

Annual governance report

London Borough of Tower Hamlets Pension Fund

Audit 2011/12



Contents

Key messages	3
Before I give my opinion	4
Financial statements	5
Fees	9
Appendix 1 – Draft independent auditor’s report	10
Appendix 2 – Corrected errors	15
Appendix 3 – Draft letter of management representation	16
Appendix 4 – Glossary	18
Appendix 5 – Action plan	21

Key messages

This report summarises the findings from my 2011/12 audit of the pension fund financial statements which is substantially complete.

Subject to the completion of the closing procedures, I intend to issue an unqualified opinion on the pension fund financial statements.

Management have amended the financial statements for the errors identified during the audit. None of these had an impact on the financial position of the pension fund.

Before I give my opinion

My report includes only matters of governance interest that have come to my attention in performing my audit. I have not designed my audit to identify all matters that might be relevant to you.

Independence

I can confirm that I have complied with the Auditing Practices Board's ethical standards for auditors, including ES 1 (revised) - Integrity, Objectivity and Independence.

I am not aware of any relationships that may affect the independence and objectivity of the Audit Commission, the audit team or me, that I am required by auditing and ethical standards to report to you.

I ask the audit committee to:

- consider the matters raised in this report before approving the pension fund financial statements;
- take note of the adjustments to the financial statements included in this report (appendix 2);
- approve the letter of representation (appendix 3), on behalf of the pension fund before I issue my opinion; and
- agree your response to the proposed action plan (appendix 5).

Financial statements

The pension fund's financial statements are an important mechanism for the pension fund to account for its stewardship of public funds. As Members you have final responsibility for these statements. It is important that you consider my findings before you adopt the financial statements.

Opinion on the financial statements

Subject to satisfactory clearance of outstanding matters, I plan to issue an audit report including an unqualified opinion on the pension fund financial statements included within the Council's Statement of Accounts. Appendix 1 contains a copy of my draft audit report.

Corrected errors

My audit of the pension fund statements identified non trivial errors which have been corrected by management, these are detailed in Appendix 2.

I found one material error during the course of my audit. The cash balance of £7.579 million was disclosed as a debtor balance with the Council's general fund. This is due to the Council's treasury arrangement whereby pension fund cash holdings are pooled with the Council's other bank balances to maximise the return on temporary investments. Officers have corrected this error to show the cash balance.

Significant risks and my findings

I reported to you in my March 2012 Audit Plan the risks that I identified relevant to my audit of your financial statements. Table 2 reports to you my findings against each of these risks.

Table 1: Risks and findings

Risk	Finding
<p>The quality assurance review of the pension fund financial statements prior to submission for audit does not identify all the matters it should.</p>	<p>The quality of the 2011/12 draft financial statements was consistent with last year. There is scope for further improvement in this area. Examples include:</p> <ul style="list-style-type: none"> - the related party transactions note and financial instruments risk note were incomplete; - several working papers and supporting notes in the pension fund financial statements were not available at the start of the audit; and - officers have deleted a note included in the draft accounts analysing securities held by the pension fund. This note is not required by the Code and included £14.2 million of working capital that were not securities. Sufficient analysis of the fund's investment portfolio is available elsewhere in the financial statements.
<p>Valuation of derivatives and misclassification of investments.</p>	<p>My review of the valuation of derivatives and the classification of investments has not highlighted any issues.</p>
<p>The Council opened a separate bank account for the pension fund in line with LGPS Regulations 2009. However, during the early part of 2011/12, some payments and receipts were still being processed through the Council's main bank account.</p>	<p>My testing found that the some payments and receipts in 2011/12 relating to the pension fund were not processed through the new pension fund bank account. Some transactions continued to originate from the Council's main bank account with a monthly transfer being made between the two accounts. This is not in accordance with the Regulations. I have confirmed that the year end cash position is materially correct.</p>

Recommendation

- R1** Undertake a more detailed quality review of the draft pension fund financial statements. In particular, ensure that all disclosure requirements are in accordance with the Code and working papers have been prepared to support all notes in the accounts.
-
- R2** The Council should ensure all payments and receipts relating to the pension fund are processed through the fund's separate bank account, in accordance with the Regulations.
-

Significant weaknesses in internal control

It is the Council's responsibility to develop and implement systems of internal financial control for the pension fund and to put in place proper arrangements to monitor their adequacy and effectiveness in practice. My responsibility as auditor is to consider whether the pension fund has put adequate arrangements in place to satisfy itself that the systems of internal financial control are both adequate and effective in practice.

