

# *West Midlands Pension Fund*

## *Report to those charged with governance*

Report to the Pension Committee and those charged with governance of the West Midlands Pension Fund on the audit for the year ended 31 March 2015 (*ISA (UK&I) 260*)

Government and  
Public Sector

23 September 2015

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## **Code of Audit Practice and Statement of Responsibilities of Auditors and of Audited Bodies**

*In April 2010 the Audit Commission issued a revised version of the 'Statement of responsibilities of auditors and of audited bodies'. It is available from the Chief Executive of each audited body. The purpose of the statement is to assist auditors and audited bodies by explaining where the responsibilities of auditors begin and end and what is to be expected of the audited body in certain areas. Our reports and management letters are prepared in the context of this Statement. Reports and letters prepared by appointed auditors and addressed to members or officers are prepared for the sole use of the audited body and no responsibility is taken by auditors to any Member or officer in their individual capacity or to any third party.*

*An audit of the Statement of Accounts is not designed to identify all matters that may be relevant to those charged with governance. Accordingly, the audit does not ordinarily identify all such matters. We have issued a number of reports during the audit year, detailing the findings from our work and making recommendations for improvement, where appropriate.*

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## **Executive summary**

### **Background**

This report tells you about the significant findings from our audit. We presented our plan to you in June 2015; we have reviewed the plan and concluded that it remains appropriate.

### **Audit Summary**

- We have completed the majority of our audit work (except in the area of investments) and expect to be able to issue an unqualified audit opinion on the Statement of Accounts on 23 September 2015.
- The key outstanding matters, where our work has commenced but is not yet finalised, are:
  - completion of our work in the area of investments;
  - review of the detailed disclosures in the Statement of Accounts;
  - approval of the Statement of Accounts and letters of representation;
  - receipt of outstanding investment confirmations; and
  - completion procedures including subsequent events review.

We will provide an update on all outstanding matters on 23 September 2015.

Please note that this report will be sent to the Audit Commission in accordance with the requirements of its standing guidance.

We look forward to discussing our report with you on 23 September 2015. Attending the meeting from PwC will be David Wallace and Aniquah Syed.

# Audit approach

Our audit approach was set in our audit plan which we presented to you in June 2015.

We have summarised below the significant risks we identified in our audit plan, the audit approach we took to address each risk and the outcome of our work.

Risk	Categorisation	Work performed
<p><b>Management override of controls</b></p> <p>ISA (UK&amp;I) 240 requires that we plan our audit work to consider the risk of fraud, which is presumed to be a significant risk in any audit. In every organisation, management may be in a position to override the routine day to day financial controls. Accordingly, for all of our audits, we consider this risk and adapt our audit procedures accordingly.</p>	Significant	<p>We performed procedures to:</p> <ul style="list-style-type: none"><li>• Review the appropriateness of accounting policies and estimation bases, focusing on any changes not driven by amendments to reporting standards;</li><li>• test the appropriateness of journal entries;</li><li>• review accounting estimates for biases and evaluate whether circumstances producing any bias, represent a risk of material misstatement due to fraud;</li><li>• evaluate the business rationale underlying significant transactions; and</li><li>• perform 'unpredictable' procedures.</li></ul> <p>We performed other audit procedures as necessary.</p>

Risk	Categorisation	Work performed
<p><b>Risk of fraud in revenue recognition</b></p> <p>ISA (UK&amp;I) 240 requires that we plan our audit work to consider the risk of fraud, which is presumed to be a significant risk in any audit. In every organisation, management may be in a position to override the routine day to day financial controls. The risk of fraud in revenue recognition is a non-rebuttable presumption that there is a significant risk that a material misstatement could occur due to the manipulation of revenue, either through recognising revenue early or fraudulent revenue recognition.</p>	<p>Significant</p>	<p>We performed procedures to:</p> <ul style="list-style-type: none"> <li>• Consider recognition criteria for one-off contributions/bulk transfers</li> <li>• Consider recognition criteria for other types of contribution given the changes to contributions that have taken place in the year.</li> </ul> <p>We performed other audit procedures as necessary.</p>
<p><b>Valuation of hard to value investments</b></p> <p>West Midlands Pension Fund holds a mixture of categories of investment within the Pension fund portfolio. For a proportion of these assets a readily available market price is not always available.</p>	<p>Elevated</p>	<p>We reviewed the monitoring procedures in place over these categories of investments with management.</p> <p>We confirmed the valuation of hard-to-value investments at year end with the individual investment managers and assessed the accuracy of the year end valuation by reviewing the latest audited accounts to information provided to management to assess the reasonableness of these unit prices.</p> <p>We reviewed the latest investment manager controls reports where available, to update our understanding of controls and procedures in place over valuation of such assets.</p>

We have summarised below the other risks we identified in our audit plan, the audit approach we took to address each risk and the outcome of our work.

