

www.pwc.co.uk

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 2014 (*ISA (UK&I) 260*)

Government and
Public Sector

24 September 2014

Contents

<i>Executive summary</i>	2
<i>Audit approach</i>	3
<i>Significant audit and accounting matters</i>	7
<i>Internal controls and other observations</i>	10
<i>Risk of fraud</i>	13

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.

Executive summary

Background

This report tells you about the significant findings from our audit. We presented our plan to you in March 2014; we have reviewed the plan and concluded that it remains appropriate.

Audit Summary

- We have completed the majority of our audit work. We will be issuing an opinion that the figures contained in the stand-alone pension scheme accounts are consistent with those included in the council's accounts. The true and fair opinion is included in the council's accounts.
- The key outstanding matters, where our work is not yet finalised, are:
 - completion of our work in the area of investments, primarily documentation surrounding the private equity investments and pooled investment vehicles as well as receipt of a number of independent investment confirmations
 - performance of a subsequent events review to the date of approval of the accounts; and
 - approval of the Statement of Accounts and letter of representation.

We will provide an update on all outstanding matters on 24 September 2014.

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 24 September 2014. Attending the meeting from PwC will be Richard Bacon and David Robson.

Audit approach

Our audit approach was set in our audit plan which we presented to you in March 2014.

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>Management override of controls</p> <p>ISA (UK&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>	<p>Significant</p>	<p>We performed procedures to:</p> <ul style="list-style-type: none"> • Review the appropriateness of accounting policies and estimation bases, focusing on any changes not driven by amendments to reporting standards; • test the appropriateness of journal entries; • review accounting estimates for biases and evaluate whether circumstances producing any bias, represent a risk of material misstatement due to fraud; • evaluate the business rationale underlying significant transactions; and • perform ‘unpredictable’ procedures. <p>We performed other audit procedures as necessary.</p>
<p>Valuation of hard to value investments</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"> • We understood the Committee and management monitoring controls, including reviewing Committee meeting minutes. • 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. • We reviewed internal controls reports on investment management and custody.
Investments may be incorrectly valued	<ul style="list-style-type: none"> • We tested the valuation of quoted investments against third party sources. • We understood how the Committee and management validate asset values provided by investment managers for investments which are not quoted. • 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.
Investments may be recorded incompletely in the financial accounting records and the accounts	<ul style="list-style-type: none"> • 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. • We reviewed the reconciliations performed in-house between investment manager and custodian assets.
Performance of investments reported may be inconsistent with the accounts	<ul style="list-style-type: none"> • We completed an analytical review of investment returns for reasonableness compared with the Fund's benchmarks and other external indices.
Allocation of investments may not be in accordance with the Statement of Investment Principles ('SIP')	<ul style="list-style-type: none"> • We reviewed the allocation of investments compared with the requirements of the SIP.

Contributions

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”)

- We reviewed the controls over payroll and validated on a sample basis that these are operating as expected.
- We undertook analytical review of contributions for reasonableness compared with the prior year, allowing for changes in membership, pay and rates of contributions.
- We considered the monthly contributions received and investigated any unusual fluctuations.
- We tested on a sample basis that the contributions are calculated and paid in accordance with the relevant schedules.
- We reviewed the timing of the payment of contributions according to bank details compared with the requirements of the schedules.

Benefits and membership

Benefits may not be correctly calculated according to the local government regulations

- We reviewed the controls operated by the administration team (including over the pension payroll) and validate on a sample basis that these are operating as expected.
- 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.
- We considered the monthly total pensions paid and investigated any unusual fluctuations.
- We performed substantive testing on a sample basis over material types of benefit payments.

Membership statistics accurately reflect the membership of the scheme

- We reviewed the results of any pensioner existence checking exercise completed during the year.
- We compared membership statistics and movements reported against the supporting data from the administration system and reviewed for reasonableness compared with our expectations.

Other areas

Current assets and liabilities may not be appropriately accounted for

- We reviewed balances compared with the prior year and against our expectations from testing of income and expenditure.
- We obtained independent confirmation of cash balances.
- We reviewed controls over cash movements and bank account authority levels.

Related party transactions may be incomplete or

- We understood the controls that the Committee and management have over the identification of related parties and transactions with

inaccurately reflected in the accounts

- them.
- We made specific enquiries for any transactions which look to be outside of the normal course of business.
-

Materiality

In our audit plan presented to you in March 2014, we reported our planned overall materiality which we used in planning the overall audit strategy. Our materiality has remained the same during the year.