I have tested the controls of the pension fund only to the extent necessary for me to complete my audit. I am not expressing an opinion on the overall effectiveness of internal control.

My testing of the council's financial systems found a number of instances where the operation of controls was not evidenced. An example of such a weakness included, but was not limited to, the monthly review by HR managers of starters and leavers. As a result, I have been unable to place reliance on the controls in these areas, as they relate to the audit of the pension fund, and have undertaken additional substantive testing.

Recommendation

- R3** Evidence the operation of controls more consistently to strengthen the internal control environment.
-

Other matters

I am required to report significant findings from the audit and other matters that are significant to your oversight of the pension fund's financial reporting process, including:

- qualitative aspects of your accounting practices;
- matters specifically required by other auditing standards to be communicated to those charged with governance. For example, issues about fraud, compliance with laws and regulations, external confirmations and related party transactions; and
- other audit matters of governance interest.

There are no matters I wish to report.

Pension Fund Annual Report

The draft Pension Fund Annual Report was submitted for audit review on 3 August 2012. I expect to report on the financial statements included in the Annual Report by 30 September 2012

Fees

I reported my planned audit fee in the March 2012 Audit Plan.

I will complete the audit within the planned fee.

Table 2: **Fees**

	Planned fee 2011/12 (£)	Expected fee 2011/12 (£)
Audit	35,000	35,000
Non-audit work	0	0
Total	35,000	35,000

Appendix 1 – Draft independent auditor’s report

INDEPENDENT AUDITOR’S REPORT TO THE MEMBERS OF THE LONDON BOROUGH OF TOWER HAMLETS

Opinion on the financial statements

I have audited the financial statements of the London Borough of Tower Hamlets for the year ended 31 March 2012 under the Audit Commission Act 1998. The financial statements comprise the Authority and Group Movement in Reserves Statement, the Authority and Group Comprehensive Income and Expenditure Statement, the Authority and Group Balance Sheet, the Authority and Group Cash Flow, the Housing Revenue Account Income and Expenditure Statement, the Movement on the Housing Revenue Account Statement, the Collection Fund and the related notes. The financial reporting framework applied to their preparation is applicable law and the CIPFA/LASAAC Code of Practice on Local Authority Accounting in the United Kingdom 2011/12.

This report is made solely to the members of the London Borough of Tower Hamlets 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.

Respective responsibilities of the Corporate Director of Resources and the auditor

As explained more fully in the Statement of the Corporate Director of Resources’ Responsibilities, the Corporate Director of Resources is responsible for the preparation of the Statement of Accounts, which includes the 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. My 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 me to comply with the Auditing Practices Board’s Ethical Standards for Auditors.

Scope of the audit of the 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 Authority and Group’s circumstances and have been consistently applied and adequately disclosed; the

reasonableness of significant accounting estimates made by the Corporate Director of Resources; and the overall presentation of the financial statements. In addition, I read all the financial and non-financial information in the explanatory foreword to identify material inconsistencies with the audited financial statements. If I become aware of any apparent material misstatements or inconsistencies I consider the implications for my report.

Opinion on financial statements

In my opinion the financial statements:

- give a true and fair view of the financial position of the London Borough of Tower Hamlets as at 31 March 2012 and of its expenditure and income for the year then ended;
- give a true and fair view of the financial position of the Group as at 31 March 2012 and of its expenditure and income for the year then ended; and
- have been prepared properly in accordance with the CIPFA/LASAAC Code of Practice on Local Authority Accounting in the United Kingdom 2011/12.