Focus area/risk	Work performed
<u>Investment assets and returns</u>	
Investments may not exist or the scheme may not have title to investment assets	<ul style="list-style-type: none"> <li>• We understood the Pensions Committee and management monitoring controls, including reviewing Pensions Committee meeting minutes;</li> <li>• We obtained independent confirmations of all externally managed investments assets from the investment managers. In the case of those investment assets managed by the in house team, we obtained confirmation from the custodian; and</li> <li>• We reviewed internal controls reports on investment management and custody.</li> </ul>
Investments may be incorrectly valued	<ul style="list-style-type: none"> <li>• We tested the valuation of quoted investments against third party sources;</li> <li>• We understood how the Committee and management validate asset values provided by investment managers for investments which are not quoted; and</li> <li>• We reviewed valuations for pooled investment vehicles and private equity investments, including reviewing the most recent audited accounts for the funds and any available internal controls reports.</li> </ul>
Investments may be recorded incompletely in the financial accounting records and the accounts	<ul style="list-style-type: none"> <li>• We reviewed the reconciliations of cash inflows and outflows from the Fund's bank account compared to contributions and other income, benefits and expenses and the movements in investments; and</li> <li>• We reviewed the reconciliations performed in-house between investment manager and custodian assets.</li> </ul>
Performance of investments reported may be inconsistent with the accounts	<ul style="list-style-type: none"> <li>• We completed an analytical review of investment returns for reasonableness compared with the Fund's benchmarks and other external indices.</li> </ul>
Allocation of investments may not be in accordance with the Statement of Investment Principles ('SIP')	<ul style="list-style-type: none"> <li>• We reviewed the allocation of investments compared with the requirements of the SIP.</li> </ul>

Focus area/risk	Work performed
<p><u>Contributions</u></p> <p>Payment of employer contributions may not be in accordance with the Rates and Adjustment Certificate and employee contributions per the prescribed rates for local government employees (England and Wales) (“the schedules”)</p>	<ul style="list-style-type: none"> <li>• We reviewed the controls over payroll and validate on a sample basis that these are operating as expected;</li> <li>• We undertook analytical review of contributions for reasonableness compared with the prior year, allowing for changes in membership, pay and rates of contributions;</li> <li>• We considered the monthly contributions received and investigate any unusual fluctuations;</li> <li>• We tested on a sample basis that the contributions are calculated and paid in accordance with the relevant schedules; and</li> <li>• We reviewed the timing of the payment of contributions according to bank details compared with the requirements of the schedule(s).</li> </ul>
<p><u>Benefits and membership</u></p> <p>Benefits may not be correctly calculated according to the local government regulations</p>	<ul style="list-style-type: none"> <li>• We reviewed the controls operated by the administration team (including over the pension payroll) and validated on a sample basis that these are operating as expected;</li> <li>• We undertook analytical review of pensions paid for reasonableness compared to the prior year, allowing for changes in membership and the effects of the pensions increase;</li> <li>• We considered the monthly total pensions paid and investigate any unusual fluctuations; and</li> <li>• We performed substantive testing on a sample basis over material types of benefit payments.</li> </ul>
<p>Membership statistics accurately reflect the membership of the scheme</p>	<ul style="list-style-type: none"> <li>• We reviewed the results of any pensioner existence checking exercise completed during the year; and</li> <li>• We compared membership statistics and movements reported against the supporting data from the administration system and review for reasonableness compared with our expectations.</li> </ul>
<p><u>Other areas</u></p> <p>Current assets and liabilities may not be appropriately accounted for</p>	<ul style="list-style-type: none"> <li>• We reviewed balances compared with the prior year and against our expectations from testing of income and expenditure;</li> <li>• We obtained independent confirmation of cash balances; and</li> <li>• We reviewed controls over cash movements and bank account authority levels.</li> </ul>

Focus area/risk	Work performed
Related party transactions may be incomplete or inaccurately reflected in the accounts	<ul style="list-style-type: none"> <li>• We understood the controls that the Pensions Committee and management have over the identification of related parties and transactions with them;</li> <li>• We made specific enquiries for any transactions which look to be outside of the normal course of business; and</li> <li>• We confirmed our recommendation relating to Related Parties included in last year's report to the Pensions Committee has been appropriately addressed.</li> </ul>

### *Materiality*

In our audit plan presented to you in June 2015, we reported our planned overall materiality which we used in planning the overall audit strategy. Our materiality increased following receipt of the 2015 draft financial statements, increasing to £114.6m (from £101.4m).

