the 31 March 2009 valuation of the Harbourvest investment in the accounts and the Harbourvest fund manager report. We do not regard this as material and so are satisfied the Council has taken steps to ensure the Harbourvest investment is fairly valued in the pension fund accounts, taking into account relevant guidance for the valuation of private equity.</p> <p>The Council has been able to provide 'Type 2' SAS70 reports for all other fund managers. We recommend officers and members formally consider key issues arising from all</p>

Issue or risk	Finding
	SAS70 reports periodically.
<p>In common with many local government pension schemes, the economic downturn has resulted in a significant decrease in the value of Lewisham Pension Fund's net assets, from £677m at 31 March 2008 to £519m at 31 March 2009.</p> <p>The volatility in the world financial markets presents risks regarding accurate recording at the year end and the adequacy of funding levels.</p>	<p>The Pension Investments Committee receives regular monitoring reports and requests that fund managers attend to explain performance levels and put action plans in place for improvement. It is important that the Council continues to monitor these action plans to ensure that fund manager meet target performance levels.</p> <p>Based on audit work performed we are satisfied that investments shown on the Net Assets Statement at 31 March 2009 are fairly stated.</p> <p>The Council seeks actuarial advice when setting funding levels. The next full actuarial revaluation will take place in April 2010, with any change in employer contribution rate taking effect from 2011/12.</p>
<p>With effect from 1 April 2008 employees' contributions to the Local Government Pension Scheme (LGPS) are on a tiered basis with differing rates depending on the band in which their pensionable pay for the previous year fell. There is a risk that contributions will not be deducted and collected at the right rates.</p>	<p>We are satisfied that contributions receivable reflected in the accounts are fairly stated in accordance with the new LGPS regulations.</p>
<p>New regulations require the preparation of an annual report for the Pension Fund, incorporating the annual accounts.</p>	<p>We have not yet reviewed the Pension Fund Annual Report for 2008/09 as this is still being prepared.</p>
<p>The Pensions SORP 2008 requires a new valuation method for investments with effect from 2008/09. Investments should be measured at bid price rather than mid-market price, as was previously the case. The Council will need to take appropriate steps to ensure the correct valuation basis is used and will need to consider the impact of any changes to the accounts that arise as a result.</p>	<p>Investments on the Net Asset Statement at 31 March 2009 are correctly shown on a bid-price basis, as notified by the fund's custodian, Northern Trust.</p>
<p>Pension fund working papers were not provided at the start of the 2007/08 audit, which is good practice. Additional audit time was spent requesting individual working</p>	<p>The accounts submitted for audit were complete and were supported by good working papers in line with our expectations. The Council has therefore made clear</p>



## Financial statements

Issue or risk	Finding
<p>papers as a result. Earlier reporting deadlines will require a more timely completion of the pension fund audit in 2008/09.</p> <p>We provided guidance on the working papers we expected to be provided at the start of the audit. We discussed these with officers as part of the accounts closure to ensure our requirements were achievable.</p>	<p>improvements since 2007/08.</p>

Recommendations
<p><b>R2</b> Obtain and review the Type 2 SAS70 report for HarbourVest promptly once issued by Ernst &amp; Young.</p>
<p><b>R3</b> Officers and members should formally consider the key issues arising from all SAS70 reports periodically.</p>
<p><b>R4</b> Continue to monitor fund managers' performance to ensure that it meets target performance levels.</p>

## Accounting practice and financial reporting

**13** I consider the qualitative aspects of your financial reporting. Table 2 contains one issue I want to raise with you.

**Table 2**

Issue or risk	Finding
<p>Accounting policy for employees retiring on 31 March 2009.</p>	<p>The Council has identified benefits payable of £26k incorrectly accrued for in 2008/09. This arose because the Council did not taken a consistent approach to accounting for benefits payable to employees who retired on 31 March 2009, accounting for the cost of some employees in 2008/09 and some in 2009/10.</p> <p>We recommend the accounts are amended to remove these items and have included this as an adjusted error in Appendix 2.</p>

**Recommendation**

**R5** Adopt a consistent accounting policy in respect of benefits payable to employees retiring on 31 March 2009.

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**Material weaknesses in internal control**

**14** We have not identified any weaknesses in the design or operation of an internal control that might result in a material error in your financial statements.