Opinion on other matters

In my 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.

Matters on which I report by exception

I report to you if:

- in my opinion the annual governance statement does not reflect compliance with 'Delivering Good Governance in Local Government: a Framework' published by CIPFA/SOLACE in June 2007;
- I issue a report in the public interest under section 8 of the Audit Commission Act 1998;
- I designate under section 11 of the Audit Commission Act 1998 any recommendation as one that requires the Authority to consider it at a public meeting and to decide what action to take in response; or
- I exercise any other special powers of the auditor under the Audit Commission Act 1998.

I have nothing to report in these respects.

Opinion on the pension fund financial statements

I have audited the pension fund financial statements for the year ended 31 March 2012 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 2011/12.

This report is made solely to the members of the London Borough of Tower Hamlets 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.

Respective responsibilities of the Corporate Director of Resources and auditor

As explained more fully in the Statement of the Corporate Director of Resources' Responsibilities, the Corporate Director of resources is responsible for the preparation of the Authority and Group's Statement of Accounts, which includes the pension fund's 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. My responsibility is to audit and express an opinion on the accounting statements in accordance with applicable law and International Standards on Auditing (UK and Ireland). Those standards require me to comply with the Auditing Practices Board's Ethical Standards for Auditors.

Scope of the audit of the 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 Corporate Director of Resources; and the overall presentation of the financial statements. In addition, I read all the financial and non-financial information in the explanatory foreword to identify material inconsistencies with the audited financial statements. If I become aware of any apparent material misstatements or inconsistencies I consider the implications for my report.

Opinion on financial statements

In my 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 2012 and the amount and disposition of the fund's assets and liabilities as at 31 March 2012; and
- have been properly prepared in accordance with the CIPFA/LASAAC Code of Practice on Local Authority Accounting in the United Kingdom 2011/12.

Opinion on other matters

In my 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.

Conclusion on Authority's arrangements for securing economy, efficiency and effectiveness in the use of resources

Respective responsibilities of the Authority and the auditor

The Authority is responsible for putting in place proper arrangements to secure economy, efficiency and effectiveness in its use of resources, to ensure proper stewardship and governance, and to review regularly the adequacy and effectiveness of these arrangements.

I am required under Section 5 of the Audit Commission Act 1998 to satisfy myself that the Authority has made proper arrangements for securing economy, efficiency and effectiveness in its use of resources. The Code of Audit Practice issued by the Audit Commission requires me to report to you my conclusion relating to proper arrangements, having regard to relevant criteria specified by the Audit Commission.

I report if significant matters have come to my attention which prevent me from concluding that the Authority has put in place proper arrangements for securing economy, efficiency and effectiveness in its use of resources. I am not required to consider, nor have I considered, whether all aspects of the Authority's arrangements for securing economy, efficiency and effectiveness in its use of resources are operating effectively.

Scope of the review of arrangements for securing economy, efficiency and effectiveness in the use of resources

I have undertaken my audit in accordance with the Code of Audit Practice, having regard to the guidance on the specified criteria, published by the Audit Commission in October 2011, as to whether the Authority has proper arrangements for:

- securing financial resilience; and
- challenging how it secures economy, efficiency and effectiveness.

The Audit Commission has determined these two criteria as those necessary for me to consider under the Code of Audit Practice in satisfying myself whether the Authority put in place proper arrangements for securing economy, efficiency and effectiveness in its use of resources for the year ended 31 March 2012.

I planned my work in accordance with the Code of Audit Practice. Based on my risk assessment, I undertook such work as I considered necessary to form a view on whether, in all significant respects, the Authority had put in place proper arrangements to secure economy, efficiency and effectiveness in its use of resources.

Conclusion

On the basis of my work, having regard to the guidance on the specified criteria published by the Audit Commission in October 2011, I am satisfied that, in all significant respects, the London Borough of Tower Hamlets put in place proper arrangements to secure economy, efficiency and effectiveness in its use of resources for the year ended 31 March 2012.