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. We agreed the de minimis threshold when the audit plan was presented in March 2014.

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 bank and 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. See Appendix 1.

We also bring to your attention the following misstatements which have been corrected by management but which we consider you should be aware of in fulfilling your governance responsibilities.

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. The following significant judgements and accounting estimates were used in the preparation of the financial statements

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

West Midlands Pension Fund

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 Group.

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.

confirm that they agree with our conclusion on our independence and objectivity.

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

West Midlands Pension Fund

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 noted the following points which we should like to discuss further with you

Summary of significant internal control deficiencies

Deficiency	Recommendation	Management's response
<p>Late contribution payments We noted that during the year there were a number of instances where contributions were received late by the Fund. We note that the situation was similar last year and a schedule is maintained to log these late payments.</p> <p>We were not able to view evidence of how frequently contact was made to actively chase these and what actions were taken to aim to reduce these instances. Reasons for late payments were also not recorded on the schedule.</p>	<p>We recommend that management consider the controls in this area and any improvements required to reduce the instances of late contributions. We do note the following however:</p> <ul style="list-style-type: none"> • The quantum of late contributions is small when compared with the total value of contributions; • We will not be required to report these late contributions to the Pensions Regulator; • Given that there is no statement about contributions in the annual report, considerations as to qualification of the opinion given in this statement do not arise. 	<p>WMPF Finance concurs with the recommendation and will implement an effective process to ensure that all employers who make late payments are followed up. Use of legislative powers to implement penalties will be considered where appropriate.</p> <p>Action plan implementation date - 30 September 2014</p>

Deficiency	Recommendation	Management's response
<p>Contributions monitoring spreadsheet</p> <p>We noted that the local management team uses a spreadsheet to monitor the timing of receipt of contributions from its participating employers, but that the spreadsheet is not kept up to date. Due to staff changes and preparations for the implementation of the new financial system, delays were experienced in maintaining the control sheet in the final two months of 2013/14. In order for this tool to be of use, it needs to be properly maintained.</p>	<p>We recommend that the contributions monitoring spreadsheet be updated on a regular basis. It would be ideal if a link could be created between the spreadsheet and the cash receipts element of the client's systems.</p>	<p>The implementation of the new financial system created delays in maintaining the control sheet. The 2014/15 record is up to date for the first quarter of the new financial year. The record will be maintained on a daily basis and arrangements are being introduced to link this with the general ledger.</p> <p>Action plan implementation date – 30 September 2014</p>
<p>Bank reconciliation</p> <p>During our re-performance of the bank reconciliation, we noted a number of very significant and out-of-date reconciling items. The net of these old items is represented by genuine outstanding lodgements and unpresented cheques but the way these old items are presented makes the reconciliation meaningless.</p>	<p>We recommend that management ensure that the old items are examined and deleted from the bank reconciliation such that only the true outstanding lodgements and unpresented cheques are presented in the reconciliation. In that way, the reconciliation will be a much clearer monthly control than it currently is.</p>	<p>WMPG Finance concurs with the recommendation and will implement an effective reconciliation process.</p> <p>Action plan implementation date - 30 October 2014</p>

We also recommend the following are for consideration by the local management team in the coming months:

- Put in place a register of related parties and related party transactions. We recommend that the implementation of this related party register take place initially at the half-year to ensure that it is fit for purpose. It should be sent to all relevant parties within the organisation for completion - for example, the Trustees, the Investments team, the Administration team, the Finance team, the Payroll department. The register should include the following details:
 - The nature of the related party transaction
 - The parties involved in the transaction
 - The date of the transaction
 - The quantum of the transaction and the value of any remaining account balances as at the statutory accounts year-end
 - Any unusual terms to the transaction
 - The register can simply be in the form of a spreadsheet.
- Review the number of account codes in place to determine whether these can be streamlined. In performing our work, we noted a number of controls accounts and other accounts which potentially can be streamlined to make the financial recording more transparent. This should be combined with a review of codes which continue to hold 'old' account balances.

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 March 2014 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.



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.

This document has been prepared only for you and solely for the purpose and on the terms agreed through our contract with the Audit Commission. We accept no liability (including for negligence) to anyone else in connection with this document, and it may not be provided to anyone else.

© 2014 PricewaterhouseCoopers LLP. All rights reserved. In this document, "PwC" refers to the UK member firm, and may sometimes refer to the PwC network. Each member firm is a separate legal entity. Please see www.pwc.com/structure for further details.