# Appendix 1 – Independent auditor’s report to Members of London Borough of Lewisham

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## Independent auditor’s report to the Members of London Borough of Lewisham

I have audited the pension fund accounts for the year ended 31 March 2009. The pension fund accounts comprise the Fund Account, the Net Assets Statement and the related notes. The pension fund accounts have been prepared under the accounting policies set out in the Statement of Accounting Policies.

This report is made solely to the members of London Borough of Lewisham in accordance with Part II of the Audit Commission Act 1998 and for no other purpose, as set out in paragraph 49 of the Statement of Responsibilities of Auditors and of Audited Bodies prepared by the Audit Commission.

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

The Executive Director for Resources is responsible for preparing the pension fund accounts in accordance with relevant legal and regulatory requirements and the Code of Practice on Local Authority Accounting in the United Kingdom 2008. In preparing the pension fund accounts, the Executive Director for Resources is responsible for:

- selecting suitable accounting policies and then applying them consistently;
- making judgments and estimates that are reasonable and prudent;
- keeping proper accounting records which are up to date; and
- taking reasonable steps for the prevention and detection of fraud and other irregularities.

My responsibility is to audit the pension fund accounts and related notes in accordance with relevant legal and regulatory requirements and International Standards on Auditing (UK and Ireland).

I report to you my opinion as to whether the pension fund accounts present fairly, in accordance with relevant legal and regulatory requirements and the Code of Practice on Local Authority Accounting in the United Kingdom 2008, the financial transactions of the pension fund during the year and the amount and disposition of the fund’s assets and liabilities, other than liabilities to pay pensions and other benefits after the end of the scheme year. I also report to you whether, in my opinion, the information which comprises the commentary on the financial performance included within the Pension Fund Annual Report, is consistent with the pension fund accounts. That information

comprises Management Performance, Strategic Asset Allocation, Largest Holdings of the Fund and the Actuary’s Statement on Valuation of assets and liabilities.

I review whether the governance compliance statement published in the Pension Fund Annual Report reflects compliance with the requirements of Regulation 34(1)(e) of the Local Government Pension Scheme (Administration) Regulations 2008 and related guidance. I report if it does not meet the requirements specified by the Department of Communities and Local Government or if the statement is misleading or inconsistent with other information I am aware of from my audit of the financial statements. I am not required to consider, nor have I considered, whether the governance statement covers all risks and controls. Neither am I required to form an opinion on the effectiveness of the Authority’s corporate governance procedures or its risk and control procedures.

I read other information published with the pension fund accounts and related notes and consider whether it is consistent with the audited pension fund accounts. This other information comprises the remaining elements of the Pension Fund Annual Report not referred to above. I consider the implications for my report if I become aware of any apparent misstatements or material inconsistencies with the pension fund accounts and related notes. My responsibilities do not extend to any other information.

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### **Basis of audit opinion**

I conducted my audit in accordance with the Audit Commission Act 1998, the Code of Audit Practice issued by the Audit Commission and International Standards on Auditing (UK and Ireland) issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the pension fund accounts and related notes. It also includes an assessment of the significant estimates and judgments made by the Authority in the preparation of the pension fund accounts and related notes, and of whether the accounting policies are appropriate to the Authority’s circumstances, consistently applied and adequately disclosed.

I planned and performed my audit so as to obtain all the information and explanations which I considered necessary in order to provide me with sufficient evidence to give reasonable assurance that the pension fund accounts and related notes are free from material misstatement, whether caused by fraud or other irregularity or error. In forming my opinion I also evaluated the overall adequacy of the presentation of information in the pension fund accounts and related notes.