ISA (UK&I) 450 (revised) require that we record all misstatements identified except those which are 'clearly trivial', i.e. those which we do not expect to have a material effect on the financial statements even if accumulated. Following the change to overall materiality, the de minimis threshold increased to £5.7m (from £5.0m).

The increases noted did not have a significant impact upon the scope of audit testing performed.



# Significant audit and accounting matters

Auditing standards require us to tell you about relevant matters related to the audit of the financial statements sufficiently promptly for you to take appropriate action. This section contains such items.

## Accounts

We have completed our audit, subject to the following outstanding matters:

- completion of our audit work in the area of investments;
- review of the detailed disclosures in the Statement of Accounts;
- approval of the Statement of Accounts and letters of representation;
- receipt of outstanding investment confirmations; and
- completion procedures including subsequent events review.

## Accounting issues

We have no significant accounting issues to bring to your attention.

## Misstatements and significant audit adjustments

We have to tell you about all uncorrected misstatements we found during the audit, other than those which are trivial.

There were no uncorrected misstatements identified as part of our audit procedures.

## Significant accounting principles and policies

Significant accounting principles and policies are disclosed in the notes to the Statement of Accounts. We will ask management to represent to us that the selection of, or changes in, significant accounting policies and practices that have, or could have, a material effect on the Statement of Accounts have been considered.

## Judgments and accounting estimates

The Authority is required to prepare its financial statements in accordance with the CIPFA Code. Nevertheless, there are still many areas where management need to apply judgement to the recognition and measurement of items in the financial statements. There were no significant audit findings in relation to these areas.

## Disagreements with management

There were no disagreements with management, individually or in aggregate, which could be significant to the entity's Statement of Accounts or our audit report.

## Management representations

We will be asking management to provide us with a signed representation letter to confirm information and statements they have given to us during the course of our audit.

### Financial standing

There are no material uncertainties related to events and conditions that may cast significant doubt on the scheme's financial standing.

### Related parties

In forming an opinion on the financial statements, we are required to evaluate:

- whether identified related party relationships and transactions have been appropriately accounted for and disclosed; and
- whether the effects of the related party relationships and transactions cause the financial statements to be misleading.

We have not identified any issues in performing our related party work which needs to be brought to your attention.

### Audit independence

We are required to follow both the International Standard on Auditing (UK and Ireland) 260 (Revised) "Communication with those charged with governance", UK Ethical Standard 1 (Revised) "Integrity, objectivity and independence" and UK Ethical Standard 5 (Revised) "Non-audit services provided to audited entities" issued by the UK Auditing Practices Board.

Together these require that we tell you at least annually about all relationships between PricewaterhouseCoopers LLP in the UK and other PricewaterhouseCoopers' firms and associated entities ("PwC") and the Authority that, in our professional judgement, may reasonably be thought to bear on our independence and objectivity.

### Relationships between PwC and the Authority

We are aware of the following relationships that, in our professional judgement, may reasonably be thought to bear on our independence and objectivity and which represent

matters that have occurred during the financial year on which we are to report or up to the date of this document.

### Relationships and Investments

We have not identified any potential issues in respect of personal relationships with the Authority or investments in the Authority held by individuals.

### Employment of PricewaterhouseCoopers staff by the Authority

We are not aware of any former PwC partners or staff being employed, or holding discussions in respect of employment, by the Authority as a director or in a senior management position covering financial, accounting or control related areas.

### Business relationships

We have not identified any business relationships between PwC and the Authority.

### Services provided to the Authority

The audit of the Statement of Accounts is undertaken in accordance with the UK Firm's internal policies. The audit engagement is subject to an independent partner review of all significant judgements taken, including our reporting to the Pensions Committee and a review of the annual report. The audit is also subject to other internal PwC quality control procedures such as peer reviews by other offices.

Apart from the audit of the Statement of Accounts, PwC has undertaken no other work for the Fund.

### Fees

We reported our fee proposals in our plan. Our actual fees were in line with our proposals.

### Services to Directors and Senior Management

PwC does not provide any services e.g. personal tax services, directly to directors, senior management.

### Rotation

It is the Audit Commission's policy that engagement leaders at an audited body at which a full Code audit is required to be carried out should act for an initial period of five years. The Commission's view is that generally the range of regulatory safeguards it applies within its audit regime is sufficient to reduce any threats to independence that may otherwise arise at the end of this period to an acceptable level. Therefore, to safeguard audit quality, and in accordance with APB Ethical Standard 3, it will subsequently approve engagement leaders for an additional period of up to no more than two years, provided that there are no considerations that compromise, or could be perceived to compromise, the auditor's independence or objectivity.