Delay in certification of completion of the audit

I cannot formally conclude the audit and issue an audit certificate as I am still to complete the work necessary to issue my assurance statement in respect of the Council's Whole of Government Accounts consolidation pack. I am satisfied that this work does not have a material effect on the financial statements or on my value for money conclusion.

Jon Hayes

District Auditor

1st Floor Millbank Tower, Millbank, London, SW1P 4HQ

xx September 2012

Appendix 2 – Corrected errors

I identified the following errors during the audit which management have corrected in the revised financial statements.

Nature of error	Item of account	Fund Account		Net Assets Statement	
		Dr £'000s	Cr £'000s	Dr £'000s	Cr £'000s
External audit fees are required to be disclosed separately in the notes to the financial statements.	External Audit Fees	35			
	Other Fees		35		
Cash in the pension fund bank account was disclosed as a debtor.	Cash			7,579	
	Debtor				7,579
Disclosure notes	Nature of adjustment				
Securities	A note detailing the securities held by the fund was removed as it is not required by the Code. The note contained working capital to the value of £14.2 million which should not have been disclosed as securities.				
Investments	An unrealised gain of £0.225 million on forward foreign exchange contracts was disclosed as an unrealised loss in the narrative to this note.				
Accounting policies	The accounting policies for cash and cash equivalents and financial instruments were not disclosed within the notes to the financial statements.				
Related party transactions	The related party transaction note was incomplete and referred to the London Borough of Tower Hamlets financial statements for information about related parties. The Code requires a separate disclosure for the pension fund.				

Appendix 3 – Draft letter of management representation

London Borough of Tower Hamlets - Audit for the year ended 31 March 2012

I confirm to the best of my knowledge and belief, having made appropriate enquiries of other [insert relevant details directors 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 2012.

Compliance with the statutory authorities

I have fulfilled my responsibility under the relevant statutory authorities for preparing the financial statements in accordance with the Accounts and Audit (England) Regulations 2011 and the Code of Practice on Local Authority Accounting in the United Kingdom which give a true and fair view of the financial position and financial performance of the Council, for the completeness of the information provided to you, and for making accurate representations to you.

Supporting records

I have made available all relevant information and access to persons within the Council for the purpose of your audit. I have properly reflected and recorded in the financial statements all the transactions undertaken by the Council.

Irregularities

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

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;
- 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; and
- the results of our assessment of the risk the financial statements may be materially misstated as a result of fraud.

Law, regulations, contractual arrangements and codes of practice

I have disclosed to you all known instances of non-compliance, or suspected non-compliance with laws, regulations and codes of practice, whose effects should be considered when preparing financial statements.

Transactions and events have been carried out in accordance with law, regulation or other authority. 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.

All known actual or possible litigation and claims, whose effects should be considered when preparing the financial statements, have been disclosed to the auditor and accounted for and disclosed in accordance with the applicable financial reporting framework.

Accounting estimates including fair values

I confirm the reasonableness of the significant assumptions used in making the accounting estimates, including those measured at fair value.

Related party transactions

I confirm that I have disclosed the identity of the Council's related parties and all the related party relationships and transactions of which I am aware. I have appropriately accounted for and disclosed such relationships and transactions in accordance with the requirements of the Code.

Subsequent events

I have adjusted for or disclosed in the financial statements all relevant events subsequent to the date of the financial statements.

Signed on behalf of the London Borough of Tower Hamlets

I confirm that the this letter has been discussed and agreed by the Audit Committee on 25 September 2012

Signed

Name

Position

Date

Appendix 4 – Glossary

Annual Audit Letter

Letter issued by the auditor to the Pension Fund after the completion of the audit that summarises the audit work carried out in the period and significant issues arising from auditors' work.

Annual Governance Report

The auditor's report on matters arising from the audit of the financial statements presented to those charged with governance before the auditor issues the opinion.

