

# Annual Governance Report Addendum

London Borough of Tower Hamlets Pension Fund  
Audit 2009/10

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# Pension Fund Addendum AGR

## Introduction

1 My work on the audit of the Pension Fund's financial statements has continued since I drafted my Annual Governance Report. This work has identified matters I wish to bring to your attention. This addendum should be read in conjunction with my Annual Governance Report delivered to the Audit Committee on 21 September 2010. The attached appendices show the final position on amendments made to the accounts and unadjusted mis-statements.

2 My work is now complete and I intend to give an unqualified opinion on the accounts on 6 October 2010.

## Main Conclusions

### Derivative Contracts

3 The Pension Fund has engaged in forward foreign exchange contracts which are a form of financial derivatives. These contracts had incorrectly been accounted for as equity instruments. Details of the amendments made to correct this error are included in Appendix 1.

4 The effect of this was to understate the value of the assets and liabilities of the Fund. The disclosure in the draft accounts did not adequately inform the reader of the accounts of the type of risks which could impact upon the Fund's investments.

5 Note 10 to the accounts now discloses realised gains from forward foreign exchange contract of £0.684m. Officers cannot fully support this figure. Officers have agreed to look into this and provide working papers to support the figure in 2010/11.

6 Reporting to Members is not as clear as it could be on the risks inherent in these complex investments. Officers should improve their own understanding of the nature of these transactions and appraise members. This will help improve governance and financial reporting in this area.

## Recommendation

**R1** Gain a full understanding of the nature of the forward foreign exchange contracts and ensure that members of the Pension Fund Committee are fully updated and informed.

## **Pensioner numbers**

**7** Officers have not been able to reconcile the number of pensioners in the payroll system to the number in the pension system. The nature of pensions systems means that, unlike the payroll system, some members have more than one valid record on the system.

**8** The membership numbers in both systems should be reconciled to demonstrate all pensions payments were to valid pensioners. Our work did not identify any pension payments to people who are not members of the pension fund. However, the lack of reconciliation is a control weakness which should be addressed.

### **Recommendation**

**R2** Reconcile the number of pensioners in the payroll system to the pensions system as part of the closedown process.

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## Appendix 1 Amendments to the draft accounts

I identified the following misstatements during my audit and officers have made the necessary adjustments. I bring them to your attention to aid you in fulfilling your governance responsibilities.

Table 1:

Description of adjustment	Income & Expenditure		Balance Sheet	
	Dr £k	Cr £k	Dr £k	Cr £k
Mis-classification of investments: Pooled Investments were incorrectly disclosed as Fixed Interest Securities in the Net Asset Statement			54,082	54,082
Pooled Investments were incorrectly disclosed as Equity Investments in the Net Asset Statement			19,213	19,213
The net asset from open derivative contracts at year end has been disaggregated from equities on the face of the net asset statement.			774	774
Adjustment to notes				£k
Note 10 – Investments				
The accounting treatment of forward foreign exchange contracts was incorrect:				
<ul style="list-style-type: none"> <li>■ A note has been added to explain what type of derivatives are held and what they are used for.</li> <li>■ Purchases and sales have been disclosed in the accounts which shows movement on investments in year.</li> <li>■ A note has been added to the accounts to show the gross value of open contracts to purchase and sell resulting from forward foreign exchange contracts. The disclosure also shows the expected gain or loss on these contracts: <ul style="list-style-type: none"> <li>– Currency contracted to purchase (£45,640k)</li> <li>– Currency contracted to purchase, equal and opposite obligation £47,492k</li> <li>– Currency contracted to sell £46,646k</li> <li>– Currency contracted to sell, equal and opposite obligation (£47,724k)</li> </ul> </li> </ul>				£33,997k

## Appendix 2 Unadjusted mis-statements in the accounts

I identified the following misstatements during my audit, but management has not adjusted the financial statements. I bring them to your attention to help you in fulfilling your governance responsibilities.

Table 2:

Description of error	Accounts affected	Value of error £ '000
The wrong contribution rate had been applied due to an incorrect manual amendment to the employee's record. I have extrapolated this error and consider that employee contributions may be overstated.	Fund account - employee contributions - creditors	88
Debtors are overstated in the accounts because the monies had been received by the balance sheet date.	Fund Account: - debtors	55

## Appendix 3 Draft letter of representation

Jon Hayes  
District Auditor  
Audit Commission  
1st Floor,  
Millbank Tower,  
Millbank, London,  
SW1P 4HQ  
X October 2010

### **London Borough of Tower Hamlets - Audit for the year ended 31 March 2010**

I confirm to the best of my knowledge and belief, having made appropriate enquiries of other officers of the London Borough of Tower Hamlets, the following representations given to you in connection with your audit of the Council's financial statements for the year ended 31 March 2010. All representations cover the Council's Accounts, Group Accounts and Pension Fund Accounts included within the financial statements.

#### **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 give a true and fair view of the financial position and financial performance of the Council and for making accurate representations to you.

#### **Uncorrected misstatements**

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

- We have not recognised the value of 13 assets identified in year on our balance sheet. We do not regard this decision as having a material impact on our financial statements.



- We recognise that we have accounted for three finance leases as operating leases. We do not regard this decision as having a material impact on our financial statements.
- £1.3m of provisions relating to a guarantee arrangement with Tower Hamlets Homes have been accounted for as pension liabilities under FRS17, rather than under FRS12. We do not regard this decision as having a material impact on our financial statements.
- We have not accounted for the Barkantine combined heat and power plant on balance sheet. We will review the accounting treatment of this asset in 2010/11. We do not regard this decision as having a material impact on our financial statements.
- The long and short term liabilities for the Private Finance Initiatives are misclassified. We do not regard this decision as having a material impact on our financial statements.

### **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 Council have been properly reflected and recorded in the accounting records. All other records and related information, including minutes of all Council 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 Council.

The Council has complied with all aspects of contractual arrangements 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.

### **Fair Values**

I confirm the reasonableness of the significant assumptions within the financial statements.

### **Assets**

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. Except as disclosed in notes 31 and 32 to the financial statements we have no other 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, other than those already disclosed in the financial statements;
- 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 other than the guarantee already disclosed in the financial statements.

### **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 Council, no additional significant post balance sheet events have occurred, other than the disclosure relating to pension liabilities, which would require additional

adjustment or disclosure in the financial statements other than those items already disclosed.

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

**Specific representations**

I have considered the Council's long-term contracts in line with IFRIC 12 and other relevant financial reporting standards and confirm that, other than those already disclosed in the accounts, these are not considered to include leases, service concession arrangements or any embedded derivatives that would require separation from the host contract.

Signed on behalf of the London Borough of Tower Hamlets.

I confirm that the this letter has been discussed and agreed by the Council on [date]

Signed

Name

Position

## Appendix 4 Action Plan

### Recommendations

#### Recommendation 1

Gain a full understanding of the nature of the forward foreign exchange contracts and ensure that members of the Pension Fund Committee are updated and understand the nature of these transactions/investments.

<b>Responsibility</b>	Chief Financial Strategy Officer
<b>Priority</b>	High
<b>Date</b>	By 31 January 2011
<b>Comments</b>	Use of forward foreign exchange contracts to be reviewed and Pension Fund Committee to be briefed on usage.

#### Recommendation 2

Reconcile the number of pensioners in the payroll system to the pensions system as part of the closedown process.

<b>Responsibility</b>	HR Pension Manager
<b>Priority</b>	Medium
<b>Date</b>	By 30 June 2011
<b>Comments</b>	It has been agreed that additional year end reports will be produced to support the figures in the accounts and to help with the reconciliation of the systems.

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