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### **Opinion**

In my opinion the pension fund accounts and related notes present fairly, in accordance with the Code of Practice on Local Authority Accounting in the United Kingdom 2008, the financial transactions of the Pension Fund during the year ended 31 March 2009, and the amount and disposition of the fund’s assets and liabilities as at 31 March 2009, other than liabilities to pay pensions and other benefits after the end of the scheme year.

## Appendix 1 – Independent auditor’s report to Members of London Borough of Lewisham

Susan M. Exton

District Auditor  
(Officer of the Audit Commission)  
First floor Millbank Tower  
Millbank  
London  
SW1P 4HQ

September 2009

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# Appendix 2 – Adjusted amendments to the draft Pension Fund’s accounts

The following misstatements were identified during the course of my audit and the financial statements have been adjusted by management. I bring them to your attention to assist you in fulfilling your governance responsibilities.

**Table 3**

Adjusted misstatements	Nature of Adjustment	Fund Account		Net Assets Statement	
		Dr £000s	Cr £000s	Dr £000s	Cr £000s
Benefits payable, (£25.0m per Fund Account in draft accounts)	Treatment of benefits payable in respect of employees retiring on 31 March 2009. benefits payable on the Fund Account cash on the Net Assets Statement		26	26	
Investment assets – HarbourVest (£20.6m per Net Assets Statement in draft accounts)	Discrepancy between pension fund accounts and HarbourVest fund manager report Change in (unrealised) market value of investments on Fund Account Investment assets on the Net Assets Statement	98			98

## Appendix 2 – Adjusted amendments to the draft Pension Fund’s accounts

		Fund Account	Net Assets Statement
Note 5 (Investment analysis)	Correction to figures disclosed in Note 5, as set out at paragraphs 9 and 10 above.	Disclosure item only: <ul style="list-style-type: none"> <li>Amend Note 5 sale proceeds and derivative receipts from £1,652m to £1,554m (-£98m);</li> <li>Amend Note 5 change in market value from £80m to £177m (+£98m).</li> </ul>	

# Appendix 3 – Unadjusted misstatements in the accounts

The following misstatements were identified during the course of my audit and the financial statements have not been adjusted by management. I bring them to your attention to assist you in fulfilling your governance responsibilities. If you decide not to do so, please tell us why in the representation letter. If you believe the effect of the uncorrected errors, individually and collectively, is immaterial, please reflect this in the representation letter. Please attach a schedule of the uncorrected errors to the representation letter.

**Table 4**

Description of error	Accounts effected	Value of error £Million
No unadjusted errors to report.		



# Appendix 4 – Draft letter of representation

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To: Susan M. Exton  
District Auditor  
Audit Commission  
Millbank Tower  
Millbank  
SW1P 4HQ

## **Lewisham Pension Fund - Audit for the year ended 31 March 2009**

I confirm to the best of my knowledge and belief, having made appropriate enquiries of other officers of London Borough of Lewisham, the following representations given to you in connection with your audit of the Lewisham Pension Fund's financial statements for the year ended 31 March 2009.

### ***Compliance with the statutory authorities***

I acknowledge my responsibility under the relevant statutory authorities for preparing the financial statements in accordance with *the Code of Practice for Local Authority Accounting in the United Kingdom: A Statement of Recommended Practice* which [present fairly/ give a true and fair view] the financial position and financial performance of the pension fund and for making accurate representations to you.

### ***Uncorrected misstatements***

I confirm that I believe that the effects of the uncorrected financial statements misstatements listed in the attached schedule are not material to the financial statements, either individually or in aggregate. These misstatements have been discussed with those charged with governance and the reasons for not correcting these items are as follows;

- reason 1 etc;
- reason 2

### ***Supporting records***

All the accounting records have been made available to you for the purpose of your audit and all the transactions undertaken by the Lewisham Pension Fund have been properly

reflected and recorded in the accounting records. All other records and related information, including minutes of all Pension Investments Committee meetings, have been made available to you.

### ***Irregularities***

I acknowledge my responsibility for the design and implementation of internal control systems to prevent and detect fraud or error.

