

London Borough of Merton Pension Fund

Pension Fund Advisory Committee/General Purposes Committee

For the year ended 31 March 2015

Audit Results Report – ISA (UK and Ireland) 260

15 September 2015 and 16 September 2015 Meetings



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Section 1

Executive summary

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The Audit Commission's Code of Audit Practice (the Code) requires us to report to those charged with governance. We regard London Borough of Merton's General Purposes Committee as the member forum ultimately responsible for the governance of the London Borough of Merton Pension Fund, however we also report our findings to the Pension Fund Advisory Committee ahead of the General Purposes Committee meeting. The Code requires us to report on the work we have carried out to discharge our statutory audit responsibilities together with any governance issues identified. This report summarises the findings from the 2014/2015 audit which is substantially complete. It includes the messages arising from our audit of your financial statements.

Financial statements

As of 2 September 2015, we expect to issue an unqualified opinion on the financial statements. Our audit results demonstrate, through the few matters we have to communicate, that the Pension Fund has prepared its financial statements to a good standard.

Section 2

Extent and purpose of our work

Extent and purpose of our work

The Council's responsibilities

- ▶ The London Borough of Merton as the administering authority of the Pension Fund is responsible for preparing and publishing its Statement of Accounts which includes the financial statements of the Pension Fund.
- ▶ The Council is also required to prepare a separate Annual Report and Statement of Accounts for the Pension Fund.

Purpose of our work

- ▶ Our audit was designed to:
 - ▶ Express an opinion on the 2014/2015 financial statements of the Pension Fund
 - ▶ Report on whether information in the Annual Report is consistent with the financial statements

In addition, this report contains our findings related to the areas of audit emphasis and any views on significant deficiencies in internal control or the Pension Fund's accounting policies and key judgments.

This report is intended solely for the information and use of the Pension Fund. It is not intended to be and should not be used by anyone other than the specified party.

Section 3

Addressing audit risks

Addressing audit risks – significant audit risks

We identified the following audit risks during the planning phase of our audit, and reported these to you in our Audit Plan presented to the General Purposes Committee on 25 June 2015. Here, we set out how we have gained audit assurance over those issues.

A significant audit risk in the context of the audit of the financial statements is an inherent risk with both a higher likelihood of occurrence and a higher magnitude of effect should it occur and which requires special audit consideration. For significant risks, we obtain an understanding of the entity's controls relevant to each risk and assess the design and implementation of the relevant controls.

Audit risk identified within our audit plan	Audit procedures performed	Assurance gained and issues arising
<p>Significant audit risks (including fraud risks)</p> <p>As identified in ISA (UK and Ireland) 240, management is in a unique position to perpetrate fraud because of their ability to directly or indirectly manipulate accounting records and prepare fraudulent financial statements by overriding controls that otherwise appear to be operating effectively. We identify and respond to this fraud risk on every audit engagement.</p>	<p>Our approach focused on:</p> <ul style="list-style-type: none"> ▶ Testing the appropriateness of journal entries recorded in the general ledger and other adjustments made in the preparation of the financial statements; ▶ Reviewing accounting estimates for evidence of bias, specifically the approach to valuation of investments, and ▶ Evaluating the business rationale for significant unusual transactions, specifically the transfer out of funds for probation staff to the Greater Manchester Pension Fund. 	<p>All our planned procedures are complete. We have no matters to bring to your attention based on our testing.</p>

Addressing audit risks – other audit risks

- ▶ We identified the following audit risks during the planning phase of our audit, and reported these to you in our Audit Plan. Here, we set out how we have gained audit assurance over those issues.

Audit risk identified within our Audit Plan	Audit procedures performed	Assurance gained and issues arising
<p>Other audit risks</p> <p>The 1st of April 2014 marked the start of a new pension scheme which all members of the LGPS now automatically joined. Benefits accrued before 1 April 2014 were protected. Key changes impacting on our financial statements audit are:</p> <ul style="list-style-type: none"> • Benefits payable for service from 1 April 2014 will be calculated on a career average basis. • There are an increased number of salary bands, which are used to determine the level of employee contributions with a maximum employee contribution rate of 12.5% <p>There is a risk that benefits payable or employee contributions may be incorrectly calculated if system parameters were not correctly updated.</p>	<p>Our approach focused on:</p> <ul style="list-style-type: none"> ▶ Using membership data and known parameters to undertake a predictive analytical review for benefits payable and employee contributions and critically comparing our predictions with the year-end figures. ▶ Walking through benefit payables and employee contribution cases to update our process understanding ▶ Substantively testing a sample of benefits paid to ensure calculations are correct. 	<ul style="list-style-type: none"> ▶ We have appropriate evidence that benefits payable and contributions are calculated as we would expect, based on the sample testing we have undertaken.

Addressing audit risks – other audit risks continued

- ▶ We identified the following audit risks during our audit. Here, we set out how we have gained audit assurance over these issues.