Audit of the accounts

The audit of the accounts of an audited body comprises all work carried out under the Code to meet the auditor's statutory responsibilities under the Audit Commission Act 1998.

Audited body

A body to which the Audit Commission is responsible for appointing the external auditor.

Auditing Practices Board (APB)

The body responsible in the UK for issuing auditing standards, ethical standards and associated guidance to auditors. Its objectives are to establish high standards of auditing that meet the developing needs of users of financial information and to ensure public confidence in the auditing process.

Auditing standards

Pronouncements of the APB that contain basic principles and essential procedures with which auditors must comply, except where otherwise stated in the auditing standard concerned.

Auditor(s)

Auditors appointed by the Audit Commission.

Code (the)

The Code of Audit Practice for local government bodies issued by the Audit Commission and approved by Parliament.

Commission (the)

The Audit Commission for Local Authorities and the National Health Service in England.

Ethical Standards

Pronouncements of the APB that contain basic principles relating to independence, integrity and objectivity that apply to the conduct of audits and with which auditors must comply, except where otherwise stated in the standard concerned.

Financial statements

The annual statement of accounts that the Pension Fund is required to prepare, which report the financial performance and financial position of the Pension Fund in accordance with the Accounts and Audit (England) Regulations 2011 and the Code of Practice on Local Authority Accounting in the United Kingdom.

Internal control

The whole system of controls, financial and otherwise, that the Pension Fund establishes to provide reasonable assurance of effective and efficient operations, internal financial control and compliance with laws and regulations.

Materiality

The APB defines this concept as ‘an expression of the relative significance or importance of a particular matter in the context of the financial statements as a whole. A matter is material if its omission would reasonably influence the decisions of an addressee of the auditor’s report; likewise a misstatement is material if it would have a similar influence. Materiality may also be considered in the context of any individual primary statement within the financial statements or of individual items included in them. Materiality is not capable of general mathematical definition, as it has both qualitative and quantitative aspects’.

The term ‘materiality’ applies only to the financial statements. Auditors appointed by the Commission have responsibilities and duties under statute, as well as their responsibility to give an opinion on the financial statements, which do not necessarily affect their opinion on the financial statements.

Pension Fund Annual Report

The annual report, including financial statements, that the Pension Fund must publish under Regulation 34 of the Local Government Pension Scheme (Administration) Regulations 2008.

Significance

The concept of 'significance' applies to these wider responsibilities and auditors adopt a level of significance that may differ from the materiality level applied to their audit of the financial statements. Significance has both qualitative and quantitative aspects.

Those charged with governance

Those entrusted with the supervision, control and direction of the pension fund. This term includes the members of the Council and the Audit Committee.

Appendix 5 – Action plan

Recommendations

Recommendation 1

Undertake a more detailed quality review of the draft pension fund financial statements. In particular, ensure that all disclosure requirements have been adhered to and working papers have been prepared to support all notes in the accounts.

Responsibility	Oladapo Shonola
Priority	Medium
Date	June 2013
Comments	Officers will conduct as thorough review of accounts as possible before publication of the draft accounts prior to the start of the audit.

Recommendation 2

The Council should ensure all payments and receipts relating to the pension fund are processed through the fund's separate bank account, in accordance with the Regulations.

Responsibility	Oladapo Shonola
Priority	Medium
Date	March 2013
Comments	Officers have made progress in ensuring pension payments & receipts are processed via the pension bank account. A review will be conducted to ensure the remaining pension transactions (mainly pension payroll) are processed via the pension bank account where practical.

Recommendation 2

Evidence the operation of controls more consistently to strengthen the internal control environment.

Responsibility	S Kilbey
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Priority	High
Date	March 2013
Comments	HR will continue to review procedures around starters and leavers and changes in procedures will be addressed as part of the implementation of Northgate system enhancements in progress.

If you require a copy of this document in an alternative format or in a language other than English, please call:
0844 798 7070

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- any director/member or officer in their individual capacity; or
- any third party.

