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Annual Audit Letter to the members of Gwynedd Pension Fund Pension Committee and to the members of Gwynedd Council

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Introduction

1. I am pleased to present to you my first Annual Letter (Letter) for the audit of the Gwynedd Pension Fund (the Pension Fund). (The Letter has been written by the Engagement Partner Kevin Thomas on behalf of the Appointed Auditor Anthony Barrett.)
2. The Pension Fund accounts form a self-contained part of the statement of accounts of Gwynedd Council (the Council) in its role as administering authority for the Pension Fund. The transactions and balances are not consolidated into the Council's accounts. The audit of the Pension Fund is not a separate audit appointment and has traditionally been undertaken as part of the audit of the Council's accounts.
3. However, the assets, liabilities, transactions and cash flows of pension funds are significant. The Auditor General has therefore determined that in 2008-09 and future years the audit of the Pension Fund accounts must, so far as is possible, be undertaken as a separate audit engagement (but not as a separate audit appointment).
4. The revised arrangements better reflect the different audit risk profile of the Pension Fund as opposed to the Council and, at the same time, enhance transparency and governance arrangements. The revised arrangements also ensure that pension funds receive the audit attention appropriate to their scale. They also facilitate the application of auditing standards and practice notes specific to pension funds. Practice Note 15, in particular, provides a useful interpretation for the application of International Standards on Auditing (ISAs) to the audit of occupational pension schemes.
5. The Auditor General's Code of Audit and Inspection Practice (the Code) requires compliance with ISA requirements for each audit. The Pension Fund audit must therefore be planned, undertaken and reported separately, rather than simply in the context of the Council as a whole. This has the benefit of facilitating a more focused audit risk analysis and approach and ensuring undivided audit focus on accounting and audit requirements that are specific to pension funds.
6. The Pension Fund has faced a year of change and challenges, most notably the introduction of the new Local Government Pension Scheme. This has led to changes in employee contributions which are now tiered, with rates differing, depending on the previous year's pensionable pay. There have also been changes to the way in which retirement benefits are accrued. Pensioners' benefits must now be calculated on two different bases, increasing the complexity of benefit calculations.

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7. There have also been specific challenges associated with:
 - the volatility in the world financial markets and the consequent impact on pension fund investment valuation; and
 - the amendment of the Local Authority SoRP to reflect the requirements of the Pension SoRP 2007. This adopts the requirements of FRS 25 (Financial Instruments: Presentation) and FRS 26 (Financial Instruments: Recognition and Measurement) with regard to reporting fair values on derivatives and investments.
 8. In recognition of such challenges, I adopted a risk-based approach to planning the audit and my work has focused on the Pension Fund's significant financial and operational risks that are relevant to my audit responsibilities.
 9. I set out the audit work planned for the year in the Pension Fund audit strategy 2008-09. Your Pension Fund audit fee for 2008-09 was based on an indicative scale produced by the Auditor General for the first year of the separate audit of pension funds. We have not made any changes to the fee of £20,031 charged compared to that set out in the audit strategy. However, external consultants conducted a comprehensive review of our fee structure recently and recommended increases to bring them in line with both the work necessary to deliver an audit of a high value, complex and technically demanding area as well as in line with the fees charged by external auditors elsewhere in the public sector. The consultant's recommendations will further inform our fee proposals for 2010-11.
 10. The Pension Fund accounts are part of the Council's accounts and consequently, those charged with governance at the Council retain this responsibility for the Pension Fund.
 11. The Council has established a Pension Committee to oversee the work of the Pension Fund. Accordingly, I submit this Letter to advise that committee of the key messages arising from the audit of the 2008-09 Pension Fund accounts. I shall also submit the Letter to those charged with governance for the Council as a whole.

The 2008-09 Pension Fund accounting statements were prepared in accordance with statutory requirements and present fairly its financial position and transactions

12. It is the Council's responsibility to:
 - put systems of internal control in place to ensure the regularity and lawfulness of the Pension Fund's transactions and to ensure that its assets are secure;
 - maintain proper Pension Fund accounting records; and
 - prepare Pension Fund accounting statements in accordance with relevant requirements.
13. The Code requires me to provide an audit opinion on the Pension Fund accounts included in the Council's statement of accounts.
14. The Pension Fund accounting statements are an essential means by which the Council demonstrates its stewardship of the resources at the Pension Fund's disposal and its financial performance in the use of those resources.
15. On 29 September 2009, I issued an unqualified audit opinion on the Pension Fund accounting statements.

The Pension Fund had appropriate financial systems in place during the year but could further strengthen its arrangements in two areas

16. The Pension Fund has appropriate financial systems in place that can be relied on to produce materially correct outputs. I have, however, identified scope to improve arrangements in two areas.
17. The Council maintains the Pension Fund's investments at book value in its accounting records whereas in the financial statements investments are shown at market value. As a result, the change in market value, from one year to the next, is calculated as a one-off annual exercise. The Council does not currently have a process in place to independently verify the reasonableness of the movement between years and should put suitable measures in place to address this.
18. In addition, the Council does not have a process in place to ensure that it has accrued for all the benefits payable for retirement and deaths up to 31 March, which resulted in a non-material under accrual in the financial statements.

The Pension Fund had appropriate governance arrangements in place during the year but faces risks over the coming years as the volatility of the world markets impact on the value of the fund

- 19.** On 1 April 2008, the Local Government Pension Scheme came into force. The Council successfully put arrangements in place to implement the requirements, most notably the introduction of banded contribution rates for employees. Draft regulations have been issued in February 2009 which make several proposals which further impact on the Pension Fund. The exact timing of when these regulations will come into force is yet to be determined.
- 20.** During the year, the Pension Fund continued to strengthen its communications to keep both employers and employees up to date with relevant issues. Surgeries were held at employees' work places to provide face-to-face consultation on the scheme. Additionally, the Gwynedd Pension Fund website was launched in March 2009 as a vehicle to provide up-to-date information and guidance to both employees and employers. Further improvements are planned during 2009-10.
- 21.** In February 2009, the Pension Fund also appointed a new Fund Manager. It is expected that this change will impact positively on the investment performance of the fund.
- 22.** However, the ongoing world economic volatility is impacting detrimentally on the value of the fund, which is due its next triennial valuation in March 2010. The value of the fund fell by £134 million between 31 March 2008 and 31 March 2009. Whilst it has rallied in the intervening period and it is inevitable that any fund will be subject to short-term fluctuation, it will take time to recover from the impact of the severity of the downturn which occurred during 2008-09. As a consequence, employer contributions into the fund may need to increase with a view to securing a fully funded position over the longer term. Until then, bodies in the fund will have negative funding positions.
- 23.** In September 2008, the Council placed a short-term deposit of £4 million with Heritable Bank, a UK subsidiary of Landsbanki, an Icelandic Bank which subsequently collapsed in October 2008. The administrators have indicated that creditors will see a return of 80 pence in the pound by the end of 2013 and therefore the Council recognised an impairment of £1.260 million, of which £178,000 was charged to the Pension Fund and recognised in its accounts. The actual loss may be reduced by the end of 2013 and the position will need to be monitored in the intervening period.



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