### Gifts and hospitality

We have not identified any significant gifts or hospitality provided to, or received from, a member of Authority's/ the pension scheme's senior management or staff.

### Other matters

We are not aware of any other matters which may impact on our independence and objectivity e.g. litigation.

### Conclusion

We hereby confirm that in our professional judgement, as at the date of this document:

- we comply with UK regulatory and professional requirements, including the Ethical Standards issued by the Auditing Practices Board; and
- our objectivity is not compromised.

We would ask the Audit Committee/those charged with governance to consider the matters in this document and to confirm that they agree with our conclusion on our independence and objectivity.

# Internal controls and other observations

## Accounting systems and systems of internal control

Management are responsible for developing and implementing systems of internal financial control and to put in place proper arrangements to monitor their adequacy and effectiveness in practice. As auditors, we review these arrangements for the purposes of our audit of the Statement of Accounts and our review of the annual governance statement.

## Reporting requirements

We are required to report to management and those charged with governance any deficiencies in internal control that we have identified during the audit. We did not identify any internal control deficiencies as part of this years' audit, and we are pleased to report that the items noted in the prior year have been addressed by management.

We did, however, note an opportunity to improve the internal control environment at the Fund - see below.

Observation	Opportunity and Recommendation	Management's response
<p><b>Leaver process not functioning at Dudley MBC payroll site.</b></p> <p>Through our sample testing performed, we noted that there were six members classified as active within the membership listings obtained from the payroll site, however all members had actually left employment. The implication is although no contributions were received following the member's date of leaving, the Fund's membership statistics are not correct due to late notification from the payroll site.</p>	<p>We note that management have procedures in place to capture member changes from the employer payroll sites. In addition, management perform an annual reconciliation exercise to pursue any discrepancies arising from the annual return process.</p> <p>We note there is an opportunity to enhance the Fund's internal control environment, and therefore recommend management:</p> <ul style="list-style-type: none"><li>Commence a more frequent reporting requirement for current active member statistics from the major payroll sites (to include Dudley MBC) to allow the Fund to reconcile membership numbers with contributions received on a regular basis. This will give management greater comfort over the active membership information and also streamline the year-end membership reporting process.</li></ul>	<p>The Fund accepts the recommendation, and will work closely with its employers to implement a timely and effective system for identifying and reconciling membership discrepancies.</p>

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# *Risk of fraud*

International Standards on Auditing (UK&I) state that we, as auditors, are responsible for obtaining reasonable assurance that the financial statements taken as a whole are free from material misstatement, whether caused by fraud or error. The respective responsibilities of auditors, management and those charged with governance are summarised below:

## **Auditors' responsibility**

Our objectives are:

- to identify and assess the risks of material misstatement of the financial statements due to fraud;
- to obtain sufficient appropriate audit evidence regarding the assessed risks of material misstatement due to fraud, through designing and implementing appropriate responses; and
- to respond appropriately to fraud or suspected fraud identified during the audit.

## **Management's responsibility**

Management's responsibilities in relation to fraud are:

- to design and implement programmes and controls to prevent, deter and detect fraud;
- to ensure that the entity's culture and environment promote ethical behaviour; and
- to perform a risk assessment that specifically includes the risk of fraud addressing incentives and pressures, opportunities, and attitudes and rationalisation.

## **Responsibility of the Audit Committee**

Your responsibility as part of your governance role is:

- to evaluate management's identification of fraud risk, implementation of anti-fraud measures and creation of appropriate "tone at the top"; and
- to investigate any alleged or suspected instances of fraud brought to your attention.

## **Your views on fraud**

In our audit plan presented to the Audit Committee in June 2015 we enquired:

- Whether you have knowledge of fraud, either actual, suspected or alleged, including those involving management?
- What fraud detection or prevention measures (e.g. whistle-blower lines) are in place in the entity?
- What role you have in relation to fraud?

- What protocols / procedures have been established between those charged with governance and management to keep you informed of instances of fraud, either actual, suspected or alleged?

In presenting this report to you we ask for your confirmation that there have been no changes to your view of fraud risk and that no additional matters have arisen that should be brought to our attention. A specific confirmation from management in relation to fraud is included in the letter of representation.

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In the event that, pursuant to a request which you have received under the Freedom of Information Act 2000, it is required to disclose any information contained in this report, it will notify PwC promptly and consult with PwC prior to disclosing such report. You agree to pay due regard to any representations which PwC may make in connection with such disclosure and you shall apply any relevant exemptions which may exist under the Act to such report. If, following consultation with PwC, you disclose this report or any part thereof, it shall ensure that any disclaimer which PwC has included or may subsequently wish to include in the information is reproduced in full in any copies disclosed.

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