There have been no:

- irregularities involving management or employees who have significant roles in the system of internal accounting control;
- irregularities involving other employees that could have a material effect on the financial statements; or
- communications from regulatory agencies concerning non-compliance with, or deficiencies on, financial reporting practices which could have a material effect on the financial statements.

I also confirm that I have disclosed:

- my knowledge of fraud, or suspected fraud, involving either management, employees who have significant roles in internal control or others where fraud could have a material effect on the financial statements; and
- my knowledge of any allegations of fraud, or suspected fraud, affecting the entity's financial statements communicated by employees, former employees, analysts, regulators or others.

### ***Law, regulations, contractual arrangements and codes of practice***

There are no instances of non-compliance with laws, regulations and codes of practice, likely to have a significant effect on the finances or operations of the Lewisham Pension Fund.

### ***Fair Values***

I confirm the reasonableness of the significant assumptions within the financial statements. For the fair values disclosed at notes 5 to 7, I confirm:

- the appropriateness of the measurement method;
- the basis used by management to overcome the presumption under the financial reporting framework;
- the completeness and appropriateness under the financial reporting framework; and
- if subsequent events [require/do not require] adjustment to the fair value measurement.

### ***Assets***

## Appendix 4 – Draft letter of representation

The following have been properly recorded and, where appropriate, adequately disclosed in the financial statements:

- losses arising from sale & purchase commitments;
- agreements & options to buy back assets previously sold; and
- assets pledged as collateral.

### ***Compensating arrangements***

There are no formal or informal compensating balancing arrangements with any of our cash and investment accounts. We have no lines of credit arrangements.

### ***Contingent liabilities***

There are no other contingent liabilities, other than those that have been properly recorded and disclosed in the financial statements. In particular:

- there is no significant pending or threatened litigation;
- there are no material commitments or contractual issues, other than those already disclosed in the financial statements; and
- no financial guarantees have been given to third parties.

### ***Related party transactions***

I confirm the completeness of the information disclosed regarding the identification of related parties. The identity of, and balances and transactions with, related parties have been properly recorded and where appropriate, adequately disclosed in the financial statements

### ***Post balance sheet events***

Since the date of approval of the financial statements by the Audit Panel, no additional significant post balance sheet events that have occurred which would require additional adjustment or disclosure in the financial statements.

The Lewisham Pension Fund has no plans or intentions that may materially alter the carrying value or classification of assets and liabilities reflected in the financial statements.

*If adoption of the financial statements and the representation are on the same day this paragraph is not required.*

### ***Specific representations***

Lewisham Pension Fund continues to hold the rights of ownership over investment assets held by HarbourVest on the fund's behalf, and the valuation of £20.6m at 31 March 2009 as shown in the Net Assets Statement is consistent with the investment's fair value at this date.

Signed on behalf of Lewisham Pension Fund

I confirm that the this letter has been discussed and agreed by the Pension Investments Committee and Audit Panel on [date]

Signed

Ms Janet Senior

Executive Director for Resources

XX September 2009

# Appendix 5 – Action Plan

Page no.	Recommendation	Priority Low Medium High	Responsibility	Agreed	Comments	Date
<b>Pension Fund Annual Governance Report</b>						
6	R1 Provide the Pension Fund Annual Report to audit at the same time as the draft accounts in 2009/10.	Medium	Head of Corporate Resources	Yes		June 2010
9	R2 Obtain and review the Type 2 SAS70 report for HarbourVest promptly once issued by Ernst & Young.	High	Head of Corporate Resources	Yes		October 2009
9	R3 Officers and members should formally consider the key issues arising from all SAS70 reports periodically.	High	Head of Corporate Resources	Yes		Quarterly
9	R4 Continue to monitor fund managers' performance to ensure that it meets target performance levels.	Medium	Head of Corporate Resources	Yes		Ongoing
9	R5 Adopt a consistent accounting policy in respect of benefits payable to employees retiring on 31 March 2009.	Low	Head of Corporate Resources	Yes		Immediate