Audit risk identified	Audit procedures performed	Assurance gained and issues arising
<p>Other audit risks</p>		
<p>1. The Chartered Institute of The Chartered Institute of Public Finance and Accountancy (Cipfa) issued in June 2014 'Accounting for local government pension scheme management costs' which pension funds are encouraged to adopt as best practice in 2014-15 and which the London Borough of Merton Pension Fund has adopted.</p>	<p>▶ We reviewed the presentation of these costs as part of our work on the Fund's fund account and associated disclosures. We reviewed the disclosure made of this change as the Pension Fund have chosen to voluntarily re-state the prior year comparators increasing investment management expenses by £0.6m, reclassifying to this heading £0.5m of administration expenses which were previously shown separately and reducing the line in the fund account for 'Gains and losses on disposal and change in market value of investments' by £124k. This is because transaction costs of £124k were previously deducted from the gains reported in the fund account.</p>	<p>▶ We have appropriate evidence supporting the amendments made.</p>

Section 4

Financial statements audit – issues and findings

Financial statements audit – issues and misstatements arising from the audit

Progress of our audit

- ▶ The following areas of our work programme remain to be completed. We will provide an update of progress at the Pension Fund Advisory Committee and General Purposes Committee meetings:
 - ▶ Completion of our work on investment disclosures
 - ▶ Receipt of a Letter of Representation
 - ▶ Final audit closing procedures and review procedures.
- ▶ Subject to the satisfactory resolution of the above items, we propose to issue an unqualified audit report on the financial statements.

Uncorrected misstatements

- ▶ Our audit has not identified any misstatements in the Pension Fund's draft financial statements.

Corrected misstatements

- ▶ Our audit identified a small number of disclosure errors which were highlighted to management for amendment.

Other matters

- ▶ As required by ISA (UK&I) 260 and other ISAs specifying communication requirements, we are required to communicate to you significant findings from the audit and other matters that are significant to your oversight of the Pension Fund's financial reporting process including the following:
 - ▶ Qualitative aspects of your accounting practices; estimates and disclosures;
 - ▶ 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;
 - ▶ Any significant difficulties encountered during the audit; and
 - ▶ Other audit matters of governance interest

We have no matters we wish to report.

Financial statements audit – application of materiality

Our application of materiality

- ▶ When establishing our overall audit strategy, we determined a magnitude of uncorrected misstatements that we judged would be material for the financial statements as a whole.

Item	
Planning Materiality	We determined planning materiality to be £5.4 million, which is 1% of net assets reported in the 2014/15 draft accounts of £542 million We consider net assets to be one of the principal considerations for stakeholders in assessing the financial performance of the Pension Fund.
Tolerable Error	We set a tolerable error for the audit. Tolerable error is the application of planning materiality at the individual account or balance level. It is set to reduce to an appropriately low level the probability that the aggregate of uncorrected and undetected misstatements exceeds planning materiality. The level of tolerable error drives the extent of detailed audit testing required to support our opinion. We set the level of tolerable error at the upper level because there were no material adjustments found in the 2013/14 audit.
Reporting Threshold	We agreed with the Pension Fund Advisory and the General Purposes Committees that we would report to the Committees all audit differences in excess of £270,000.

Financial statements audit – internal control and written representations

Internal control

- ▶ It is the responsibility of the Council and the Pension Fund to develop and implement systems of internal financial control and to put in place proper arrangements to monitor their adequacy and effectiveness in practice. Our responsibility as your 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.
- ▶ We have tested the controls of the Council and the Pension Fund only to the extent necessary for us to complete our audit. We are not expressing an opinion on the overall effectiveness of internal control.
- ▶ We have not identified any significant deficiencies in the design or operation of an internal control.

Request for written representations

- ▶ We have requested a management representation letter to gain management's confirmation in relation to a number of matters. We are not requesting any specific representations over and above the standard ones.

Section 5

Independence and audit fees

Independence and audit fees

Independence

- ▶ We confirm there are no changes in our assessment of independence since our confirmation in our Audit Plan presented to the General Purposes Committee on 25 June 2015.
- ▶ We complied with the Auditing Practices Board's Ethical Standards for Auditors and the requirements of the Audit Commission's Code and Standing Guidance. In our professional judgement the firm is independent and the objectivity of the audit engagement partner and audit staff has not been compromised within the meaning of regulatory and professional requirements.
- ▶ We confirm that we are not aware of any relationships that may affect the independence and objectivity of the firm that we are required by auditing and ethical standards to report to you.
- ▶ We consider that our independence in this context is a matter that should be reviewed by both you and ourselves. It is therefore important that you consider the facts of which you are aware and come to a view. If you wish to discuss any matters concerning our independence, we will be pleased to do so at the forthcoming meetings of the Pension Fund Advisory and General Purposes Committees on 15 and 16 September 2015.

- ▶ We confirm that we have met the reporting requirements to the Audit Committee, as 'those charged with governance' under International Standards on Auditing (UK and Ireland) 260 – Communication with those charged with governance. Our communication plan to meet these requirements were set out in our Audit Plan.

Audit fees

- ▶ The table below sets out the scale fee and our final proposed audit fees.

	Proposed final fee 2014/2015	Scale fee 2014/2015
	£	£
Audit Fee: Code work	21,000	21,000

- ▶ Our actual fee is in line with the agreed fee at this point in time, subject to the satisfactory clearance of the outstanding audit work.
- ▶ We confirm that we have not undertaken any non-audit work outside of the Audit Commission's Audit Code requirements.

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